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TRADE AND FINANCING STRATEGIES
FOR THE NEW NICs:
THE PERU CASE STUDY

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This working paper is one of five country papers prepared as part of a study of the appropriate choice of external strategies for intermediate-level developing countries in the difficult trade and investment conditions of the 1980s. An earlier stage of the project analysed the experience of 25 intermediate-level and more advanced developing countries to determine whether the lessons that have been drawn from the most successful appeared to apply to a larger number, and under differing external conditions. The country studies are intended to examine the same questions at a much more detailed level. It is hoped that a final report drawing conclusions from both parts of the study will be published in 1989. The project is directed at ODI by Sheila Page. We are grateful for financial support from the Overseas Development Administration, the Economic and Social Research Council, and the International Development Research Centre of Canada, but they are not responsible for the views expressed here.

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Working Paper No. 23 Zimbabwe
Working Paper No. 28 Peru

The author of the Peru study is a Member of the Centro de Investigacion and Dean of the Economics Faculty at the Universidad del Pacifico, Lima. The final version of this paper was received in February 1988.

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Introduction

In the post-1945 period, Peru has suffered five general economic crises (1948-9, 1957-9, 1967-8, 1975-8 and 1983-4), each one more serious than the one before. Over and above the purely economic crises, and also increasing in scale, have been sharp social and political conflicts (manifesting themselves as strikes in the 1970s and in terrorism in the 1980s).

In each case an 'orthodox' process of economic stabilisation became necessary because of a severe 'external constraint', and, again in each case, economic recovery came from a sharp rise in exports rather than (and even in spite of) the adjustment policies followed. For this reason, it is not surprising that Peru was the first and most frequent Latin American client of the IMF's conditional lending.

In recent years, between 1985 and 1987, the economic indicators have once again shown an economic recovery, but there will probably again be drastic cuts in the standard of living. This sequence of crises, and their growing severity, makes it necessary to propose, appraise, and then implement alternative forms of economic policy and legal, institutional, and administrative reforms, in order to attain greater economic (and political) stability in the medium term.

The theoretical framework for these new policies, which we shall also use as a basis for analysing Peru's history from 1970 to 1985, will be discussed in the first chapter. It is necessary to set the policies and proposals within the wider context of a strategy of development. But this, in turn, is shaped (and limited) by economic and political conditions, both internal to the country and international.

The design of trade and external financing policies, if they are to be viable, cannot be shaped in a vacuum, without relation to certain aspects of Peruvian society. The first chapter will therefore describe key conditions since World War II including the structure of the economy, the socio-political system, the characteristics of the Peruvian Government and the interaction among different social groups. This will allow us to determine the rationale behind macroeconomic decisions, and thus will be the basis for the analysis in later chapters.

In Chapter 2, we shall analyse the country's economic history, concentrating on the different economic policies adopted, especially for the external sector, during the last 15 years. The theoretical framework will be tested against events in three periods, 1970-4, 1975-9, and 1980-5. While this division roughly coincides with the administrations (Velasco, Morales Bermudez, and Belaúnde, respectively), this is because these periods also differ in the economic policies that were tried. Although there are some useful lessons to be drawn from these past policies, especially on what should not be done in the future, the main one is that new, radically different, policies are required.

The most recent experiences of Peru, and its present situation and prospects, are described in Chapter 3. This examines the administration of Alan García, and its prospects to the year 1990, emphasising developments in the external sector.

The Appendix gives basic data on the Peruvian external sector for the period 1970-87 plus a bibliography.

1. The Political Rationale for Economic Policies

There is a general dissatisfaction with the ability of economists to explain and to analyse. As with other subjects, and for economics at other times, the current lack of confidence, especially since the end of the 1960s, has grown out of the many inconsistencies between economic theory and the real problems of our economies. The reasons suggested for this are many but, in our opinion, can be reduced to one central problem: the lack of interdisciplinary awareness on the part of many economists.

In order to correct this fault, at least partially, this chapter will try to outline some unconventional (at least for the orthodox economist) theoretical concepts, in order to capture the relationship between economic policies and some 'non-economic' factors. These must be brought into our analysis not only to give a satisfactory explanation of the economic process but, fundamentally, to permit us to propose an economic policy that is viable, economically and politically.

We believe that in Latin America, and especially in Peru, it is not possible to understand (or to forecast) the state of the economy and economic policy without first explaining the political process, the alliances and conflicts among social groups, the actions of the government, etc., that lie behind them. This requires a theoretical framework, which, taking advantage of recent advances in the social sciences, can show how these interdependences work.

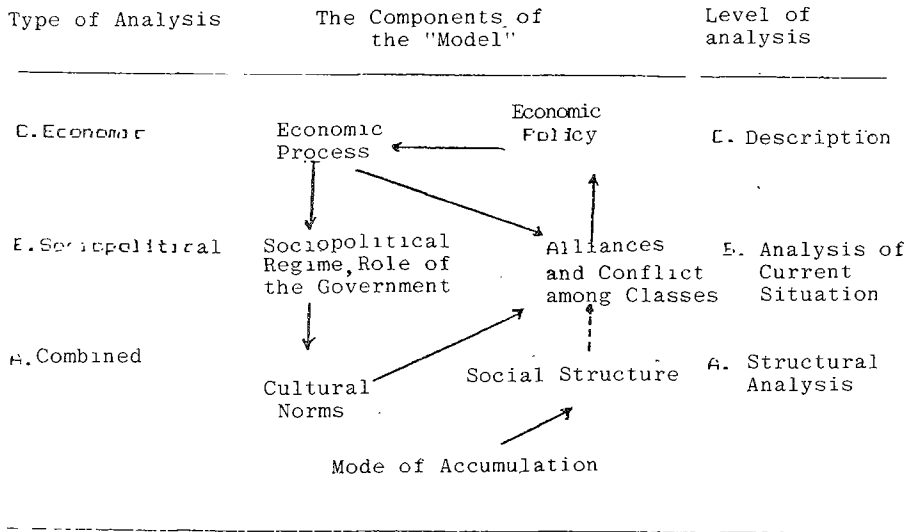
Graph 1 illustrates, very schematically, the levels of analysis and the structure of such a 'model'. Level C is what is to be explained (although we should not ignore the feed back from it to A and B) by levels B and A, which are those which most economists leave to one side. We believe that economic analysis can only be scientific if it includes these explanatory factors.

Therefore the solution of the problem must start from an explanation of the different modes of accumulation, which are ultimately determined by the processes of metropolitan capitalism. Each model of development leads to (and is derived from) a particular socio-political structure which first creates it, and then may destroy it from within. This process is expressed through the political regime and through the state, whose form reflects the struggle between social groups and classes. One example is the fundamental dependency relationship, [Cardoso and Faletto, 1977, p. 374].

From this point of view, the course of the economy and economic policy in the short and medium terms are simply the result of the interaction between the mode of accumulation and the current economic position: the tensions, contradictions, and interdependences enable us to understand the 'economic variables' which the pure economist studies.

We believe that only by starting from a conceptual framework as broad as that presented here is it possible to study economics, as a social science to be distinguished from conventional economic analysis which does not go beyond social engineering. Graph 1 summarises our general assumptions about the links among the 'variables'.¹ Here, we shall only explain the way in which levels C and B have interacted in the post-war

Graph 1
ECONOMIC ANALYSIS, THE SOCIOPOLITICAL PROCESS
AND MODES OF ACCUMULATION



period, leaving A constant (the continuing policy of import substitution).

1.1. Populism and manipulation of relative prices

The cycles in the Peruvian economy since 1945 can be explained basically by the socio-political process, once the 'import substituting' model is taken as given. This process reflects the conflicts between the groups which were politically powerful (developmental and populist alliances) and those with economic power (the exporters and those allied to them).

According to this analysis, the post-war economy has followed a sequence which starts with a cyclical expansion in which the relative prices of the secondary sector (manufacturing and construction) and of the tertiary (services) and real wages all rise, until the increase in imports (given a constant exchange rate) hits the external constraint. Following this, the primary, exporting, sector forces a devaluation, which lowers real wages and puts the brake on industrial growth. Once the balance of payments has recovered and inflation has been reduced, a new cycle begins, with the process repeated (in periods whose average duration for Peru in the post-war period fluctuates between 6 and 10 years).

This pendulum movement in the economy (and in politics) is not only a fundamental characteristic of capitalism, but is reinforced by the socio-political characteristics of the country, at least since World War II. It was then that the 'new social forces' appeared, which questioned the power of the primary-exporting bourgeoisie (with its industrial, financial, and commercial allies), which had been solidly entrenched up to that point, and that of the land-owners. Their economic policy had corresponded practically perfectly to textbook neo-classical liberalism.

This alliance saw its economic and political power gradually reduced and we then begin to see a situation of 'shared power': the 'grande bourgeoisie', the national and foreign industrialists, the lower middle class, the working class, formed populist alliances which sought to achieve economic and political policies different from those of the primary-exporter model. This marked the beginning of the 'import substitution' phase, supported, principally, by populist and development-orientated political parties.

This socio-political process of 'shared power' (and of 'constrained hegemony') explains the volatility of the economic situation in Peru, and the recurrence of crises: 'developmental' policies in one phase of the cycle, and then 'stabilising' ones in the other, and so on. In the upward phase of the cycle, reformist economic policy is directed to transferring an increasing share of national income from the exporting sector to those favouring internal development. In the downward phase, economic orthodoxy has tended to transfer the resulting surplus back to the exporting sector, and brought into question the import-substitution policy.

In other words, since 1945, economic policy has oscillated between a tendency to return to the mode of development from outside (in periods of crisis and recession) and a tendency to follow 'development from within' (to use the terms introduced by ECLA), with this side becoming increasingly powerful each time, as the industrial bourgeoisie and the middle

and working classes grew. None of the classes which benefitted from these alternating patterns could obtain permanent supremacy. 'For this reason, policy became a sort of no man's land, in which the workers and the grande bourgeoisie had to be represented by parties and organisations formed by the middle classes, which did not represent completely the interests of the workers or the industrialists' [Abalo, 1976, p. 90].

In this period, we thus see a divided front for the bourgeoisie, which explains why power was shared: on one side, the primary-exporting groups, which sought periodic devaluations, wage restraint, brakes on industrial expansion, using well-known orthodox economic policies; and on the other side, the industrial bourgeoisie which instituted economic policies tending to expand the internal market by transferring profits from the exporters.

This conflict between two groups of the bourgeoisie which has marked the last three decades remains latent (and is likely to continue), as neither side has been able to obtain undisputed hegemony, the essential condition for 'stability'. It is certain, however, that before World War II, it was the primary-exporting sectors which held hegemony, and that, gradually, it is the industrial bourgeoisie, and within this, the exporters, which has tended to supplant them.

Let us turn now to the basic elements of the economic policy which the populist alliances have supported. One of the central ones has been government fixing of fundamental 'prices': the exchange rate, the interest rate, rents, 'basic' goods, wages, etc. This demand for 'administered' prices comes either directly from pressure from the social groups which brought the alliances to power or from their need to obtain political support from the remaining social groups supporting reformist policies.

Such economic measures are in sharp contrast to the aims of the pro-exporting and pro-oligarchy groups: these generally support totally free prices, a policy which favours the classes which they represent directly or indirectly in the government. When they are in power, therefore, there is an opening up of the economy, while under reformist policies there is a selective closing of the economy to the outside world.

The fundamental goal of the reformist governments is to 'reduce external dependency and achieve improved social justice', which is to be accomplished by promoting the development of the economy through industrialisation and expanding the internal market, raising profit rates in the industrial sectors. In this context the 'freezing' of prices (minimum as well as maximum) attempts to alter the distribution of income in favour of the 'modernising' sectors of the economy, and away from agriculture and other primary-exporting sectors.

Let us examine why fixing basic prices is 'essential' for the political survival of reforming governments. This fixing can mean two different things: either establishing specific prices or resisting pressures to raise them.

The prices, and the means and criteria for fixing them, are as follows:

1. prices of basic agricultural and manufactured goods: these are held below their marginal cost.
2. interest rates: these are held constant, at levels below inflation rates or returns on capital.
3. rate of exchange: over-valued.
4. import prices: held above domestic prices by means of tariffs, to protect national industry.
5. rents, fares, electricity prices, etc.: frozen, at levels below those consistent with 'free' markets.
6. minimum wages: above those justified by productivity.

Each sector of society which supports the reformist regime is helped by one or more of these fixed prices, directly or indirectly. In general terms, reformist governments need support from the following sectors: the industrial bourgeoisie (orientated towards the internal market), the middle classes, and workers in the modern sectors of the economy; they also tend to favour urban sectors over rural.

First, fixing prices of basic (agricultural) goods directly favours all parts of the alliance. Employed workers gain cheap food. This raises their real income, and allows them to buy more manufactured products (especially durables: cars, white goods, furniture, etc.). For the industrialists, and the secondary and tertiary sectors in general, this means low real wages and growing demand for their products.

Second, a negative real interest rate benefits the workers (especially the middle strata), who can acquire durables on credit, and thus virtually free, while cheap credit allows investment to increase production (with a rising demand assured).

A high exchange rate, whose over-valuation increases as the process continues, eases the importation of cheap food (in response to rising internal purchasing power) during the rising phase of the cycle, and at the same time reduces the quantity of domestic primary production (already damaged by controlled domestic prices). Further, the industrial sector, which is highly import-intensive, can obtain intermediate goods and equipment at low prices.

Thus, with regard to these three prices (agricultural goods, interest rates, and the exchange rate), there is no conflict of interests among the classes supporting the internal development model.

The situation is more problematic for the other three (tariffs, rents and wages).

Some industrial sectors benefit from high tariffs on competitive imports. This measure is adopted explicitly to favour them (as is the freezing of electricity prices), while their gains from low interest rates and low food prices are only indirect effects.

The middle classes (and higher paid workers) are helped deliberately by means of fixed rents and electricity prices, as well as indirectly from the negative interest rate (which favours house purchases and increases their purchasing power) and from the high exchange rate (which keeps down the price of travel and some luxury imports, especially smuggled goods).

Fixing a minimum wage and urban fares is designed to favour workers (especially urban ones). They also benefit indirectly from the exchange rate (cheap food).

There are some difficulties in reconciling the interests of all the groups in the alliance. The first potential conflict of interests is of course with respect to minimum wages which, at first sight, favour workers and hurt the industrialists (as well as distorting the economy). The latter do try to evade them, not so much by not paying them, but by substituting capital for labour, which is encouraged by the over-valuation of the currency (and by loans for importing equipment). This increases the capital intensity of the industrial sector, and the conflict is thus real only in the short term, but it appears in the medium term.

Tariffs (and controls on imports) on final goods directly benefit the sectors which produce competing goods, thus hurting, directly, the middle and working classes. These face higher prices (and perhaps lower quality), with imported goods either more expensive or unobtainable. Industrialists gain a captive market with monopoly profits. Here, therefore, there is a latent conflict as income is transferred away from the workers to the industrialists. If the conflict does not materialise, this is because it is not seen as a major issue. And the best organised workers themselves gain from the production of the goods, by being guaranteed a job (even if this is at the expense of other workers and potential workers in primary or other exporting sectors).

Finally, control of rents apparently benefits the middle classes directly and hurts the construction industry and indirectly also other industrialists. However, if we take into account the rising rate of growth of the money supply and falling real rates of interest, we can see that again the conflict is largely apparent rather than real (especially for the middle classes), because the stimulus to construction is greater (the interest rate effect on demand being greater than that from rents).

In summary: the need on the part of 'developmental' governments to establish a 'social' equilibrium, a worker-industrialist alliance in the 'modern' sector, has inevitably required manipulation of relative prices. This also necessarily leads to economic disequilibrium and crisis, given the model of capitalism on the periphery: the social groups hurt by such an economic policy are exporters, suppliers of agricultural products to the internal market, and some importers. The first two, that is, those who produce foreign exchange and food, are the worst hit, so that in the end a crisis appears: partly because of the disequilibria brought about by manipulating prices, partly because of the way sectors which are hurt react - capital flight, cuts in output, lack of investment, under-pricing of exports, etc. This reaction damages the level and structure of investment, employment, output, and imports.

This is why we argue that the economic measures used in Peru can only be understood as part of a political process which is directed by a particular mode of accumulation and by socio-political circumstances. Any package of economic measures has a socio-political rationale, but this may or may not coincide with economic rationality, as this is secondary. Therefore, criticisms focusing on the government's economic measures, especially those made by orthodox economists, fall on deaf ears if they look only at economic variables and criteria, as these are only a part of the integrated whole. The economist should, therefore, instead of applying a universal package of economic measures, accept criteria for his packages which take account of the socio-political situation and the mode of accumulation in force (or desired) if he wants his recommendations to be successful.

1.2. Relative prices and crises

So far we have outlined the fundamental characteristics of the interventionist economic policy and its socio-political rationale. In this section, we shall examine its results, and the way in which it has inevitably led to economic (and political) crises. The exceptions prove the rule: they are the result of exceptional circumstances in the external sector. A prolonged 'boom' in exports can allow the policy to continue without high inflation or balance of payments deficits. Latin America as a whole, however, has followed the model explained below: fixing each of the fundamental 'prices' contributes to high rates of inflation, fiscal and current deficits, reduced employment, etc. - and they mutually reinforce each other - just as neo-classical analysis suggests will result from 'interventionism' in the markets for goods, finance, and intermediate goods.

We shall not assume a fixed sequence in the fixing of prices, as this varies from economy to economy. In general, the first to be fixed is the exchange rate; then, the prices of essential goods and a minimum wage. This indicates that the fixing of prices, and the economic policies which follow from it, are not part of a preconceived plan, but rather a response to the problems of the moment, and above all to pressures from groups represented in the governing alliance, and from those whom the government must compensate for exclusion from it.

In some cases, however, the fixing is more simply the result of the fact that the price in question has not been used in normal policies. This would be the case for interest rates, which generally have only been modified in times of grave crisis, and, usually, on the recommendation of a foreign economic mission. Only in economies which have had a long history of inflation, e.g. Chile, has the interest rate been a flexible instrument of policy.

In the rest of this section we shall explain the consequences of fixing each of the six prices for the rest of the economy.

Fixing the exchange rate is one of the distinctive features of reformist economic policy, probably the one that distinguishes it most clearly from orthodox economic measures. In the initial phase of the economic cycle, it is fixed, usually, without any particular thought, or because international reserves are 'too high'. The 'reasoning' comes when there are pressures to devalue: then depreciation is resisted in order to

avoid rises in the cost of living, whether directly, because the country imports considerable quantities of food (so that devaluation would damage the indispensable political support from the middle classes and urban workers), or indirectly, because of the high import content of industry (they could raise prices to compensate, but this would lose markets).

From the beginning of the upward phase of the cycle, internal prices rise. Even if the consumer price rise is less than 10%, this leads - *ceteris paribus* - to over-valuation. The results are well known: there is an implicit subsidy to importers from exporters, which encourages imports and reduces investment in the export sector. Thus the demand for foreign exchange exceeds the supply, by a growing margin. The gap (in the current account of the balance of payments) must be financed: by borrowing and using reserves, because foreign investment falls. Once the reserves run out and the limits on credit have been reached, the crisis unfolds, in this case starting from the balance of payments.

The more the over-valuation increases, the more expectations of devaluation grow, so that import-intensive sectors increase their stocks of foreign goods.

The loss of international reserves leads to a large increase in internal credit (given the incentives offered by the negative real interest rate), without increasing liquidity demand, thus creating inflation. (But this is clearly not to be seen as a monetary phenomenon.)

It is not rational in these circumstances to bring in foreign funds because multinational investors can use domestic credit, while it is in their interest to repatriate profits. The first hurts the capital side of the balance of payments; the second, the balance on invisibles. At the same time the demand from the multinationals increases pressures to expand internal credit.

Over-valuation makes it necessary to limit imports, prohibiting certain goods or raising their price by means of tariffs. Although the immediate explanation for such measures may be to avoid deterioration in the trade balance or to reduce external dependency (in the wrong sense of the term), the basic explanation of the intervention is to safeguard the import-substituting sectors, by providing them with a captive market (and monopoly profits).

The economy thus moves away from the situation indicated by comparative advantage. Resources flow towards goods for the home market and away from those which now have low returns because of price controls (for example, agriculture) or because of the high exchange rate (exportables). Use of labour and domestic inputs falls relative to imported inputs and capital (reinforcing the effect of the over-valuation itself).

In the presence of very high effective protection and an absence of internal competition, unemployed resources, capital wastage, and high prices are inevitable.

The nominal rate of interest, as we have said, tends to be fixed (or even reduced) once a crisis is over, effectively frozen by reformist governments until a new crisis requires it to be raised as part of a stabilisation policy. This freezing of the nominal interest rate, while

inflation increases, results in a negative real rate. The results of this are well known.

First, given the high minimum wage, entrepreneurs increase the use of capital relative to labour so that, although labour productivity may rise, unemployment also rises. This reinforces the growth of the 'reserve army of labour', reinforcing the effect of migrations from the country to the city. At the same time, imports of foreign equipment also rise.

Second, negative interest rates on savings reduce the propensity to save, so that the share of personal saving in total national saving falls, and it covers a declining proportion of national investment; by the end of the cycle, it may even be negative. This reinforces the effect of easy credit on personal consumption (generally, resulting in higher demand for durables). It tends to imply an increase in imports, of consumer goods and also of the inputs and capital goods needed to produce substitutes for these.

Third, low interest rates on borrowing lead to acceleration in investment, but also to a need to ration domestic credit, which favours the sectors in the governing alliance, especially construction and industry. This changes the allocation of resources, from the primary sector to the secondary (and tertiary). This is in line with the expansion of demand in these sectors, but it is reinforced by the fixing of prices and the growing intervention of the government itself as entrepreneur. Clearly these tendencies can be accompanied by rapid and large rises in the money supply. Finally, given that the sectors benefiting are more import-intensive than those losing (especially than the primary), the pressures on the trade balance are intensified.

Fixing the minimum wage is a response to the growing political power of some groups of workers, and to the need to rely on their support. This measure is accompanied by others with similar effect (restrictions on dismissals, higher social security payments, profit-sharing), designed to favour the most privileged, and highest paid workers: civil servants, urban workers, workers in the growing sectors. Their effects are clear.

First, they tend to reinforce the effects of the negative real interest rate and high exchange rate in encouraging substitution of capital for labour, reducing the absorption of labour. At the same time, the increase in imports damages the current balance.

Second, combined with growth in employment in the public sector, for the minimum wage to rise faster than productivity inflates the size of government spending. This, with the other influences mentioned, further reduces net government saving, possibly leading to a deficit. Financing this can be done initially by increasing public foreign borrowing, and then by increasing domestic credit. At this final point, it comes into increasingly severe conflict with the private industrial demand for credit, which is crowded out. Finally, raising the wage increases personal consumption.

The control of essential agricultural prices begins, usually, when inflation accelerates, in the expansionary phase of the cycle, in the

hope of attracting the loyalty of workers, especially in the urban sector.

The price freeze leads to an increasingly distorted relationship between the prices of food and manufactures and therefore between rural and urban incomes. The slower rise in rural incomes gradually eliminates their profit margins. The result, unless other measures are taken to increase agricultural production and productivity, is that some people transfer their investments to other (usually non-productive) sectors, while other people migrate to the city, adding to the army of those seeking work or in the tertiary sector. The worst effect is the reduction in agricultural production which leads to higher food imports that the government then has to subsidise. Both these factors put pressure on the trade balance and on government expenditure. All reflect suppressed inflation [Sjastaad, 1976].

'Cheap' food in an expanding economy increases the demand for 'non-essential' goods, mainly directed to manufactures, which, given this sector's high import propensity, gives an additional impetus to the growth in imports.

Finally, it is necessary to summarise the results of some other prices which are fixed to benefit the urban sector, because of their high weight in the cost of living: bread, milk, fares, petrol, electricity, etc. In each case, fixing maximum prices generates an excess of demand over supply, which gives rise to results like those analysed above.

In summary, the policy of manipulating the basic prices of the economy leads inevitably, (and in accordance with the simple mechanisms of conventional economic analysis) to: increased inflation rates, a serious imbalance on the current account, low absorption of labour and high urban unemployment, a worsening distribution of national income, and fiscal deficit.

The severity of the crisis varies with the type of government. We suggest the two following hypotheses: the more authoritarian and reformist the government, the longer the period in which the elements of the crisis may remain unknown or concealed. In order to avoid losing the political support of 'the masses', the controls will increase as therefore will the disequilibria; the government will try to suppress the visible elements of the crisis. The greater the degree of democracy and the weaker the governing coalition, the more rapidly the crisis will be perceived and criticised by the opposition; this will lead either to rapid adoption of anti-crisis measures or to a military coup. Thus the period between the discovery of the signs of the crisis and the adoption of measures to deal with it is shorter, and the danger of increasing the imbalances, reduced.

In spite of the spectacular failures of IMF stabilisation policies in these circumstances, every time such crises have unfolded, the prescription has taken exactly the same form. The programme in each case included the following measures which led inevitably to economic recession: cutting public spending, drastic devaluation, economic and political restraints on wages, rises in the nominal rates of interest (on borrowing and saving), and selective reduction in tariffs. The IMF missions have always provided the same diagnosis (excess of aggregate

demand over supply, because of public spending), so that the stabilisation measures have also been the same.

2. Evolution of the External Sector of the Economy, 1970-86

In this chapter we analyse trends in the Peruvian economy and economic policy in the last 15 years, using the theoretical framework outlined in Chapter 1.

The first section analyses the course of the economy during the Velasco administration (more precisely, 1970-75); the second, the four years 1976-79 (the government of Morales Bermúdez); and the third, the government of Belaúnde, 1980-85.

We concentrate on this period because during it a large variety of economic policies were tried, including practically all possible policies for trade and external financing. The lessons derived from this analysis are not only useful for economic policy, but also for understanding the complex and changing relationships among the economic process, the international context, and the actions and reactions of various social groups in Peru.

In Peruvian economic history, the external constraint has been one of the most important factors in the cyclical crises which have hindered growth and has become more serious since access to international loans has been cut off. During the last 30 years, productive capacity to export has failed to grow sufficiently to generate the resources necessary to pay for essential intermediate goods, capital equipment, and consumption goods.

There are many reasons for this behaviour of exports, but it is worth emphasising two of them. The first is the lack of a deliberate policy to promote production for export. Export volume has grown only in a series of jumps, each the result of special circumstances, such as the rise of fishmeal as a feedstuff for cattle and the discovery of oil, or the impact of direct investment, as in copper and oil. After the government took control of the principal export enterprises, including CENTROMIN (metals), HIERROPERU (iron), PESCAPERU (fish), PETROPERU, and Tintaya, investment in production for export fell even further.

The second is that, since the end of the 1960s, production for domestic demand has been better rewarded than for export. The process of intense import substitution favoured the industrial sector, in many cases to the detriment of primary sectors, especially agriculture, and increased the demand for imported inputs without leading to a genuinely integrated process of industrialisation through import substitution. As a result, the principal instruments of economic policy have been applied erratically to the external sector, especially the exchange rate and the level and structure of tariffs and other barriers to imports. The constant changes in policy, accelerating devaluation or postponing it, and the changes in duties, surcharges, exemptions, licences and prohibitions, have caused the Peruvian producer to take a very short-term view, and therefore to treat exports as a way of disposing of surpluses, especially for manufactures, and have not encouraged investment to provide a permanent stream of exports.

2.1. From expansion to disequilibrium (1970-74)

The Revolutionary Government of the Armed Forces (GRFA), starting in 1968, gave a strong impetus to the import substitution process, and at the same time instituted major structural changes designed to modify almost all aspects of society. The consequences of this transformation persist today; the changes are not only economic, but also political, ideological, and even cultural.

In the plan brought into effect by the GRFA the state had a central role, both directly and as the regulator of the economy.

In its role as producer, by 1975 the state had come to control 184 enterprises, which represented 31% of the total capital of the country. It was responsible for three-quarters of exports and half of imports, for more than half of investment, two-thirds of borrowing, and a third of employment. At the same time, and partly linked to this expansion, there was an increase in the institutional mechanisms available to it, in administration as well as in law enforcement and defence.

A second characteristic of this period was the control of basic prices. Here, the GRFA instituted the classic package of measures characteristic of populist regimes, designed to encourage the import substitution process. It followed a policy of fixed exchange rates, control of interest rates (at a very low level) absolute protection against imports (using prohibitions on many products and high tariffs on others), and control of essential product prices (rents, fuels, fares, and other public sector prices), and introduced the necessary accompaniment of subsidies for a wide range of popular consumption items.

The disequilibrium caused by the growth of the state's role and the management of relative prices, as well as the collapse of the external balance, brought about an economic crisis. To understand the way the economy developed during this period, it is useful to differentiate between two sub-periods. The first was one of expansion, between 1970 and 1972; the second, 1973-4, was when the external disequilibrium and the domestic inflationary pressures appeared.

2.1.1. Expansion, 1970-72

When it took power, the GRFA applied very restrictive fiscal and monetary policies, continuing the stabilisation policies of the first Acción Popular government, in order to control the crisis which had begun in 1968. By 1969 these policies had succeeded in reestablishing equilibrium and reducing the rate of inflation from 19% to 6.2%. At the same time, the recovery of the primary sector and of construction permitted an acceleration in growth to 4.3% in 1969. In 1970, once this had been accomplished, the GRFA began in earnest its development strategy and its structural transformation policies. Nationalisation of the International Petroleum company was followed by agrarian reform, and then by reform in labour law.

During the three years 1970-2, GDP grew at an average of 6%, sustained by growth in the secondary sector. This growth rate was the result of the expansion of internal demand resulting from the government's policy, so

that the government became the principal engine of the economy. During this period, although there were some disequilibria in the government budget and on external account, leading to repeated external borrowing, the economy was able to respond to the reflationary stimulus.

Because the growth of internal demand was accompanied by an increase in production, there was no strong pressure on prices. The rate of inflation rose slightly from 5% in 1970 to 7.2% by 1972, but the system of price controls restrained inflationary pressures. The expansion of internal demand put pressure on the external balance in two ways. First, through imports of consumer goods, principally food, because of the contraction of the agricultural sector and the real rise in wages and salaries. And second, through the effects of an import-intensive industry: this led to an increase in demand for foreign inputs and capital goods. Nevertheless, it was possible to maintain a precarious surplus on the trade balance.

But the rapid growth in imports and the slower growth in exports of goods (because of low prices as well as poor volume growth) and a growing deficit on services (because of debt servicing and profit remittances) led to a deficit on the current account. This moved from a surplus of \$184.9m, in 1970 to a small deficit of \$31.7m in 1972. At the same time, there was a worsening in the fiscal balance as public sector income was insufficient to finance the expansion in public investment. The current account deficit and a significant proportion of the fiscal deficit were financed by foreign borrowing, increasing the public external debt by 14.4% between 1970 and 1972.

2.1.2. External disequilibrium with inflation, 1973-74

It was in these two years that the inherent contradictions of the GRFA programme appeared. Once it had consolidated its position and purged the military ranks of dissidents, the GRFA turned to further structural reform, while continuing the expansionary policy begun in 1970. GDP expanded rapidly; in 1973, it grew by 6.2% and in 1974 by 6.9%. This expansion was mainly in the secondary sectors, with a small recovery in primary output because of increasing internal demand, derived from the public sector stimulus.

From 1973, the economy could no longer respond adequately to the increase in demand so that the external deficit rose and inflationary pressures appeared. In 1973, the current account deficit was six times larger than in 1972, and in 1974 it was 7% of GDP (largely because of Peru's high dependence on imports of petroleum). For the first time in six years, there was a large trade deficit of about \$400m. The rate of inflation rose to 9.5% in 1973 and to 16.9% in 1974, although many prices remained under official control.

As Sánchez Albavera [1984] remarked, 'the military experiment repeated, with some variations, the traumatic outcome of other Latin American reform efforts'. This conclusion, with which Schydowsky and Wicht agree, emphasises the fundamental fact about the crisis that developed after 1975, namely that it was the consequence of the failure of a model of development based on indiscriminate import substitution. In Peru, this process was accelerated because of the growth of the State relative

to its financial resources and by the early appearance of a bottleneck in the external sector.

The intervention in relative prices which accompanied the reformist attempt to encourage industrial development through import substitution has inevitably led to crises in the Latin American context. The Peruvian case followed the classic pattern, but with some modifications because of the political events which accompanied the development strategy.

During 1973-4, aggregate demand, consumption as well as investment, grew significantly above the productive potential of the economy. The savings-investment gap grew as a result of the decline in the rate of domestic saving, which fell from 16% of GDP in 1970 to 8.5% in 1975, while investment rose from 12% to 18%. The main demand for saving came from the state which accounted for more than half of investment. At the same time, consumption grew at an average rate of 8%.

The increase in government institutions, and the new roles which they took on, caused a progressive reduction in government saving which brought it into deficit by 1975, while the total public sector deficit rocketed to almost 7% of GDP in 1974, mainly because of the ambitious programmes of public investment.

Tax reform was introduced in 1972. This brought in value added tax, unified and raised the taxes on wealth, and increased income tax, among other measures. The possible positive effect of the reforms on collections was offset by the proliferation of exemptions and privileges to promote different sectors. Total tax revenue was not increased, however, nor were larger resources provided for the government. Revenue remained at about 13% of GDP; as a consequence, the use of external financing rose significantly.

The trade surplus finally moved into deficit, at 4.8% of GDP by 1974, because of increased imports, driven by the over-valuation of the currency (which reached 43% in 1974), the high import content of public investment, and the rise in the oil price (Peru was still an importer in 1974). This more than offset increases in exports. Payments for services, interest payments, and repatriated profits put strong pressure on the current account, where the deficit grew to 7% of GDP by 1974.

Political factors also contributed to increased borrowing. The change in the political situation in the Southern Cone countries, and the international isolation in which the GRFA found itself after 1973 led to a need for a significant increase in spending to maintain military equipment. The excess of liquidity in the international banking system allowed easy access to credit, and, in order to reduce the cost of servicing (which had reached 38% of exports), the GRFA refinanced and restructured its external debt, reducing servicing by \$449m. for 1973 and 1974. Of this reduction, \$226m. was by means of refinancing and \$243m. by replacing short-term debt with long-term. The inflow of foreign capital meant that the level of reserves increased each year until 1974.

2.1.3 Why the experiment failed

The military reformist experiment hit a bottleneck in the external sector quite early on because of two fundamental factors. First, the stagnation of the export sector, which failed to generate the resources necessary to finance the programme of development and structural change. The volume of exports fell from 1970 on; by 1974, the economy was exporting 30% less than in 1970. During 1971 and 1972, exports fell in price as well as in volume, and the fall in volume offset the effect of the rise in prices in 1973-74. Secondly, the reformist experiment inherited a high rate of debt service. Even in 1970, the GRFA had to devote more than 25% of total export revenue to service the debt, a level which was much higher than that of the rest of the region at the time.

In October 1974, the first signs of the impending crisis appeared. The government rejected warnings of a crisis and refused to apply any corrective measures. The political situation in the rural areas, the tensions with neighbouring countries, and dissension within the government itself made any programme to correct the disequilibria impossible. Finally in February 1975, some - very timid - measures were taken, but the major economic crisis was not recognised.

Only with the promulgation of the 'Readjustment plan for the Economy', in June 1975, did the GRFA accept the gravity of the situation, and take the first measures to stabilise the economy and restore the external balance.

2.2 From the crisis to the unexpected boom in exports, 1976-79

The radical programme of structural changes brought a division within the GRFA which undermined the ideological unity of the Armed Forces. By 1974, clear factions had appeared. The revolutionary leadership became preoccupied with institutional questions, and the state bureaucracy became embroiled in conflicts among ministries, agencies and outside bodies. The political crisis within the GRFA turned into a political blockage, which prevented the regime from undertaking coherent policies or retaining control of the economy. It was in this context that the first programmes to tackle the economic crisis were introduced; these found no consensus among the different factions, and therefore failed to treat the problem decisively.

The first reaction to the crisis was merely to alter the prices of certain basic goods, in order to reduce the fiscal deficit. The June 1975 Plan raised fuel prices, reduced the fertiliser subsidies, and increased the prices of certain imported foodstuffs (including wheat, dairy products and oils) by 5-20% in order to reduce the subsidies on them. Wage increases were granted to compensate for the price rises, and maximum rates were fixed for wages settled by collective bargaining.

In August 1975, a coup within the leadership replaced General Velasco Alvarado by General Morales Bermúdez. This began what is called the Second Phase of the Military Government. The events of August did not imply a clear triumph for one of the factions, however. There was general agreement that Velasco had to be replaced, but the struggles within the government continued. Conflict on the management of the economy increased, and this was reflected in policy inconsistencies and

in the subsequent events which culminated in the political crisis of July 1976.

The struggle within the GRFA reached a peak that month when a military revolt from the right, led by General Bobbio Centurión, produced a sequence of events ending in the elimination of the progressive officers (such as Generals Fernández Maldonado, De La Flor and Gallegos) from the government. After this, the Second Phase managed to re-establish military unity by imposing a Military Junta over the Cabinet, admitting high-ranking officers to the policy-making circle, and meeting the demands of the Navy and the Police. In this way, the GRFA recovered relative internal unity, which permitted the adoption of more coherent measures, and brought policy back under control.

During the period of political uncertainty up to mid-1976, the government had not been able to confront the economic crisis decisively. The first Minister of the Economy in the Second Phase, the civilian technocrat Barúa Castañeda, drew up a stabilisation plan. In November 1975, the foreign exchange markets were reorganised: he established a single exchange rate, of 45 soles to the dollar; this implied a devaluation as the official rate had been frozen at 38.7 since 1969.

In January 1976, Barúa presented an economic plan to reduce the fiscal deficit by raising the rate of income tax and imposing it on state enterprises and co-operatives, increasing the tax on companies' capital, and raising various minor taxes (on passports and foreign spending). At the same time he ordered a reduction in public sector current spending of 7%, strengthened the external position by restricting travel abroad, and imposed import licensing. The prices of some essential goods were increased (fuels by 43%, fares by 28.6%, and some foods by 12%). Because of the political crisis, however, the measures taken were too little too late so that during 1975 and the first half of 1976 the economic situation continued to deteriorate rapidly.

In 1975 the external problem had become much more severe. The deficit on external trade reached \$1,097m., 8.9% of GDP. The worsening of the trade balance was the result of a reduction in the value of exports, with falls in both prices and volume, and a sharp rise in imports, both public and private. Including invisibles, the current deficit in 1975 reached \$1,538m. (11.3% of GDP).

The external deficit was in part the result of servicing the external debt, which took 36.7% of export revenue. Increased borrowing by the GRFA raised external debt to more than \$1 billion, 22.5% of GDP. But even this inflow of foreign capital was not sufficient to finance the deficit so that reserves had to be used.² These fell from \$692.5m in 1974 to \$115.8m in 1975. In the first half of 1976, they fell a further \$668.9m. reaching a level of \$-553m by June 1976.

The external account worsened because it was impossible to control spending. The central government deficit reached 5.5% of GDP and for the first time since 1970 there was a negative balance excluding capital spending. The high cost of subsidies contributed significantly to this. The total public sector deficit grew even more, reaching 9.8% of GDP because of investment by public sector enterprises. In spite of the

measures taken in January 1976, the deficit grew in the first half of 1976.

During this period, Peru did not sign an agreement with the IMF. Between January and May 1976, it did use IMF low conditionality loans (gold tranche, oil facility, and compensatory finance) four times receiving in total \$220m.

2.2.1. Isolation and confrontation (July 1976-July 1978)

The package of economic measures taken in June 1976 marked a significant turning point in economic policy. The package was intended to be an orthodox one, using strongly contractionary monetary and fiscal policies with periodic adjustments of the exchange rate. This reversal of economic policy reflected the change within the GRFA, and contributed to the political crisis of July.

The June measures were intended to correct the principal internal disequilibria by freeing the principal markets and returning to market prices. The currency was devalued by 44% to make it competitive, and in September a new policy of regular adjustments (mini-devaluations) was adopted. After a long period of stability, the interest rate was raised. The nominal rate on borrowing rose from 12% to 13.5%, while the rate on savings was increased from 9% to 10%. At the same time, price controls were eased.

An attempt was also made to reduce the fiscal deficit. A tax of 15% was imposed on traditional exports, the rates of value added and car tax were increased, and tariffs were unified into a single ad-valorem scale. Tax exemptions on imports were simplified and significantly reduced. The tax on petrol was increased as well as the prices of other fuels. On the spending side, wages and salaries in the public sector were frozen, subsidies were reduced, purchases of goods and services were frozen, and investment was reduced. The Certex, a subsidy to non-traditional exports, was reduced by 25%, from 40% of the export value to 30%.

The June measures had a sharp effect on the prices of basic goods, and wage rises were insufficient to protect real incomes. Together with the freezing of collective bargaining (imposed for six months), this led to a general strike on 20 June 1976 and increased social conflict.

As a result, there was a tightening of controls on the civilian population. The government eliminated what was left of the free press, closing the independent journals, a curfew was imposed in Lima (for nine months), and a state of emergency was decreed, suspending individual rights (this lasted 14 months). Dismissals of striking workers were authorised; as a result more than 2,000 union activists lost their jobs, seriously weakening the labour movement. In this context of repression, in January 1977, a new package of price rises was introduced, and interest rates were raised to a maximum of 17% on loans and 11.5% on savings.

The introduction of a strongly deflationary stabilisation programme brought a strong reaction from the productive sectors and from factions within the government, leading to a confrontation between the Minister for the Economy and the interministerial Commission created to supervise

economic policy. Faced with the impossible task of imposing fiscal discipline, the Minister, Barúa, resigned in May 1977.

The businessman Walter Piazza was chosen to replace him. He tried to continue with the basic elements of his predecessor's policy. He announced an Emergency Programme on 10 June, designed to reduce the fiscal deficit by freezing spending on wages, goods and services in all public sector bodies for 12 months, and reducing spending on average by 8%. At the same time he decreed large rises in controlled prices, significantly greater than the rise in wages and salaries. For the second time, a Minister for the Economy was unable to survive the imposition of a deflationary programme and Piazza was forced to resign on 6 July, only 52 days after his appointment.

Faced with growing discontent, the government took a step back on its stabilisation policy. The Ministry for the Economy was put back under military control, under General Alcibiades Sáenz Barsallo, who stopped the series of mini-devaluations from 7 July, and later reduced some food prices. This reduction meant an increase in current spending, on subsidies, thus damaging the fiscal position.

The accelerating deterioration on external account forced the government to negotiate a stand-by agreement with the IMF, the first since 1971. The Letter of Intent was signed on 17 October, requiring as pre-conditions (on 10 October) a package of economic measures. This was the first 'IMF package' and meant an increase of 25% on petroleum products (except petrol) and some tax rises (on cars, wages and salaries and a surcharge on property).

Three days before, the exchange rate had been freed, after being frozen for three months, leading to an immediate devaluation of 7%. The exchange regime was changed, establishing a single foreign exchange market, abolishing the foreign exchange quota for the private sector, but retaining import licensing. The private sector was permitted to hold foreign exchange, thus ending the previous strict system of capital controls. Foreign currency bank accounts were allowed and banks could issue foreign currency Certificates of Deposit.

The programme collapsed quickly, leaving all its goals unachieved. The government announced that it was going to correct the faults in it. It decreed a new package in January 1978 with large adjustments in prices (electricity and petroleum products increased by 33%, fertilisers by 18%, and basic foods by an average of 25%) and higher taxes (the tax base was broadened by imposing value added tax on imported goods, and including tariffs in the base on which tax was calculated; a tax of 4% on revaluation of capital, and an increase in the tax on some petroleum derivatives and some minor taxes). After a devaluation in the last quarter of 1977 of approximately 50%, the government, through a 'gentleman's agreement' with bankers in the region, again fixed the rate of exchange; this lasted until April 1978.

In spite of the January 1978 measures, the IMF did not pay the second tranche of the stand-by, thus removing the possibility of obtaining a credit of \$260m from a consortium of private banks. The Government once again had to begin negotiations with the IMF, and sent two missions to Washington. One, the 'National Unity' mission, included the Minister of

Foreign Relations, representatives of the private sector, and Manuel Moreyra, an ex-official of the Central Bank, and had the objective of obtaining political support at international level. Because the military government had started a process of democratisation, this obtained the support of the Carter Administration, the US Treasury, and the Inter-American Development Bank. The second, headed by the Minister for the Economy, met the IMF, but failed to reach an agreement.

In order to achieve an agreement with the IMF, the government imposed in May 1978, on the 9th and 15th, a collection of economic measures to reduce the fiscal deficit. This increased the tax on traditional exports to 15%, imposed a surcharge of 10% on the cif value of imports, reduced tax exemptions on imports, raised general rate of tax on goods and services, and increased taxes on fuels. On the expenditure side, it cut spending in some budget sectors and raised some controlled prices by 50% on average to reduce the cost of subsidies. The exchange rate was freed again, breaking the 'gentleman's agreement', and leading to a devaluation of 13.3%.

The package of 15 May, called the 'package with no minister' as it took place after the resignation of Sáenz and before the appointment of Silva Ruete, marked the end of the second stage of stabilisation within the second phase of the GRFA, a stage which was characterised, as we have seen, by inconsistent stabilisation measures. During this period, the economic situation deteriorated dramatically.

From 1976 to 1978, the recession and inflationary trends worsened. Growth had continued during 1976, but GDP fell in the following years, by 1.2% in 1977 and 1.8% in 1978. Inflation increased to an annual average of 33.5% in 1977 and 57.8% in 1978.

Because of an increase in the value of exports, from higher prices for traditional products, and a reduction in imports, because of the devaluations and the fall in demand, the external deficit was reduced during this period. The deficit on the trade balance went down from \$1,097m. in 1975 to \$422m. in 1977, 3.4% of GDP. Because of debt servicing, which absorbed 36% of export revenue, the current deficit was 7% of GDP during 1977-8. The inflow of capital from abroad was not sufficient to finance the deficit, leading to a serious fall in net foreign exchange reserves. In 1976, these fell \$868m. and in 1977, \$349m. so that net reserves remained negative until 1978. The contractionary effect of the loss of reserves on the liquidity of the economy helps to explain the recession.

In spite of the tax measures taken as part of the stabilisation policies, the fiscal deficit grew during this period. The Central Government deficit reached 7.5% of GDP. This increased mainly because of a rise in current spending, the deficit on current operations rising from 1.5% to 3.7% of GDP in 1977, while the level of investment by public enterprises kept the public sector deficit at about 10% of GDP.

The public sector deficit was finally reduced after the 1978 measures, to 6% of GDP. The low sensitivity of the fiscal deficit to the measures that had been taken previously can be explained in part by the economic effects of the measures themselves. The attempts to reduce spending and increase income were neutralised by increases in wages and salaries to

compensate for the rise in cost of living, by the increase in the cost of goods and services bought by the state, and by the devaluations, which increased the local currency cost of servicing the debt. And it was not possible to impose fiscal discipline on military spending. The tax measures did not succeed in raising the tax take, which remained at its historic level of about 13% of GDP. The reduction in economic activity, the proliferation of exemptions, the general tax evasion, and an inefficient tax system all help to explain this.

The only consistently orthodox measures taken during this period were those on wages and salaries. By means of state intervention in collective bargaining and delayed adjustments to price rises, real wages and salaries were significantly reduced. The share of labour earnings in national income fell from 42% in 1975 to 37% in 1978. Real wages fell by 12% and salaries by 15% between 1975 and 1978. The reduction in real personal income reduced demand, affecting production in the secondary sector.

2.2.2. Export boom and recovery: 1978-80

Starting in the second half of 1978, there was a spectacular growth in exports. Revenue increased from \$1,954m. dollars in 1977 to \$3.916m. in 1980, an increase of 100% in only three years. This expansion resulted from a large rise in international prices for traditional exports, the 'second oil shock' which raised the value of petroleum exports from \$50m to \$845m. in 1980, and the spectacular take-off of manufactured exports which reached 22% of the total in 1980.

The recovery of the external sector, helped by the more co-ordinated management of economic policy by the team led by Silva Ruete and Moreyra after May 1978, and the financial relief of a new agreement with the IMF, allowed the country to reduce the external and fiscal deficits and revive productive activity. It is important to note that, in contrast to their predecessors, the economic team was supported by the military government, which strengthened the Ministry of Economy and Finance as the department in charge of formulating economic policy, and allowed it to emerge victorious in conflicts within the Cabinet.

Economic policy was directed towards curing the disequilibria through a combination of strongly deflationary monetary and fiscal policies and a policy of mini-devaluations. The programme was similar to that tried by Minister Barúa, differing only in the time allowed and in degree. The team decided on a 'gradualist' approach, planning to cure the imbalances over a period of 30 months. The measures taken from the second half of 1978 went beyond a simple programme of stabilisation and were directed at restructuring the entire economy. Recognising the structural distortions produced by the import-substitution policy, the economic team tried to change Peru's trade pattern, by promoting exports of manufactures. A law to promote non-traditional exports strengthened the measures available for assisting local firms to produce for the external market, and the government encouraged an alliance between the state and this sector.

From the second half of 1978, there was a timid opening of the economy. The National Register of Manufactures was abolished, and instead a temporary list of prohibited imports was drawn up to remain in force until 1980. The market for foreign exchange was freed, permitting

current accounts in dollars, and restrictions on financing imports by the private sector were reduced.

Given the critical situation of the reserves, urgent measures were taken to avoid the suspension of debt payments; these included arranging a 'roll-over' of \$185m. with the commercial banks, 'swaps' with Latin American central banks, and other short-term measures. In September, an agreement with the IMF was finally signed, which permitted a restructuring and refinancing of the debts repayable in 1979 and 1980. The conditions of this second agreement, unlike the first, were more than achieved because of the external recovery.

The economic team faced the fiscal problem by increasing taxes. Copper and zinc were made subject to export tax, the surcharge of 10% on imports was extended for a further two years, income tax was increased (and estimates of income through consumption patterns were instituted), and a tax of 10% was imposed on the revaluation of capital. These measures were accompanied by attempts to reduce public spending: public sector employees were 'invited' to take early retirement in exchange for compensation, and subsidies were reduced.

Between May 1978 and June 1979, there was a sharp increase in prices of controlled products. Fuels rose by 65% on average; bread, by 72%; sugar, by 177%; rice by 128%; milk by 52%; fares by 83%; pasta, by 80%; all of which seriously affected low-income earners.

From 1979, economic policy had a clear anti-inflationary bias, and was directed to offsetting the expansionary effect of the export boom, which was having a strong influence through the effect of reserves on money supply. To offset this pressure, the rate of devaluation was reduced, and from February, the government introduced prior warning of exchange-rate changes in order to calm expectations.

In an attempt to 'sterilise' the reserves, imports were liberalised; the average tariff fell from 66% to 40%, and the items subject to prohibition from more than 1,000 to only 9; and financing requirements were eliminated. To reduce the inflow of foreign exchange, short-term credits and other loans which had been negotiated to support the balance of payments were cancelled and the refinancing loans which had been arranged with the commercial banks were pre-paid in January 1980. The debt restructuring arranged with the Paris Club was also cancelled. Credit controls were adopted to contain the growth of the money supply.

The economy recovered to a rate of growth of 4.3% in 1979, and inflation fell to 66.7%, from 73.7% in 1978.

The external balance also improved. In 1978, there was a surplus of \$300m. on the trade balance and the current deficit was reduced to 1.5% of GDP. During 1979, in spite of an increase in imports, the trade surplus rose to the record figure of \$1,722m. 12.4% of GDP. Because of the reduction in debt service, to only 22% of exports in 1979, there was a surplus on current account of 6.9% of GDP. In spite of the attempts to sterilise them, reserves rose by \$1,579m. giving the country its first positive balance for three years, of \$550m.

The fiscal deficit, which had fallen slightly during 1978, was further reduced in 1979. The central government had a surplus on current spending of 3.5% of GDP, so that its deficit was reduced to only 0.6% of GDP, and the total public deficit to 1.1%. This improvement came from an increase in tax revenue, which rose from a normal past level of 13.5% to 17.1% of GDP in 1979 and to 20.6% in 1980 - mainly the result of increased revenue from export taxes which reached 2.8% of GDP in 1979. Income and corporation taxes also rose because of higher taxes on mining and oil profits, to 3.8% of GDP in 1979 and 6% in 1980. Current spending by the central government fell from 18.2% of GDP in 1977 to 14.9% in 1979. Capital spending by both the central government and state enterprises continued to increase, however.

The first half of 1980 saw preparations for elections and a return to civilian government. Therefore, although the basic elements of the anti-inflationary policy were retained during the first quarter, in the second prices were controlled and subsidies introduced, significantly increasing the deficit. The Military Government transferred power to Acción Popular (AP) in July 1980, leaving behind an economy which was apparently healthy and growing.

2.3. The attempted return to orthodoxy, 1980-84

Once Acción Popular was restored to power, it is possible to identify three periods of very different economic policy: the first, which lasted until mid-1982, in which the anti-inflation bias of policy was continued, and the government tried to follow a neo-liberal programme directed at restructuring the economy by altering its pattern of the last 40 years; the second, from mid-1982 to 1984, during which, because of the collapse of the external sector, economic policy was principally directed to closing the external gap, and therefore followed an adjustment programme which put inflation control at a lower priority and progressively abandoned the plans to restructure the economy; and the last year of Belaúnde's administration, July 1984 to July 1985, in which the government tried to put into practice the slogan of 'austerity without recession' as a response to the political and electoral collapse of the government party.

2.3.1. Populist neo-liberalism, July 1980-July 1982

The economic policy which the AP Government followed surprised voters and professional observers alike. Given the basis of support for the two parties in alliance in the government, two alternative directions might have been expected: promotion of exports, consolidating the alliance between the State and that part of local industry orientated to the external market, encouraged under the previous regime; or a modernised version of import substitution. Both programmes would have had to be politically sensitive to retain the popular support necessary to any democratic regime.

The economic team headed by the Prime Minister and Minister for the Economy, Manuel Ulloa, had a good margin for manoeuvre because the external and fiscal gaps had been 'cured'. The government inherited a solid level of reserves and AP in alliance with a smaller party had achieved majorities in both Chambers of the legislature which gave it

ample freedom to act. As Daniel Schydowsky noted: 'This government could do anything'.

In spite of all this, the regime, while continuing with a stabilisation policy similar to that introduced by the Silva Ruete-Moreyra team, introduced a plan of orthodox liberalism, directed to transforming the productive base of the country, in order to adapt it to the existing international division of labour (which meant a shift to primary production). Thus the economic team followed the tendency of the decade in the Southern Cone in making a return to orthodoxy. But, in contrast to the typical cases of the Southern Cone, this was tried, not under an authoritarian political regime, but in the situation of a return to democracy, which rapidly constrained it.

As Sánchez Albavera argued, the general orientation of economic policy was directed towards opening the economy to trade and capital flows, to easing controls on foreign investment, and to freeing internal markets; it accepted the concept of a 'subsidiary' role for the state, and emphasised the free play of market forces, promotion of private initiative, and reducing the entrepreneurial role of the state. The restructuring of the productive base of the economy was closely meshed with the stabilisation policy, establishing a clear tie between the policies for adjustment and those directed at a medium-term restructuring.

The programme of the Ulloa economic team was only introduced in full from January 1981. The first measures were taken during the second half of 1980, but the tone of the political and economic debate was set by the municipal elections of November. The economy finished the year with a growth of GDP of 2.8%, due to recovery in the primary sectors, construction, and commerce. Inflation remained at a level similar to that in 1979, held back in part by the price restraints put on before the elections.

The boom in the export sector reached its peak during the year, with export income of \$3,916m. Nevertheless, because of the opening of the economy and the exchange-rate policy, there was a rapid increase in imports, which led to a reduction in the surplus of the trade balance to 4.8% of GDP. Interest payments turned this into a current deficit of 0.6% of GDP, but, because of an inflow of capital, reserves increased by \$722m.

On the fiscal side, there was a clear deterioration: the public sector deficit increased to 4.7% of GDP, in spite of record tax revenues. The Central Government and the rest of the non-financial public sector had large surpluses on current spending; the deficit came from continued high investment, financed by external and internal borrowing. The monetisation of reserves and the inflow of credits increased the liquidity of the economy.

During 1981 and the first months of 1982, the objective of economic policy was to contain the inflationary pressures, particularly by means of controlling the money supply. For this reason, trade and exchange-rate policies were directed towards neutralising the monetary impact of the accumulation of reserves, and fiscal and credit measures were taken to control the growth of the money supply.

The AP Government extended the trade liberalisation begun in 1979, further reducing tariffs, eliminating non-tariff barriers to imports and simplifying customs procedures. In September 1980, the maximum tariff was fixed at 60% and the average was reduced to 35%. This policy continued in 1981, reducing the average tariff to 32%, and the intention was to reduce it gradually to an average of 10% by 1985. At the same time other restrictions were reduced, so that by December 1981 98% of import lines were free of controls.

The exchange-rate policy maintained the anti-inflationary bias dating from 1979. The economic team continued a policy of mini-devaluations without warning during the period. The devaluations lagged behind the differential between internal and external inflation, thus reducing competitiveness. This was possible because of the high level of reserves, and reinforced the opening of the economy and the sterilisation of reserves.

The tax reform of June 1981, imposed through powers granted by the legislature to the executive, concentrated on: improving the value added tax, by fixing a general rate of 16% applicable to all stages of production instead of the differentiated system which preceded it; restructuring income tax, simultaneously raising deductions in order not to increase the tax take; and reducing export taxes. These measures were introduced from the beginning of 1982. In general terms, the tax reform was intended to simplify and modernise the system rather than to increase revenue, as revenue was still high because of the good performance of the external sector. Trade taxes, direct and indirect, accounted for 10.5% of GDP in 1980 and 7.9% in 1981. The tax on fuels was gradually becoming the pillar of tax revenue, a process which had begun with the extension of tax to all petroleum derivatives in 1978.

The government introduced a reform of the financial system which was intended to improve efficiency by promoting greater competition in the system. Restrictions on new commercial banks were eliminated and a greater role allowed to foreign banks. In January 1982, a common interest rate was introduced for all savings, eliminating the previous differentials. Mergers of commercial banks and of banks with other types of financial intermediaries were also authorised.

Interest rates were raised three times during 1981 and 1982, to encourage savings, and the 'spread' between loan and savings rates was eliminated, freeing the market to encourage competition and to offer higher real interest rates for deposits in local currency. The objective of these measures was to reduce inflationary pressures, by encouraging saving, and also to reduce the differential in returns between saving in dollars and saving in local currency. Since 1978, with the liberalisation of exchange controls, there had been a rapid dollarisation of the economy because of the preference for balances in foreign currency. In 1981 45% of savings in the financial system was in dollars.

As part of the economic restructuring, the treatment of foreign capital was liberalised, and this brought into question the common regulation of foreign investment under the Andean Pact. In this area, the most important change was in the contracts with the petroleum companies operating in Peru. They were given better incentives for exploration and production. Investment and reinvestment by the oil companies accounted

for 87% of foreign investment during 1981-5. As Decision 24 of the Pact (severely regulating and limiting the role of foreign investment) remained, in principle, in force, there was not a significant inflow of direct investment. Similarly, opening the financial system to foreign banks did not lead to a significant penetration on their part.

The short-lived export boom came to an end in 1981, gradually revealing the underlying economic problems, which had remained unresolved since 1976. The economic policy of the administration, because it did not adapt to the change in external conditions, contributed to the worsening of the exterior and fiscal balances. By the middle of 1982 a return to strict adjustment measures, which aggravated the recession and fuelled inflationary pressures, was necessary.

Growth continued during 1981, however. GDP grew at 3%, mainly because of an exceptional harvest (the agricultural sector grew by 12.3%) and the performance of the construction sector (although this fell back from the 1980 rate of 18%, it still managed 11%). The growth of the construction sector was the result of public investment. Because of the freeing of internal prices, especially after the January measures, the rate of inflation rose to 72.3%.

The external situation worsened rapidly. There was a trade deficit of \$553m., equivalent to 2.7% of GDP. This was as much the result of a decline in the value of exports as of the acceleration of imports encouraged by the trade liberalisation and the exchange-rate policy. Exports fell because of a sudden fall of almost 20% in the international prices of traditional exports and because of the reduced incentives for manufactured exports; these fell by 18%. In 1981, the CERTEX subsidy was eliminated for some sectors, and reduced and made uniform for the rest. The international recession reduced demand for all exports, and the slowing of the devaluation reduced the competitiveness of manufactured exports.

The external gap was increased by debt service which suffered from the rise in international interest rates; this had begun in 1978 but had been blunted by the export boom. Debt service amounted to 54% of exports in 1981, including the advance repayments of debts (\$377m. as part of the government's programme of sterilising reserves). The deficit on current account was \$1,728m., 8.6% of GDP. External financing was insufficient so reserves fell by \$500m during the year.

The public sector maintained the same level of spending, but tax revenue fell from 20.6% of GDP to 17.4% because of the fall in income from export taxes. These fell from 5.5% of GDP to 1.9%. Taxes on imports and fuels, however, continued to keep tax revenue above pre-1978 levels. Because of this, the public sector was able to keep its current spending in balance, but the total deficit worsened because of the programme of investment and debt repayment, to 8.9% of GDP. This was financed by increasing domestic credit, which offset part of the negative effect of the loss of external reserves on liquidity.

The serious external situation meant a return to negotiations with the IMF after three years without it. A Letter of Intent was sent in April 1982, and an agreement was signed in June. This gave an Extended Credit Facility of \$734m. for three years, and compensatory financing of \$226m.

The agreement implied strong conditionality, expressed in targets [Schuldt, 1985]: during 1982 the public sector deficit had to be cut to 4.3% of GDP; there was a limit of \$1,000m. on new long-term borrowing, and a maximum use of reserves of \$100m.

The economic team had been forced to return to the IMF to obtain support for a more restrictive policy. For this reason, the regime found itself isolated from the business sectors, because of trade liberalisation and the reduction in CERTEX, and from its popular support, because of the fall in living standards as a result of the wage policy. There were also strong divisions within the governing party between the economic team and those more inclined to take account of political considerations.

2.3.2. Adjustment and stagflation, June 1982-April 1984

The seriousness of the external situation and the commitments made to the IMF required drastic adjustment to restrain domestic demand and to alter the relation between trade prices and domestic prices, by means of deflationary monetary and fiscal policy and a new exchange-rate policy. But the economic team proved to be incapable of imposing the necessary fiscal discipline. Further, because of the 'dollarisation' of the economy, it lost control of monetary policy. Quasi-money in national currency was falling relative to total liquidity. The principal measures taken were in exchange-rate and price policy, with some attempts to increase tax revenue to restructure and refinance external debt.

After April 1982, mini-devaluations became a basic instrument for managing the balance of payments. Exchange-rate policy was intended to cut imports and encourage exports, especially the non-traditional as these, unlike the traditional, are sensitive to the rate of exchange. From that date the devaluations were greater than required to maintain competitiveness.

Nevertheless, during 1982, imports remained almost as high as in the preceding year, showing little sensitivity to either devaluation or the reduction in domestic demand. This is the more surprising as tariffs were increased during the year, with a surcharge of 15%, introduced to raise revenue. This meant that the average tariff rose to 36%. The strong increase in imports came from durable consumer goods imports and foodstuffs - to be accounted for in part by the existence of still unsatisfied demand from high income earners.

Traditional exports rose, but this was offset by the fall in manufactured exports. This fall, which occurred despite the accelerated devaluation, was for two reasons: the revaluation of the dollar, which reduced the Peruvian gain in competitiveness, and growing protection in industrialised countries which affected important sectors of Peruvian exports. The result was that the trade deficit reached 2.1% of GDP.

The current account deficit was \$1,600m. with debt service at 45% of exports. Commercial banks continued to provide finance, in spite of the impact of the 'Mexican crisis' on international financial markets, in contrast to the situation in other Latin American countries. This financing allowed Peru to meet its internal obligations and even to increase its reserves.

The public deficit worsened during 1982. The fall in capital spending reduced the central government's total deficit to 3.9% of GDP, but the continued investment by state enterprises gave a total public sector deficit of 9.3% of GDP. GDP grew by only 0.9% in 1982, with clear signs of recession in the secondary sector, because of external competition and the fall in domestic purchasing power.

At the end of April 1983 the renewal of the agreement with the IMF was approved, with some corrective measures as a prior condition. These (mainly increases in some prices to reduce the public deficit) were approved by the government. By this time, policy was under the control of the new Minister for the Economy, the banker Carlos Rodriguez Pastor; Manuel Ulloa had resigned in a ministerial crisis at the end of 1982. Rodriguez Pastor and his team designed a new policy with a more radical adjustment programme. As it was not possible to pay the debt service, which had reached 57% of exports, they sought to refinance and restructure the debt. His term was marked by a series of natural disasters, which cost an estimated \$1,500m.; by the municipal elections of November 1983; and by further negotiations with the IMF and external creditors.

At the end of April 1983, the country notified its creditors that it was suspending debt servicing, and that it intended to renegotiate with the Paris Club. In July, agreement was reached, giving 90% relief for the period from 1 May 1983 to 30 April 1985, equivalent to approximately \$440m., with restructuring over a period of eight years, including three grace years. Refinancing for payments due between 1 May 1984 and 28 February 1985, on the same terms, with the details to be decided at a later meeting, was also agreed. This relief was worth \$670m.

In economic policy, the mini-devaluations continued, in an attempt to improve competitiveness and to support the balance of payments; interest rates were raised again; and the level of protection was increased, the surcharge of 15% being changed to 10% on the cif value, and extended to December 1983. The main objective was to reduce the large differences in tariff protection offered to different sectors. There was also hope of an increase in revenue from raising all tariffs by 10 points. Imports by the state sector were exempted. Although there was no change in declared policy, these measures began the reversal of the trade liberalisation.

In August 1983, important changes were made in the management of economic policy, which appeared to be related to the municipal elections in November. After a 6% devaluation, there was a return to 'pre-announced' devaluations in order to reduce inflationary pressures arising from expectations, and the rate of devaluation was reduced. "Pre-announcing" continued until February 1984. At the same time, price controls were used to reduce inflation. In September a limit of 3% a month was put on price rises for petrol and fuels up to December, and a limit of 4% on rises for basic products (rice, bread, milk, medicines) and on public services (electricity, telephone charges, and water).

The economic situation worsened dramatically during 1983. GDP fell by 11.8% and inflation rose to 125%. Natural disasters and the deflationary impact of economic policy explain the contraction in production, which affected all sectors. There was relative success, however, in improving the external sector. In spite of a fall in exports, there was a surplus in the trade balance of 1.9% of GDP because imports fell by 30%, as a

result of recession, the increased rate of devaluation, the tariff surcharges, and the saturation of the domestic market for imported consumer goods. Thanks to the relief on debt servicing achieved by refinancing, this took only 24.7% of exports, reducing the current deficit to 5.4% of GDP.

The economic team was not able to reduce the government deficit. Current spending by the central government, as a proportion of GDP, rose for all components, increasing the deficit from 0.2% in 1982 to 5% in 1983. The reduction in tax revenue because of the fall in income, to 13.9% of GDP, contributed to this. As investment by the public sector was not restrained, the total public deficit reached 12.1% of GDP.

Rodriguez Pastor's term of office ended with the electoral collapse of the AP. In the municipal elections, the government party achieved only 17% of the national vote, and in Lima, it fell into last place with 12% of the votes, taking not a single district. This must be compared with 45.8% of the national vote in the presidential elections of 1980. The regime's political isolation had led to strong internal dissent, starting at the beginning of 1983, led by a group which saw the political need for a change in economic policy. This group advocated a middle-of-the-road policy, not as market-oriented as those of Ulloa or Rodriguez Pastor, but not as ultra-populist as that of the secretary general of the party. The electoral disaster strengthened this group, and it pressed for the dismissal of Rodriguez Pastor, which occurred in April 1984.

Simultaneously with this conflict within the government, there were problems in complying with the IMF agreement. The mission which visited the country at the end of 1983 to evaluate the economy indicated that important changes would be needed to ensure the continuation of the Extended Credit Facility. It did not approve the policy of 'pre-announcement' or the price restraints introduced in August. The 'pre-announcement' system was therefore ended and large price rises were decreed. Petrol reached the equivalent of \$1.15 a gallon, electricity charges were raised by 32%, and basic product prices and fares were raised. In December 1983 the Budget for 1984 included a large rise in taxes to attack the fiscal deficit, including a rise in value added tax to 18%.

In spite of these measures, the IMF agreement was not approved, and the resignation of Rodriguez Pastor, and then of Prime Minister Schwalb, ended any hope of continuing the Stand-By.

2.3.3. 'Austerity without recession', July 1984-July 1985

After Benavides Muñoz was appointed Minister for the Economy, there was a waiting period without any clear definition of the new direction of economic policy. The picture was cleared by a speech in May 1984 by the new Prime Minister Sandro Mariategui in which he announced a policy of austerity without recession. This reflected a temporary triumph for the centre sector of the party, and the intention of the party to recover its support in the general election of April 1985. Mariategui criticised the previous economic policy as 'a doctrinaire dogmatism which ignores the influence of social factors on policy', and he tried to win support from the industrial sector.

Special powers for 60 days were granted to the executive by Parliament in order to bring in the measures necessary to enforce the new economic programme. Under this legal regime, the government made 30 decrees, which disappointed expectations. The only measures with immediate impact were tax reforms, including a restructuring of income tax, to take effect in January 1985, and a reduction of value added tax from 18% to 8%; and the explicit reversal of trade liberalisation. Some major categories of imports were added to those requiring prior licenses and all imports of these were prohibited until December; they included textiles, clothing, and shoes. Later, in 1985, more products were added to the temporary prohibition list. The surcharge on imports had been raised to 15% of the cif value in April, and to this was added a new set of increases in individual tariffs, thus increasing differentials among goods. The explicit aim of these measures was no longer greater tax revenue but the provision of adequate protection to domestic output. Finally, there were various tax and other incentives to individual sectors.

The initial support which the Cabinet received from the business sectors dissipated rapidly. First, there was confusion in economic management, characterised by repeated advances and retreats and contradictory policies, such as a tax on interest payments and the immediate raising of the value added tax back to 11%. Second, some elements of the deflationary policy continued, such as the increase in interest rates which meant a positive real rate on borrowing, thus making production more expensive, while rates on savings continued to be negative, discouraging saving in national currency. The rate of devaluation increased, and credit to the private sector was reduced.

When it found itself unable to obtain the continuation of the Extended Credit Facility, the government signed a Stand-by agreement with the IMF which included targets which were impossible to achieve. It was signed in April 1984, but was broken immediately. After this, it was impossible to refinance the external debt, and Peru entered into a situation of unilateral suspension of payments from the second half of 1984.

As can be seen in the tables in the Appendix, there was a slow economic recovery during 1984, and the suspension of debt servicing reduced the current deficit to 1.5% of GDP. But, as the Central Bank pointed out [Memoria, 1984], 'we have still not recovered the level of output of the past; three-digit inflation has become endemic; the problem of the debt is still there; the public sector deficit is too high; and saving in domestic currency has fallen, aggravating the problem of dollarisation'. To which we must add that the population was becoming poorer and the social situation was explosive. This was the situation which the new democratic government inherited in July 1985.

3. Recent Trends and Forecasts for the External Sector to 1990

Having described the history of Peru between 1970 and 1985, we now turn to analysing the present situation: the events of the last two and half years and forecasts for the external accounts up to 1990.

In the first section, we shall sketch the economic policy and development strategy of the present government. From this, we shall draw our own central conclusion about external policy, namely that: domestic capital formation and creating a national market must have priority in a country like Peru; policy on trade and external finance must be treated as the 'residual', in contrast to both the primary producing-exporting or the import-substitution models. (Although the latter appears to be a strategy for development 'from within', in the end it leads to an even more fundamental dependency than the former.) What is interesting in the way the present Aprista government has developed is its movement away from an initially overt, irreconcilable conflict with the commercial banks and the international institutions; it then returned, little by little, to the fold, as the fall in reserves forced a return to negotiations.

The second section examines the present situation, and prospects for the balance of payments up to 1990. This is in order to understand the way in which policy-makers were thinking about external policies at the end of 1987. Combining these sections, we can judge what the government should do in the remaining two and half years of its term.

3.1. The change to 'heterodoxy', 1985-7

The coming to power of Alan Garcia brought a radical change in Peru's economic policy, rejecting the orthodoxy which had led to stagnation with inflation. For the first time Peru attempted, partly because of the influence of the Argentine 'Plan Austral', an economically 'heterodox' programme, with some theoretical coherence, which showed a spectacular success in its first 18 months (effectively to December 1986). The attempt is also interesting because it tried to achieve changes in the economic structure by means of short-term economic policy, embodying long-term aims in the adjustment plan. From 1987, there was a failure of nerve on the part of the economic team, and in spite of rapid growth during that year (6.5%), constraints on the policy appeared, and, with these, the problem of erratic political management by President Garcia.

Alan Garcia argued [1985] that the present crisis affecting Peru could be attributed basically to three factors. The first, linked to the international crisis, is that the countries at the centre 'reserve high technology for themselves, and close their frontiers' to our exports, at the same time as they 'demand implacably that we repay our external debt, which was the result of the unequal exchange between our primary materials and their manufactured products'. The second factor is that the application of neo-liberal economic policies from the end of the 1970s has aggravated Peru's economic and social problems. Thirdly, the

crisis is fundamentally the result of the persistence of a deformed and unjust economic (and social) structure, the result of

our history of dependency on external forces which, allied to powerful domestic interests, has brought the country to the present crisis. Lacking a national plan, lacking an established and popular leadership, we have lived by adapting our economy to the interests of international capitalism. For this reason, we have been successively an exporter of primary materials, then an importer of equipment for an industry based only in Lima, and alien to the country, and today we are merely a debtor country, open without protection to the trade of other countries and becoming constantly poorer because we are less productive.

This 'external dependency' has led, through a process dating from the sixteenth century, to profound injustices: 'these explain the economic problems which we suffer today'. They have three dimensions, closely linked. The first is regional injustice, beginning with the Conquest which 'shifted the historic orientation of Peru from the Andes to Lima', where 80% of national industry is now located, as well as the State, with services like education and health. The second is the economic separation into sectors, grossly differentiated:

the modern sector, which takes 85% of investment and provides work for only 38% of Peruvians, and on the other side, the marginalised sector, rural Andean agriculture.... and those human beings whom some call the informal urban sector.

Finally, there is social injustice, which is reflected in the unequal distribution of national income:

I have spoken symbolically of a pyramid, at the summit 2% of the population receive the highest incomes because of their monopolistic enterprises and their ownership of the means of production.... But below them there is a marginalised 70%, the rural and the unemployed, migrants, some outside the capital and some in the shanty towns.

In order to end these severe social and economic inequalities, the President proposed 'opening the way to social democracy' within the context of an 'egalitarian society': democracy must not be only for those with high income and privileges, but also for those who up to now have had nothing. 'We must understand that we cannot live with poverty, and that one city, Lima, or one region, the coast, should not rule over the unheard population which is our traditional majority.' This means that we must 'reaffirm the traditional independence of our people', starting with 'economic emancipation from all forms of imperialism'. These long-term goals require, according to the government's supporters, a radical change in the traditional economic structure, so as to integrate the whole population into an authentically national economic capitalist process.

To achieve this, the first Presidential Message proposed 'a recovery which would be a historic revolution in our country', a social and economic recovery, going beyond the centralist and modern economy, in

Table 1: Characteristics of the 'technological sectors' of Peru:
1981 and projections for 1991

Economic sectors:		Modern urban	Informal urban	Modern rural	Andean rural	Total
1. Economically						
active population '000 people	1981	2 566.0	1 271.6	756.0	1 134.1	5 227.6
	1991 A	3 409.1	1 904.4	983.1	1 252.1	7 549.3
	1991 B	2 969.7	2 363.8	963.1	1 252.7	7 549.3
% of total:	1981	44.8	22.2	13.2	19.8	100.0
	1991 A	45.5	25.2	12.7	16.6	100.0
	1991 B	39.3	31.3	12.7	16.6	100.0
Annual growth rate:	1991 A	2.9	4.1	2.4	1.0	2.8
	1991 B	1.5	4.0	2.4	1.0	2.8
2. Value of output						
\$m.:	1981	11 085.0	990.8	1 360.9	680.4	14 117.1
	1991 A	18 056.3	1 037.6	2 113.4	680.4	21 887.7
	1991 B	15 656.5	5 381.0	2 113.4	2 254.9	25 385.8
% of total:	1981	78.7	7.0	9.6	4.0	100.0
	1991 A	82.5	4.7	9.7	3.1	100.0
	1991 B	61.6	21.6	8.3	8.9	100.0
Annual growth rate:	1991 A	5.0	0.8	4.5	0	4.5
	1991 B	3.5	17.8	4.5	12.7	6.0
3. Value of capital						
\$m.:	1981	33 357.6	546.4	3 024.2	249.5	37 177.7
	1991 A	54 160.8	572.2	4 692.0	245.0	59 678.0
	1991 B	46 909.4	2 978.6	4 692.0	2 163.4	57 243.4
% of total:	1981	89.7	1.5	8.1	0.7	100.0
	1991 A	90.8	1.0	7.8	0.4	100.0
	1991 B	81.9	5.2	8.2	4.7	100.0
Annual growth rate:	1991 A	5.0	0	4.5	0	4.5
	1991 B	3.5	17.9	0	26.0	4.0
4. Average monthly income						
\$m.:	1981	180	63	90	48	116
	1991 A	220	47	100	43	126
	1991 B	219	157	100	110	168
5. Average productivity						
\$m.:	1981	4 320	816	1 800	600	2 464
	1991 A	2.0	4.0	1.9	1.0	n.d.
	1991 B	2.0	9.5	2.0	8.6	n.d.
6. Capital per worker						
\$m.:	1981	13 000	450	4 000	220	3 490
	1991 A	14 795	300	4 871	195	7 905
	1991 B	15 796	1 260	4 871	2 126	7 582
Rate of growth	1991 A	2.0	24.0	2.0	1.0	2.0
	1991 B	2.0	10.8	2.0	25.6	1.5

Source: calculated from Carbonetto (1985, tables 16-18).

Note: Values are in 1981 US\$.

other words not concentrated, as has been the case for most recoveries, solely on the modern urban sector. More precisely, Garcia distinguished between two forms of recovery:

the recovery of output, directed to 'stimulate agriculture...so that it produces the food which we now buy abroad'; and

the recovery of consumption, to ensure that 'the hundreds of thousands of unemployed and underemployed people in the shanty-towns have access to income or to employment'.

Both these processes would come together, in the medium term, in a country 'rebuilt from its foundations';

thus, when we link, in the foundations of society, agricultural production with consumption by those who now cannot eat because they lack work, a different Peru will appear, and then it will be the national market to which the producers in the industries of Lima can turn, instead of facing steadily falling demand.

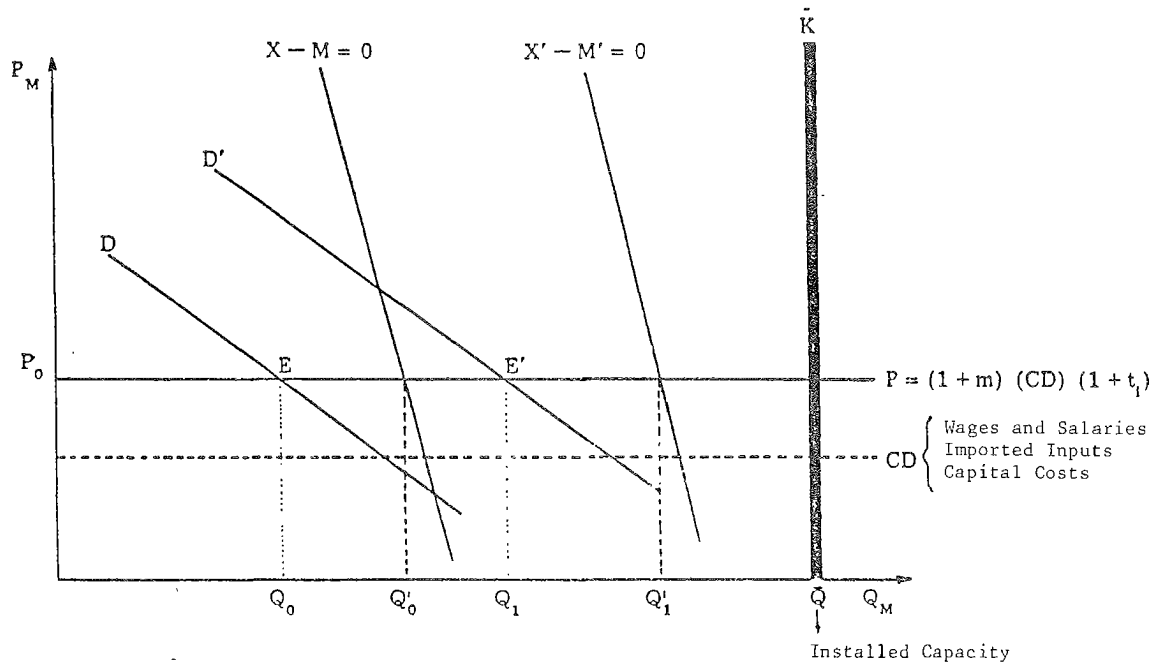
In summary, on the one hand, the aim is to establish a national integrated market, incorporating into the system the sectors and groups that have been marginalised by the process of capitalist development; and on the other, it is argued that, in the medium term, the major beneficiaries will be the industrialists of the modern sector. In this way, although the first target of government policy would be the rural Andean and informal urban sectors, the strategy would also lead to industrial recovery, thanks to the redistribution to, and the recovery of, the 70% who are poorest sectors of the population, because, as the President asked, 'For whom can Lima produce in the future if the country becomes steadily poorer and Lima continues to attract people from the provinces?' The strategy is thus a precise and coherent one to spread the capitalist process and accelerate it, from below.

To understand this new strategy of development, we must examine the way in which Garcia and his prime minister, Alva Castro, analysed the Peruvian economy. This was based on a work by Daniel Carbonetto [1985], in which he presented a description of the 'four technological sectors': the modern urban sector (MUS), the informal urban (IUS), the Andean rural (ARS), and the modern rural (MRS). Table 1 gives data for each sector on employment, output, capital, income, and productivity.

In addition to their geographical dispersion, the four sectors show strong differences with regard to all these factors. The figures presented by Carbonetto show the large differences between, and within, the sectors, which explain, according to the government, the country's regional and social disparities.

Using this analysis, Garcia put forward the need to reduce the sectoral, social, and regional inequalities by creating a national market which would bring about the economic, cultural, and social integration of Peru. This change in economic structure should be based on the resources and internal potential of the country; it demands a radical change in economic policy and in the role of the State, as well as in Peru's relations with other countries. Within this, the kernel of the programme, in contrast to conventional plans, involves changing 'the technical

GRAPH 2: BASIC RELATIONSHIPS OF THE MODERN SECTOR



characteristics of the productive system' [Alva Castro, 1985], in other words, changing the relative productivity of the four economic sectors specified above.

The way to this rests on an 'intersectoral redistribution of capital', consisting, to take an illustrative example, of extracting 30% of the net saving of the MUS, and transferring half to the ARS and half to the IUS. Even if this reduces investment in the modern sector, the increased investment in the backward sectors has a high productive potential. In those sectors, low labour productivity is combined with a high marginal productivity of capital. There, 30 to 50 cents of investment yields an output of one dollar. In the modern sector, an investment of \$2-2.50 is needed to achieve an output rise of a dollar.

The Peruvian economy and society will thus be made more homogeneous, in terms of productivity, types of economic structure, average income, etc., while more employment and income are created in total. The mechanism to achieve this was not made clear at the beginning, but during the government's first two years it was done through public spending (which generated programmes of massive employment at the minimum wage) and by the spectacular rise in agricultural prices (relative to industrial) although this was more unintentional than planned (it was the result of stimulating demand through private consumption, as we shall see below).

Up to the present, in spite of assertions to the contrary, the economic team has taken only short-term measures, although they have important long-term implications which have not been fully understood. This tendency was reinforced by the fact that they were operating only with a short-term model.

Graph 2 summarises the essence of the model which, it must be emphasised, applies only to the modern urban sector. It is assumed that this has unused capacity, that it buys imported, non-competitive, inputs, and that it is characterised by oligopoly. The components of the model can be summarised as follows:

a. The price equation (P) tells us that these are a function of the unit costs (CD), to which capitalists add a profit margin (m) and the government, its indirect taxes (t). The policy was based on manipulating the various cost components (raising wages and the cost of foreign exchange, but offsetting these by a reduction in the cost of borrowing), and thereby reducing inflationary expectations while maintaining the profit margin. This was expected to produce 'zero inflation' in the MUS. The recorded rise in these prices was scarcely 10% in the first year (although this underestimates the real rise as many businesses moved into the informal sector, lowered the quality of their products, or modified their products to escape the price freeze), and the dollarisation was almost entirely reversed during the government's first 18 months (65% of the total liquidity had been in foreign currency when Garcia came to power).

b. Effective internal demand (D) is determined by consumption (by agricultural labourers, industrial workers, the government, and capitalists) and investment (public and private). The intersection of this with the price equation determines the equilibrium (E), with a level of prices (P) and a level of output (Q). Rises in wages should be,

according to the government, the driving force of spending, rather than public spending (the usual source of stimulus in the past) or private investment (as there was unemployed capacity). And, in fact, during the first two years of the government, private consumption explains the tremendous economic revival.

The growth of demand for the output of the modern sector, however, has fairly well determined limits, as follows:

c. In theory, potential output was a constraint, but (because of the long recession) it was estimated that, at mid-1985, there was 60% unused capacity, so this constraint was not binding (by end 1987, the government estimated that excess capacity was 10%).

d. Certainly the external balance (BP) was the most worrying constraint at the beginning of the administration. The current account balance in 1986 had a large deficit (\$1,055m.), equivalent to 5% of GDP, mainly because of the elimination of the trade surplus (of more than \$1,000m.) of the two previous years. Imports grew vigorously because of the economic revival, but exports were lower. The value of exports fell by approximately \$500m. (16%) compared with 1985, because of the continued fall in international prices for Peru's primary materials, and a large fall in exports of non-traditional products. Export prices in 1986 were about 26% lower on average than in 1985, in spite of rises for coffee and fishmeal. The average purchasing power of Peruvian exports in 1986 was less than half what it had been at the beginning of the decade. Metals, especially copper, were particularly depressed. The fall in the oil price alone reduced income by about \$300m.

Non-traditional exports fell by \$70m. in 1986. This was the result of difficulties in selling some products, lower supply in some sectors, and also falls in prices of some products, notably in the agricultural sector and chemicals. The problems have been aggravated in recent years by the adjustment policies undertaken by the majority of other Latin American countries because of their indebtedness. There has been a clear fall in intra-regional trade.

Payment of debt with exports, arranged with the Soviet Union and some other socialist countries as part of the debt renegotiation, has been one means of avoiding these difficulties, permitting the export of some difficult-to-sell products.

As we saw in Section 2, it had been impossible since 1984 to make new refinancing agreements, under acceptable terms, because of the size of the debts falling due and the conditions demanded by creditors. Therefore in 1986, for the third consecutive year, Peru was obliged to postpone repayment of most of its public debt. Net borrowing by the public sector during 1986 was close to \$600m, of which more than 80% represented unpaid interest. This was an increase of 5.6% in medium-and long-term external debt.

This indebtedness had been falling since 1982, and there was also a change in the nature of the loans. Up to 1982, most debt was new loans, while, in 1983-4, most was renegotiation and, since 1984, most is unpaid interest.

Private medium- and long-term capital, and short-term credit lines, had seen an outflow of on average \$500m. a year, in 1983-5, but in 1986 there was an inflow of about \$220m. This was mainly the result of higher commercial credits because of higher imports and the restriction of remittances.

The economic team was well aware that the renewed growth of demand would quickly lead to a loss of reserves, and for this reason proposed cutting debt service to 10% of exports of goods and services.³

Later, in August 1986, the same aim of reducing the drain on reserves was pursued further with the prohibition of the remitting of profits of foreign subsidiaries (this measure was taken at the time that the IMF declared Peru 'ineligible'). The oil companies had remitted, just between 1980 and 1985, \$2,470m. (that is, an annual average of \$412m.). Since then: 1986: \$147m.; 1987, first quarter, \$23m. For other foreign firms, the flow was \$1,530m. (annual average \$255m.) from 1980 to 1985, and only \$3m. in 1986 and the first half of 1987. The regulations have thus reduced remittances from an average of \$677m. in 1980-85 to \$150m. in 1986 and about \$30m. in 1987. The measures were intended to move the external constraint to the right (see Graph 2). From October 1986, however, Peru once again began to lose reserves steadily.

Although it still had reserves worth six months of imports, the government was already aware, as we shall see later, that it had to re-establish links with the international community. This remains the most critical point of its programme. In recent months, it has tried to meet it by increasing devaluations and special assistance to exports, especially of non-traditional goods, and particularly of manufactures.

e. Finally, we have the constraint of inelastic agricultural supply, which was probably the principal short-term constraint. The increase in demand from the modern urban sector drastically raised agricultural prices, as it increased demand both for agricultural inputs to industrial production and for food (because of an increase in wages in the MUS and in employment in the IUS). As could be expected, it was inevitable that this should lead to an inflationary spiral in proportion to the increase in demand, unless the demand for foods was satisfied by imports (as in fact happened in 1986-7), which gave a further twist to the external constraint.

The various economic measures implemented by the Aprista government in its first two years were guided by this model. The government chose its inflation control measures to fit this model of price formation. Control of inflation (and of expectations) was initially by means of restructuring and freezing the principal components of costs, thus restraining prices, without necessarily affecting the profit margin.

The system of daily mini-devaluations was abandoned, and after a large reduction in the exchange rate (12%) at the beginning of August 1985, the rate was fixed until December 1986, in order to reduce inflation and reverse the dollarisation. It should be noted, however, that although the central rate remained fixed until that date, an increasing number of transactions were done under the financial rate, in which (from August 1986) there were two quotations: the rate for certificates, fixed at 25% above the central rate, and the free rate, fixed in the market. From

January 1987, both the central and financial rates were devalued by 2.2% a month (an annual rate of 39%, compared with inflation which was close to 100%).

Imports of non-essential goods were restricted temporarily. Then, there was a strict control of imports (through the Central Bank), with a licence for foreign exchange required as well as the licence to import.

But, according to the theory, and this was confirmed in practice, this can only work for a limited time; by end 1987, expected inflation was 200% (because of expected rises in fuel and import costs).

As for reflation, this was also done according to the model. Given the high excess capacity, demand was able to expand without production constraints, increasing employment, output, and even total profits. The problems came from the balance of payments and from the supply of food and agricultural inputs.⁴

The model worked well enough during the first 20 months of the government, and for the short-term objectives. There were indeed two points which did not appear in the model, because it only considered 'one good', but which proved to be beneficial.

First, it did not foresee the effects which the internal expansion would have on the demand for food. Thanks to this, prices of agricultural products rose explosively, redistributing income to peasants (as well as to wholesale and retail dealers), although the government also had to import food on a massive scale, to meet the demands of the urban population. Secondly, the programme to help temporary labour and the rigid control of prices in the modern sector brought an unprecedented revival in informal urban activity (and income), which redistributed income to this 'marginal' group.

With these two effects, these large low income sectors (Garcia's '70% of the population traditionally at the margin') received a substantial increase in income. Richard Webb (1987) has estimated that in 1986 the real income of the informal urban sector rose by 20% and of the peasant, 24%.

3.2. Results and forecasts to 1990

The situation at end-1987

In mid-1985, the Peruvian economy had a high level of unemployment and underemployment and stagnation of output, with the GDP per capita in real terms at the level of 20 years before. At the same time, inflation was high and increasing (it was approaching 250%), which led to speculation and dollarisation of the economy, and discouraged productive investment. Linked to these problems, there was a climate of lack of confidence and lack of interest by economic groups in exploring development opportunities, which was translated into transfers abroad (the total of exported capital is estimated, conservatively, at US\$7,000m.).

This situation had damaging effects on the allocation of resources, stability of costs, and income distribution, with a consequent explosion of severe social tensions. Terrorism increased, endangering the democratic system. Peru faced serious difficulties in access to international financing and in debt servicing. These external difficulties, as has been discussed, were the result of the unfavourable world situation, with a continuing decline in terms of trade, growing difficulties in selling Peruvian exports, and high rates of interest. All these problems had been altered for the better during the first two years of the government, with increasing growth, the end of dollarisation, income redistributed, and lower rates of inflation. These successes, however, were precarious.

By the middle of its term of office, December 1987, the economic situation of the country, initially improved, could be summarised as follows:

1. economic growth, after exceeding expectations in 1986 and 1987 (5% a year, or 10.3% cumulative, was expected, and 7.6%, 15.8% cumulative was achieved), had fallen as the constraints on the economy started to appear:

- a. Practically all the excess capacity had been brought into use, in the strategic sectors of the economy, such as cement, steel, paper, even though there was still 10% excess on average.

- b. International reserves had fallen to very low levels, because of the high demand for foreign exchange, increased by speculation in 1987.

- c. Investors were worried by government policy.

2. Inflation had increased (from the end of 1986) because:

- a. It had been necessary to increase tariffs and controlled prices.

- b. There was growing uncertainty about future changes, fuelled by the rapid fall in international reserves.

- c. There was speculative stock-building by businesses, aware that the negative interest rates and the cost of foreign exchange would have to rise.

In addition, dollarisation of the economy was returning, the terms of trade had turned back against agriculture, and, above all, there was a growing threat by the guerrillas in an atmosphere of increasing social unrest. It was clear that in 1988 it would be necessary to raise the basic prices of the economy, and that both inflation and growth would deteriorate, in other words: stagflation.

We would argue that this failure of the heterodox economic policy is attributable to three central factors:

- a. The absence of structural changes during its application, specifically the fact that there was no change in patterns of production or of consumption to reduce the marginal propensity to import.

b. Growth in the economy had been general, instead of directed selectively towards popular consumption goods and the inputs needed to make them.

c. There had been inadequate stimulus for non-traditional exports.

These conclusions lead us to the forecasts presented in Table 2 for the balance of payments to 1990.³

The forecast of the external accounts is a projection, prepared in accordance with our best understanding of the national and international situation. It must take into account the probable evolution of some variables which are completely exogenous to the Peruvian economy, like the international rate of interest, world inflation or terms of trade, and also internal variables which depend on economic policy or the long-term economic situation of the country. For this reason, it is necessary to define the assumptions behind these variables. Forecasting, however, always implies a certain margin of error, particularly when the international situation is subject to large variations.

Before presenting the base scenario, it is necessary to consider what the goal should be for economic growth during the period under consideration. GDP in Peru, in real terms, grew at an annual rate of 5.3% between 1961 and 1976. Since 1977, output has suffered a long period of stagnation and crisis, which, in combination with the increase in population, has meant that in 1984 real GDP per capita was 20% below that in 1976. Taking this as a reasonable measure of personal income, it is a priority that the economy should at least recover the 1976 level of GDP per capita (the population is assumed to have grown at 2.6% p.a., the rate between the last two censuses).

Although this goal appears relatively modest and unambitious, it nevertheless implies that the economy must grow by 7% p. a. between 1985 and 1989. This rate is high, but similar to that recorded between 1961 and 1966 and between 1970 and 1974. It must also be related to the large quantity of resources which are still underemployed because of the fall in output of 1983. and which, with good management, could be brought into use. The urgency of achieving this goal can be better appreciated if we note that, if growth were 4%, the 1976 level would only be reached in 1999.

The forecast

For exports (Table 3), it is necessary to remember that traditional exports behave differently from non-traditional. Their prices fluctuate in world markets and their volumes are not very sensitive in the short term to internal policies, as most require investment with long maturity periods, much of which is foreign or financed by foreign borrowing.

In the past, the value of traditional exports has fluctuated mainly because of international prices, but also because new projects have come on stream, some resources have been exhausted, and there have been crises in some sectors. Total export capacity has remained practically unchanged for the last 15 years.

Given that primary export prices were extremely depressed at end 1987, for the forecast for 1988-90 we assume a gradual recovery (5% p.a.).

Table 2

BALANCE OF PAYMENTS 1985-90

	1985	1986	1987	1988	1989	1990
1. <u>CURRENT ACCOUNT</u>	<u>605.0</u>	<u>-657.1</u>	<u>-820.5</u>	<u>-485.6</u>	<u>-581.5</u>	<u>-524.3</u>
A. <u>TRADE BALANCE</u>	<u>1172.0</u>	<u>-16.1</u>	<u>-179.8</u>	<u>-132.2</u>	<u>-223.7</u>	<u>-152.8</u>
1. Exports of Goods	2978.0	2509.0	2586.2	2805.9	3154.3	3563.2
2. Imports of Goods	1806.0	2525.1	2766.0	2938.1	3378.0	3716.0
B. <u>FINANCIAL SERVICES</u>	<u>-531.0</u>	<u>-433.0</u>	<u>-352.0</u>	<u>-268.0</u>	<u>-308.4</u>	<u>-351.0</u>
1. Public Sector	-227.0 ^a	-240.0 ^a	-210.0	-118.0	-143.4	-176.0
2. Private Sector	-304.0	-193.0	-142.0	-150.0	-165.0	-175.0
C. <u>NON FINANCIAL SERVICES</u>	<u>170.0</u>	<u>-304.0</u>	<u>-390.7</u>	<u>-225.4</u>	<u>-199.4</u>	<u>-190.5</u>
1. Exports services	814.0	796.0	816.5	874.6	983.0	1110.5
2. Imports services	984.0	1100.0	1207.2	1100.0	1182.4	1301.0
D. <u>TRANSFERS</u>	<u>134.0</u>	<u>96.0</u>	<u>102.0</u>	<u>140.0</u>	<u>150.0</u>	<u>170.0</u>
1. Long Term Capital	223.0	205.1	285.0	636.0	846.4	670.0
E. <u>PUBLIC SECTOR</u>	<u>346.0</u>	<u>189.1</u>	<u>157.0</u>	<u>536.0</u>	<u>736.4</u>	<u>550.0</u>
1. Receipts	693.0	475.0	425.0	801.0	1016.4	850.0
2. Repayments	-347.0 ^a	-286.9 ^a	-260.0	-265.0	-380.0	-300.0
F. <u>PRIVATE SECTOR</u>	<u>-123.0</u>	<u>17.0</u>	<u>128.0</u>	<u>100.0</u>	<u>110.0</u>	<u>120.0</u>
1. Basic Balance	829.0	-452.0	-535.5	150.4	264.9	145.7
G. <u>SHORT TERM CAPITAL</u> AND ERRORS AND OMISSIONS	<u>-548.0</u>	<u>-7.0</u>	<u>-121.0</u>	<u>-50.0</u>	<u>-70.0</u>	<u>-85.0</u>
<u>BALANCE OF PAYMENTS</u>	<u>280.0</u>	<u>-459.0</u>	<u>-656.5</u>	<u>100.4</u>	<u>194.9</u>	<u>60.7</u>
2. <u>NET RESERVES</u>	<u>1383.0</u>	<u>924.0</u>	<u>267.5</u>	<u>367.5</u>	<u>562.6</u>	<u>623.5</u>

^aTreatment of arrears differs from Table A-1

It is necessary to note that, in the past, there have been large fluctuations in the prices of these products. For example in 1979, prices rose by 42% and in 1982 they fell by 18% (this variability is worse for some products, such as silver, which in January 1980 rose to \$50 per Troy ounce and in June 1982 fell to \$4.9 per Troy ounce).

For volume, we expect growth to be 2-3% p.a., taking account of some mining operations which will come into production in the period, the gradual recovery of the agricultural sector and of marine resources, but also the gradual fall in output of oil. Remote possibilities have been ignored, for example of an exceptional discovery or natural disaster. In addition, no change was assumed in incentives to direct investment which might stimulate new mining investments and therefore higher traditional exports. This would probably only have effects over a longer period as such projects require long periods of investment, and are high risk. Foreign direct investment could play an important role in this as a complement to domestic saving, particularly in petroleum which is subject to serious risks. But some metal products could be seriously affected by technological change.

Traditional exports of agricultural and marine products would be difficult to increase given the growing use of substitutes for cotton and fishmeal, and the presence of quotas in some markets, for example for sugar and coffee. These may hold prices above a free market level, but they restrict the volume. It therefore seems unlikely that traditional products could be increased more than in the base scenario.

These forecasts imply income from traditional exports of \$15,700m. during the period. A change of 10% in prices would make a difference of \$300-400m per year in this income.

Foreign sales of non-traditional products are mainly manufactures, whose prices vary less than for primary goods. Their volumes depend partly on factors external to the Peruvian economy, such as protectionism in their markets, but also on internal factors, including local demand, production capacity, and internal promotion.

Peru can create industries which would be internationally competitive. But this must be based on the natural resources which are available, the type of labour available, and possibly on its relatively low energy costs (especially if it is possible to complete the hydro-power programme). In certain sectors, especially those linked to natural resources like mining and fish, it would be possible to compete in the market for providing technology, especially in countries at similar or lower levels of development in Africa, Oceania and Asia.

Processing of agricultural, fish, mining, forestry, and tropical products, as well as Andean specialties, could be the basis for an industry including semi-processed and finished manufactures, mass production goods and specialty products, mass and luxury consumption products, and capital goods using intermediate technology.

Non-traditional exports, in the short term, are more sensitive than the traditional to internal policy to increase their profitability, because of the considerable excess capacity and because their internal production can be increased by means of quickly maturing investments and by shifting

TABLE 3
EXPORTS FOB - PRINCIPAL PRODUCTS (US\$m)

	1984	1985	1986	1987	1988	1989	1990	86/85	87/86	% change 88/87	89/88	90/89
I: TRADITIONAL PRODUCTS =====	2420.7 =====	2264.0 =====	1861.0 =====	1896.2 =====	1955.9 =====	2154.3 =====	2353.2 =====	-17.8 =====	1.9 =====	3.1 =====	10.1 =====	9.2 =====
1. Fishmeal	137.3	118.0	204.0	238.9	285.1	312.1	347.2	72.9	17.1	19.3	9.5	11.2
Volume ('000 tonnes)	401.0	508.0	716.0	784.3	862.7	931.7	1006.3	40.9	9.5	10.0	8.0	8.0
Price (\$/tonne)	342.4	232.6	285.5	304.1	330.5	335.0	345.0	22.7	6.5	8.7	1.4	3.0
2. Cotton	22.8	51.0	39.0	21.3	25.0	26.3	28.7	-23.5	-45.4	17.4	5.2	9.1
Volume ('000,000 lb)	246.0	624.0	473.0	212.8	250.0	260.0	273.0	-24.2	-55.0	17.5	4.0	5.0
Price (cents/lb)	92.6	82.6	82.0	100.1	100.1	101.0	105.0	-0.7	22.1	0.0	0.9	4.0
3. Sugar	48.8	23.0	22.0	15.0	13.4	18.4	22.6	-4.3	-31.8	-10.7	37.3	22.6
Volume ('000 tonnes)	116.0	64.0	55.0	33.0	30.0	33.0	35.0	-14.1	-40.0	-9.1	10.0	6.1
Price (cents/lb)	19.4	16.8	18.5	70.5	20.5	25.6	29.7	10.1	10.8	0.0	24.9	16.0
4. Coffee	126.0	151.0	272.0	153.4	151.9	157.1	172.9	80.1	-43.6	-1.0	3.4	10.1
Volume ('000 tonnes)	51.0	60.0	74.0	75.0	78.2	80.9	83.0	23.3	1.4	4.3	3.5	2.6
Price (cents/lb)	112.7	115.9	169.0	94.0	89.3	89.3	95.8	45.8	-44.4	-5.0	0.0	7.3
5. Copper	441.9	476.0	437.0	488.3	541.3	564.7	626.6	-8.2	11.7	10.9	4.3	11.0
Volume ('000 tonnes)	337.0	363.0	341.0	351.6	361.6	368.0	372.0	-6.1	3.1	2.8	1.8	1.1
Price (cents/lb)	59.5	59.3	58.0	63.0	67.9	69.6	76.4	-2.2	8.6	7.8	2.5	9.8
6. Iron	57.8	76.0	58.0	64.7	63.0	62.7	68.3	-23.7	11.6	-2.6	-0.5	8.9
Volume ('000,000 tonnes)	4.2	5.2	4.2	4.5	4.7	4.9	5.1	-19.2	7.1	4.4	4.3	4.1
Price (\$/tonne)	13.9	14.6	13.8	14.4	13.4	12.8	13.4	-5.5	4.3	-6.9	-4.5	4.7
7. Refined Silver	227.3	140.0	110.0	91.4	0.0	142.2	168.3	-21.4	-16.9	-100.0	ERR	18.4
Volume ('000,000 troy oz)	26.8	22.3	19.5	12.0	0.0	18.0	19.8	-12.6	-38.5	-100.0	ERR	10.0
Price (\$/troy oz)	8.5	6.3	5.6	7.6	7.8	7.9	8.5	-11.1	35.7	2.6	1.3	7.6
8. Lead	233.2	202.0	164.0	219.7	223.3	225.9	249.2	-18.8	34.0	1.6	1.2	10.3
Volume ('000 tonnes)	180.0	174.0	130.0	136.7	139.9	143.3	147.0	-25.3	5.2	2.3	2.4	2.6
Price (cents/lb)	58.7	52.7	57.4	72.9	72.4	71.5	76.9	8.9	27.0	-0.7	-1.2	7.6
9. Zinc	340.8	268.0	246.0	242.9	245.6	258.0	281.4	-8.2	-1.3	1.1	5.0	9.1
Volume ('000 tonnes)	512.0	459.0	491.0	453.4	458.4	469.9	481.6	7.0	-7.7	1.1	2.5	2.5
Price (cents/lb)	30.2	26.4	22.7	24.3	24.3	24.9	26.5	-14.0	7.0	0.0	2.5	6.4
10. Petroleum, crude and refined	618.3	645.0	236.0	305.6	342.3	321.9	323.0	-63.4	29.5	12.0	-8.0	0.8
Volume ('000,000 barrels)	24.1	27.1	22.0	19.2	18.5	17.4	17.0	-18.6	-12.7	-3.6	-5.9	-2.3
Price (\$ /barrel)	25.6	23.9	10.7	15.9	18.5	18.5	19.0	-55.2	48.6	16.4	0.0	2.7
11. Others	166.5	114.0	73.0	55.0	65.0	65.0	65.0	-36.0	-24.7	18.2	0.0	0.0
II: NON-TRADITIONAL PRODUCTS =====	726.3 =====	714.0 =====	648.0 =====	690.0 =====	850.0 =====	1000.0 =====	1210.0 =====	-9.2 =====	6.5 =====	23.2 =====	17.6 =====	21.0 =====
TOTAL =====	3147.0 =====	2978.0 =====	2509.0 =====	2586.2 =====	2805.9 =====	3154.3 =====	3563.2 =====	-15.7 =====	3.1 =====	8.5 =====	12.4 =====	13.0 =====

production from the national market to exports. The forecast is that these will average US\$ 1,000m. per annum.

In the medium and longer term, Peru has many potential products which could compete internationally, but it will need to overcome particular problems to implement a policy of producing for export. As regards cotton, a fibre in which Peru is highly competitive because of the characteristics of its crop, the policy has been to promote substitute crops like maize and rice, which not only restricts exports, but also hinders the development of exports of textiles and clothing, based on the quality advantages of Peruvian cotton. It is obvious that Peru's capacity to compete in sugar when faced with the subsidies in the US and the EEC, is marginal, even if it can obtain high prices in the protected US market. Replacing this product could lead to a substantial increase in agro-industrial production, some of which could be for export, especially of high value crops. In the case of alpaca wool, genetic research and new systems of cattle management could substantially increase the production of the wool; this would again support development in the textile industry.

To these, we can add some new products where Peru has particular advantages in entering export markets. In agriculture, and marine culture, it may be possible to 'cultivate' intensively some sea resources, including fish and shellfish. World demand for these products is one of the most dynamic areas of growth, and there are opportunities not only for those already exported like shrimp and scallops, but a broad range of products which could supply protein for poorer countries, as well as frozen fish for intermediate markets and luxury products for the Asian and industrial markets. It is also possible to promote new tropical products, as both woods and tropical foods have been under-developed.

In order to increase exports significantly, it is necessary to have a long-term programme to increase productivity, and thus increase international competitiveness, in some sectors; in others, what is necessary is incentives to produce. This must be in accordance with the needs of the market. It is necessary to ensure in advance that the product is suitable, identifying the requirements of the consumers. This is a substantial change from past practice in industry, where exports of surpluses meant the products were suitable for the internal market. It also implies more resources for design, research and marketing, on a continuing basis.

A second requirement for the industrial sector is that it should be selective in choosing exports. Before investments are made, it is necessary to establish which branches have the greatest potential over a reasonable horizon. Third, it is necessary to take the initiative, which requires an aggressive export mentality in both the private and public sectors. This requires the country to have a permanent export policy and not alternate between rewards and disincentives to exports, in a way which prevents the development of an export sector.

In the early 1970s, the Andean Group planned a system of general integration which would start from measures to free trade and reduce restrictions on almost all products, then move to a common external tariff, and eventually form a true wider market to promote intratrade and

rationalise production. The hard realities of the negotiation of the agreement meant that exceptions to the rules arose which effectively resulted in a high proportion of production in the member countries remaining outside the integration process.

In spite of this, the Andean Group achieved some initial success in increasing trade among its member countries. This was partly because some countries, especially Venezuela, followed internal policies which favoured imports from the other members, while others established systems to promote their exports which improved their competitiveness in the Andean market. For certain countries in the subregion, and especially for Peru, the Andean market was a promising one for some branches of industry whose capacity to compete in other markets was marginal, including metal products, steel, and chemicals.

When the balance of payments problems of the region increased, and some countries adopted adjustment programmes, the measures taken not only changed relative exchange rates in ways that meant a major change in relative prices among the member countries, but also led to a gradual closing of national markets, with prohibitions or quantitative restrictions on imports. This brought a dramatic fall in regional trade, and growing disenchantment.

Many of the reasons which stimulated integration in the 1960s, however, remain valid. It is still true that there are economies of scale to be gained from the subregional market, although new technologies in many cases reduce these. The idea of a wider market which could have the same weight as those of the large countries of Latin America like Argentina, Brazil, and Mexico also remains a possible goal; even Brazil and Argentina have seen the advantages of co-operation, in agreements signed in 1986.

At present, discussion of the future of the Andean integration process is complex. Many governments do not see a way out of their present difficulties, and have no plans which would allow them to overcome the crisis, while others have stopped all government action. In order to re-establish the original enthusiasm for the integration process it would be necessary to offer the Andean countries an alternative of partial integration which would allow them the freedom to use the principal tools of economic policy, without excessive loss of sovereignty, and then later to move to more complete integration, as an ultimate objective.

First, the Andean Group could cut the cost for individual countries of analysing new technological innovations. New processes based on microelectronic and genetic applications are probably the most likely to benefit from joint action at the subregional level. This could begin with basic research and training of the researchers needed to take advantage of the new techniques, and extend to the implementation of experimental production in which the subregional market could be a step towards international competitiveness.

Secondly, there are in the Andean Group some products, especially in industry, which must be adapted because of technological changes. Again, although it may be more difficult, it is possible to agree joint programmes to reduce the cost to each country of this restructuring. For this it will be necessary to include the companies affected in the

planning process, to receive their assistance, and to show them the advantages of a gradual and orderly transformation which will eventually permit them to compete at world level.

Thirdly, it would be possible to promote a wide range of opportunities for regional co-operation which would strengthen the links among the Andean Group and increase its international standing, and thus its negotiating position relative to other areas. These types of measure include strengthening the role of the Andean Reserve fund (FAR) and the Andean Development Corporation (CAF) on the financial side; research on social programmes; co-operation on agriculture, cattle raising and fishing; and joint commercial negotiations, both bilateral and multi-lateral.

There are three other large markets which could be relevant to Peru, individually or as part of a process of Latin American integration. The most important of these is Brazil, which will be one of the most important economies in the world by the beginning of the 21st century, with a large internal market and a financial and technological superiority compared with the rest of Latin America. It is politically impossible to ignore the presence of Brazil and what it will imply for Peru. The design of a strategy for Peruvian relations with Brazil, and for Peru to act as an 'economic link' between it and the other area of high economic growth, the Pacific Basin, is a subject which deserves serious analysis.

Among the countries of the Basin, Japan, Singapore, and Hong Kong are particularly important as suppliers of finance and consumers of luxury products; Malaysia, Indonesia and Thailand would be countries with similar levels of development with which trade in technology is possible; South Korea and Taiwan are producers of advanced manufactures; and Australia and New Zealand have many similarities in natural resources, such as mining and fishing. All offer large potential for trade (and, probably, financing) for Peru and Latin America. Peru has an exceptionally favourable location to take advantage of this and benefit from it. There has also been a high degree of complementarity, which could increase if Peru follows this route. This, however, would require changes on both sides and more contacts between the business sectors.

As regards Mexico, transport difficulties and the natural linkage of Mexico with the US are problems for closer relationships with Latin America.

Latin America is an area to which Peru, at least economically and commercially, has given little attention in the past. If it wants to reduce its present linkages with the US and the EC, which are harmful from some points of view, more trade with Latin America, especially with the other Andean countries and Brazil, could be an appropriate strategy.

Finally, sales of services were forecast (excluding tourism, which was treated as a non-traditional export). These were expected to grow only in line with world inflation. They do not present opportunities for greater growth, as they consist mainly of income from diplomatic missions in Peru, insurance, and telecommunications.

Imports are mainly goods, and within these mainly intermediate and capital goods, with consumption goods less important. Imports of inputs and capital goods in recent years have been, on average, about 11% of GNP. But a rapid expansion of production usually leads to a greater increase in imports, and the reverse for a lower rate, because expansion encourages economic agents to make replacement investments, expand capacity, and increase stocks.

The manufacturing sector has been developed in conditions which favour intensive use of capital and imported inputs. The traditional mining sectors have a high share of imported capital because they have a high need for infrastructure and sophisticated machinery. Given that technology and industrial structure are difficult to change in the short run, these imports are essential for economic growth.

There are natural and structural limits to the domestic production of some goods, like agricultural materials and capital goods, but there are opportunities for substitution for some imports. In the medium term, it is not possible to achieve significant changes in consumption habits or in the use and development of technology. Nor is it possible to achieve a increase in arable land. But this does not mean that it is not essential to make efforts in these directions for the future. In Peru, there are various examples of this difficulty in changing consumption preferences.

Estimating the structure and sectoral composition of imports over the last 25 years, an elasticity of 1.2 relative to GDP has been found, implying total imports in the forecast period of \$10,000m. (Table 4).

The first type of imports to analyse is food products. In 1984 these were 10% of the total, made up principally of meat, dairy products, wheat, and soya oil. \$25m. of meat was imported annually in spite of the efforts made to promote fish consumption and the existence of a significant potential of marine resources which could be used more intensively for human consumption. The same is true for dairy products, where imports were \$35m. because of the preference for evaporated over powdered and pasteurised milk whose local production has a significantly smaller use of imported inputs. Similarly, Peruvians consume bread made with wheat flour, which costs about \$80m. a year, instead of using flour from other grains - cassava, sweet potato, potato, among others - whose national output is much greater than that of wheat.

Because of the problems in changing consumption habits, it would be necessary to look at the possibilities of increasing domestic production of the imported products. In the medium term, there are serious limits to this. For meat and dairy products, it would be necessary to increase pastures without displacing cultivated land in existing agriculture areas and to avoid competition between increasing production of meat and dairy products. A step in this direction would be the 3000 hectares for pastures which could come from the Majes project. But it would still be necessary to import new cattle to increase production. For wheat, it is not really possible, given the country's productive infrastructure, to reduce foreign purchases significantly in the medium term. Local production is almost entirely of white soft grains, not used in the flour industry, which buys almost all its inputs from imported hard grain. To increase the production of this variety, without at the same time cutting

Table 4

Imports f.o.b.

(\$m.)

	1984	1985	1986	1987	1988	1989	1990	% Changes				
								86/85	87/86	88/87	89/88	90/89
<u>CONSUMPTION GOODS</u>	<u>255.1</u>	<u>112.0</u>	<u>351.0</u>	<u>331.8</u>	<u>290.1</u>	<u>270.0</u>	<u>250.0</u>	<u>213.4</u>	<u>- 5.5</u>	<u>-12.6</u>	<u>- 6.9</u>	<u>- 7.4</u>
Public Sector	37.7	11.0	116.0	112.3	113.0	110.0	105.0	954.5	- 3.2	0.6	- 2.7	- 4.5
Private Sector	217.4	101.0	235.0	219.5	177.1	160.0	145.0	132.7	- 6.6	-19.3	- 9.7	- 9.4
<u>INTERMEDIATE GOODS</u>	<u>948.9</u>	<u>841.0</u>	<u>1279.0</u>	<u>1475.2</u>	<u>1629.0</u>	<u>1779.0</u>	<u>1980.0</u>	<u>52.1</u>	<u>15.3</u>	<u>10.4</u>	<u>9.2</u>	<u>11.3</u>
Public Sector	323.9	296.0	372.0	471.4	450.8	500.0	529.0	25.7	26.7	- 4.4	10.9	5.8
Private Sector	625.0	545.0	907.0	1003.8	1178.2	1279.0	1451.0	66.4	10.7	17.4	8.6	13.4
<u>CAPITAL GOODS</u>	<u>771.0</u>	<u>558.0</u>	<u>691.1</u>	<u>753.0</u>	<u>849.0</u>	<u>1257.0</u>	<u>1311.0</u>	<u>23.9</u>	<u>9.0</u>	<u>12.7</u>	<u>36.3</u>	<u>13.3</u>
Public Sector	400.0	169.0	158.1	146.0	161.0	181.0	210.0	- 6.4	- 7.7	10.3	12.4	16.0
Private Sector	371.0	389.0	533.0	607.0	688.0	976.0	1101.0	37.0	13.9	13.3	41.9	12.8
<u>OTHERS N.E.S.</u>	<u>164.0</u>	<u>295.0</u>	<u>204.0</u>	<u>195.0</u>	<u>170.0</u>	<u>172.0</u>	<u>175.0</u>	<u>- 30.8</u>	<u>- 4.4</u>	<u>-12.8</u>	<u>1.2</u>	<u>1.7</u>
Public Sector	94.0	227.0	159.0	150.0	130.0	132.0	135.0	- 30.0	- 5.7	-13.3	1.5	2.3
Private Sector	70.0	68.0	45.0	45.0	40.0	40.0	40.0	- 33.8	0.0	-11.1	0.0	0.0
<u>TOTAL</u>	<u>2139.0</u>	<u>1806.0</u>	<u>2525.1</u>	<u>2755.0</u>	<u>2938.1</u>	<u>3376.0</u>	<u>3716.0</u>	<u>39.8</u>	<u>9.1</u>	<u>6.6</u>	<u>15.0</u>	<u>10.0</u>

the former, would require a significant increase in productivity or in cultivated land - changes which could only be achieved over a longer term.

Imports of soya oil are worth approximately \$50m. There is no possibility whatsoever of increasing its domestic production significantly, given that the quality of the land in Peru does not permit profitable cultivation of soya. An increase in palm oil, which could permit a significant reduction in imports of soya oil, could only be achieved over 6 or 7 years, as a result of the advances which are being made at the edge of the forest. On the other hand, given that fish oil is complementary for making mixed oils, its greater production could contribute significantly to reducing soya imports.

A substantial reduction in food imports would only be possible if measures like rationing were taken. But this would introduce inefficiencies and distortions into the economy, and damage consumer welfare.

Other foreign spending which could be restrained without adversely affecting the level of growth would be Peruvian tourist spending abroad and imports of luxury consumption goods. These include private cars, colour TVs, stereophonic sets, toilet articles and jewellery. Luxuries represent 4% of total imports, and tourism, 3%. A reduction of these outflows of funds could be achieved through prohibitions, quotas or high tariffs which, like rationing, have prejudicial effects on the efficiency of the economy and the well-being of the consumer.

The analysis of external financing must consider two components - direct investment and borrowing; both supplement domestic saving, but the second can also be used for temporary balance of payments financing.

Foreign investment has an important role in a country like Peru with metal and oil resources and without a high level of internal saving. It also has the advantage that the country itself does not take the risk inherent in exploiting such resources; normally it leads to productive investment and expansion of economic output.

Achieving a significant level of foreign investment requires a policy that takes into account international conditions as well as the needs and priorities of the host country. It is necessary to remember, however, that both foreign investment and borrowing have a cost for the economy in terms of profits remitted or interest payments.

In the forecast discussed here, it was assumed that net direct investment would be nil during the 3-year period. In spite of the expectation of some new investment, high mining and oil investments in the past 10 years will lead to a substantial outflow. The two factors were expected to be offsetting, unless there was some significant change which attracted capital (for example to exploit natural gas), not allowed for in the forecast.

Foreign borrowing depends partly on internal decisions (how much does a country want to increase its debts?), and partly on the supply of international finance. The excessive debt incurred before 1984 and the high international rates of interest constituted a serious problem for Peru. We should note that, given the structure of Peruvian debt, in

order for such borrowing not to be an unsustainable burden on the economy, the ratio of debt to production should not exceed approximately two thirds. A higher debt might permit an artificial growth of the economy in the short term, but it would lead to later crises in which this extra growth would be lost. Peru's experience in the past 15 years shows that only in periods of great difficulty (1977-8 and 1983-4) did it greatly exceed this ratio.

This analysis of the individual variables allows us to obtain a general view of the prospects for the next three years, and also helps us to understand the possible problems which the external sector of the economy could present. The base scenario described here, as can be seen in Table 2, shows a cumulative deficit on current account of almost \$1,700m. for the three years 1988-90. Probably it will be much greater as our forecasts for non-financial services exports are very optimistic.

The results of this on the capital account show that Peru must re-establish its relations with the commercial banks, given the large inflows needed by the public sector (\$900m. per annum on average). It is also necessary to achieve a large increase in non-traditional exports and to obtain international agreement on reducing the heavy costs of financing the external debt. In order to remove the external constraint, it is essential to make efforts on both the international and the national level.

Internally, the policy which is to hand, and indispensable, is to increase the country's capacity to earn foreign exchange. To do this, non-traditional exports should be encouraged; these are a central element of policy in the short term. They should have priority as they increase output and utilisation of resources as well as earning foreign exchange. This is preferable to cutting spending or depending on external finance.

Traditional exports should be stimulated with equal vigour, not only by domestic efforts, but by encouraging a significantly higher inflow of foreign investment as a complement to domestic spending. This would make a significant contribution to improving the balance of payments in the medium term. Both types of exports require new measures, which should be treated as permanent and as an integral part of a macroeconomic policy and a coherent development strategy.

Foreign borrowing should be complementary to these efforts, especially that which can come from sources of soft credits, such as the international organisations, given the high cost and poor prospects for borrowing from the commercial banks. Nevertheless, the greater part of the foreign exchange gap should be covered by improving the balance of trade. This should be done through energetic policies to reduce imports which are not essential for production and in combination with policies to increase exports.

If these efforts are insufficient, the only alternative is to reduce imports still further, which would require acceptance of a lower rate of growth, and a slower recovery of the 1976 income level.

NOTES

1. This is more fully developed in Schuldt (1980), chapter 1.

2. Traditionally Peru has used the concept of Net Reserves. Since July 1985, it has added to this holdings of gold and silver and included liabilities to the IMF.

3. The 10% limit on debt service is justified by the following arguments:

a) In relation to the short and long-term objectives of the governments, by the pressure of the external constraint. In order to improve immediately the living conditions of the majority of the population and to establish a new pattern of development, that is to satisfy the 'internal social debt', it was essential to cut the payments.

b) As far as the duration of the moratorium is concerned, initially it was fixed at six months. Then the government extended it to an indeterminate period 'until conditions change', that is until the terms of trade improve, interest rates fall, and the industrial countries reduce their protection.

c) Concerning different types of debt: in the first 24 months of the government, the limit was restricted to specified official external debt, according to criteria of borrower maturity, and the nature of the credit.

The government did not have an idea of 'capacity to pay' of the sort which economists use. Thus the figure of 10% was not based on an empirically based calculation. It wished to maintain the 'supply of essential goods and services to continue the minimum acceptable development', but this term not defined. It was not a question of limiting the payment to some specified maximum percentage of exports, derived from future import needs or from some criterion of equilibrium in the balance of payments, or some target level for international reserves.

There were various reasons given for this informal procedure, suggesting to us a confused combination of all of them (a reflection of the 'mental state' and of the knowledge which the government possessed when it took power).

The first is that a set of economic criteria would have led to permanent confusion, partly because they would have been too complex for the layman (and, at the political level, the 'limit' was intended to impress him), partly because it would have been necessary to recalculate the payments at least every quarter as the terms of trade, GDP, imports, the global deficit on the balance of payments, or reserves changed. We believe that a precise and (apparently) simple limit of 10 % was adopted as a means of enforcing on the government itself a drastic reduction of debt servicing compared to previous years. A too precise and specific calculation would have led rapidly to questioning by the economists of the opposition parties.

The second explanation comes from the fact that, because of the goals which the government was pursuing, it was not possible to calculate a capacity to pay. Because it was proposing a radical change in the

pattern of production and consumption, in the long term - once economic and social equilibrium has been attained - there will be no need for support to the balance of payment. But, until this final equilibrium is attained, the country needs a cushion of reserves. Net reserves can only be eliminated once this situation has been reached, not before. There is no way to connect the concept of the capacity to pay with the new pattern of autonomous development. In addition,

In the third place, the idea of the partial moratorium on the external debt is an idea which emerged only a few weeks before the first Presidential Message. Until then neither Alva Castro (1984) nor Alan Garcia (1985), as can be seen from their earlier speeches, had considered such a limit.

4.

Additional details on the economic policy and its results can be found in the work of Carbonetto et al. [1987], Herrera et al. [1987], Chávez [1986], Schuldt [1986, 1987].

5. These forecasts are based on reworking and updating those presented in [BCR, 1984].

APPENDIX II:

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TABLE A-1

PERU: BALANCE OF PAYMENTS 1970-86 (\$m)

60

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
I: CURRENT ACCOUNT	185	-34	-32	-192	-807	-1535	-1072	-783	-164	953	-102	-1729	-1609	-871	-221	125	-1055
A: Trade Balance	334	159	133	79	-405	-1097	-675	-422	304	1722	826	-553	-429	293	1007	1172	-16
1. Exports	1034	889	945	1112	1503	1330	1341	1726	1972	3676	3916	3249	3293	3015	3147	2978	2509
2. Imports	-700	-730	-812	-1033	-1908	-2427	-2016	-2148	-1668	-1954	-3090	-3802	-3722	-2722	-2140	-1806	-2525
B: Financial Services ¹	-149	-125	-121	-181	-219	-284	-375	-439	-646	-931	-909	-1019	-1033	-1130	-1165	-1011	-831
3. Public Sector	-34	-51	-53	-70	-101	-177	-216	-262	-344	-435	-437	-453	-548	-636	-806	-707	-605
4. Private Sector	-115	-74	-68	-111	-118	-107	-159	-177	-302	-496	-472	-563	-485	-494	-359	-304	-226
C: Non-Financial Services	-82	-107	-83	-132	-228	-231	-104	-26	48	10	-166	-318	-314	-253	-221	-170	-304
D: Transfers	82	39	39	42	45	77	82	104	130	152	147	161	167	219	158	134	96
II: LONG-TERM CAPITAL	24	-28	115	383	895	1135	642	728	444	656	463	565	1194	1384	1189	691	603
E: Public Sector	101	15	120	314	693	793	446	659	405	617	371	305	989	1431	1392	814	586
5. Receipts	164	158	210	418	820	917	781	1067	849	1084	1208	1620	1934	1530	1026	693	475
6. Refinancing	26	26	76	254	215	160	15	227	227	539	372	80	109	1024	499	201	
7. Amortisation	-121	-156	-164	-352	-338	-284	-282	-402	-659	-980	-1203	-1394	-1054	-1145	-1441	-1329	-1453
8. Other ²	32	-13	-2	-6	-4		-68	-6	-11	-26	-6	-1		22	1308	1249	1564
F: Private Sector	-77	-43	-5	69	202	342	196	69	39	39	92	260	205	-47	-203	-123	17
III: BASIC BALANCE	209	-62	83	191	88	-400	-430	-55	280	1609	361	-1164	-415	513	968	816	-452

Short-term capital and errors and omissions		48	-14	-32	-178	194	-177	-438	-294	-204	-30	361	660	539	-553	-721	-536	-7
		----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----
IV: BALANCE OF PAYMENTS		257	-76	51	13	282	-577	-868	-349	76	1579	722	-504	124	-40	247	280	-459
		=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====
MEMORANDUM ITEMS																		
Net reserves		423	347	398	411	693	116	-752	-1101	-1025	554	1276	772	896	856	1103	1383	924
Current ac./GDP		2.9	-0.5	-0.4	-1.8	-6.0	-9.3	-6.8	-5.5	-1.3	6.1	-0.4	-6.8	-6.3	-4.4	-1.1	0.7	-4.0
Current ac./Export		17.9	-3.8	-3.4	-17.3	-53.7	-115.4	-79.9	-45.4	-8.3	25.9	-2.6	-53.2	-48.9	-28.9	-7.0	4.2	-42.0
Terms of Trade		n.d	n.d	n.d	n.d	n.d	120.0	111.9	116.9	100.0	134.5	152.7	125.0	102.9	110.3	101.1	86.8	64.3
		=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====	=====

PRELIMINARY:

1: Excluding cost of unpaid debt servicing

2: Includes other public sector borrowing and, from 1983, equivalent to net movement of arrears on external debt.

Source: Banco Central de Reserva del Peru.

TABLE A-2
PRINCIPAL EXPORTS 1970-86 (\$m)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
I: TRADITIONAL PRODUCTS	1000	858	895	998	1352	1234	1204	1502	1619	2866	3071	2548	2531	2460	2421	2264	1861
	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----
FISHMEAL	303	267	219	138	202	168	168	184	196	256	195	141	202	80	137	118	204
Volume('000 tonnes)	1873	1750	1524	348	629	781	592	436	483	657	417	315	616	205	401	508	716
Price (\$/tonne)	162	152.8	144	395.4	321	215.8	284.2	421.8	405.3	389.7	469.4	448	378.5	386.7	342.4	232.6	285.5
COTTON	52	45	47	63	97	53	71	48	38	49	77	63	85	44	23	51	39
Volume ('00,000 lb)	1456	1104	1086	1019	1034	737	776	461	394	434	702	685	1287	670	246	624	473
Price (cents/lb)	35.8	40.4	43.2	62.1	93.3	71.9	91.4	103.3	96.5	113.7	101.8	92.8	66.1	66.4	92.5	82.6	82
SUGAR	61	69	86	78	194	269	85	78	47	34	13		20	35	49	23	22
Volume('000 tonnes)	403	429	481	407	462	422	284	412	266	181	53		59	89	116	64	55
Price (cents/lb)	6.9	7.4	8.2	8.8	19.3	29.3	13.8	8.7	8.1	8.7	11.4		15.2	17.9	19.4	16.8	18.5
COFFEE	44	36	49	64	35	49	106	198	168	245	140	107	114	116	126	151	272
Volume('000 tonnes)	44	43	55	58	27	42	47	44	54	69	44	46	43	55	52	60	74
Price (cents/lb)	45.8	38.8	41.2	50.1	59.3	53.8	104	204.8	144.6	162.1	146.9	107.4	119.4	96.8	112.7	115.9	169
COPPER	252	180	193	333	316	183	236	385	425	693	750	529	460	442	442	476	437
Volume('000 tonnes)	213	195	209	194	184	156	182	321	349	377	350	324	335	292	337	363	341
Price (cents/lb)	53.6	41.9	42.1	78	78.2	53.2	58.8	54.5	55.3	83.5	97.4	74.1	62.3	68.8	59.5	59.3	58
IRON	72	61	67	66	75	52	63	91	74	85	95	93	108	75	58	76	58
Volume (m.tonnes)	9.9	8.9	8.8	8.9	9.7	5	4.5	4.1	4.8	5.7	5.8	5.3	5.7	4.3	4.2	5.2	4.2
Price (\$/tonne)	7.3	6.8	7.7	7.4	7.7	10.4	14.1	14.9	15.5	14.8	16.5	17.7	19.1	17.5	13.9	14.6	13.8

GOLD	0	0	0	0	3	0	8	19	17	13	40	74	56	69	67	43	8
Volume (m.troy oz)	0	0	0	0	21	0	62	130	89	49	65	157	149	164	183	135	21
Price ((\$/troy oz)	0	0	0	0	157.9	0	123	143.4	191.6	265.2	616.5	472.7	375.6	420.8	366.7	320.6	354.2
SILVER	29	22	32	38	60	92	90	116	119	222	315	312	205	391	227	140	110
Volume (m.troy oz)	16.8	14.5	20	15.2	13.6	20.7	21	25.1	22.5	23.8	16	28	26	32.7	26.8	22.3	19.5
Price (\$/troy oz)	1.8	1.5	1.6	2.5	4.4	4.5	4.3	4.6	5.3	9.3	19.7	11.1	7.9	11.9	8.5	6.3	5.6
LEAD ¹	63	49	58	80	123	99	107	140	164	330	384	218	215	294	234	202	164
Volume ('000 tonnes)	163	147	168	179	149	142	172	166	165	156	152	146	177	191	181	174	130
Price (cents/lb)	17.5	15	15.6	20.3	37.4	31.6	28.2	38.3	45.1	96.2	114.4	68	55.2	69.6	58.7	52.7	57.4
ZINC	49	48	70	99	150	163	180	155	137	174	211	267	268	307	300	268	246
Volume ('000 tonnes)	334	344	402	407	422	358	415	422	445	422	468	477	491	522	511	459	491
Price (cents/lb)	6.6	6.3	7.9	11	16.2	20.6	19.7	16.7	14	18.6	20.4	25.4	24.8	26.7	30.2	26.4	22.7
PETROLEUM CRUDE AND REFINED	7	6	7	15	28	41	50	52	186	652	792	690	719	544	618	645	236
Volume (m.barrels)	2.4	1.4	1.8	2.6	2.2	4	4.8	4.1	13.7	24.1	22.4	19.9	22.8	20.5	23.5	27.1	22
Price(\$/barrel)	2.8	3.9	3.6	5.8	12.8	10.1	10.5	12.6	13.6	27.1	35.2	34.6	31.6	26.6	26.3	23.9	10.7
OTHERS ²	68	75	67	24	69	65	40	36	48	113	64	54	79	63	100	71	65

II: NON-TRADITIONAL
PRODUCTS

34	31	50	114	151	96	137	224	353	810	845	701	762	555	726	714	648
----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----

III: TOTAL VALUE

1034	889	945	1112	1503	1330	1341	1726	1972	3676	3916	3249	3293	3015	3147	2978	2509
====	====	====	====	====	====	====	====	====	====	====	====	====	====	====	====	====

- Notes: 1. Includes silver content
2. Principally minor metals

Source: Banco Central de Reserva del Peru, Department for the External Sector

TABLE A-3

Imports f.o.b. 1970-86 (\$m)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
I: CONSUMPTION GOODS	75	84	95	144	160	216	147	136	87	135	372	558	445	335	240	112	351
Public Sector	28	21	18	15	16	42	21	8	3	44	108	169	28	82	23	11	116
Private Sector	47	63	77	129	144	174	126	128	84	91	264	389	417	253	217	101	235
II: INTERMEDIATE GOODS	257	353	372	387	920	1173	932	925	753	921	1172	1401	1321	1025	949	841	1279
Public Sector	74	113	176	250	497	596	491	513	260	275	420	442	395	441	325	296	372
Private Sector	183	240	196	137	423	577	441	412	493	646	752	953	926	584	624	545	907
III: CAPITAL GOODS	187	189	197	318	611	796	668	526	450	625	1087	1454	1411	900	771	558	691
Public Sector	99	108	127	201	395	425	395	275	247	257	426	511	518	457	400	169	158
Private Sector	88	81	70	117	216	371	273	251	203	368	661	943	893	443	371	389	533

IV:	OTHERS	181	104	148	184	217	242	269	561	378	273	459	389	545	462	180	295	204
	Public Sector	137	92	138	173	203	208	237	521	322	210	398	324	480	362	110	227	159
	Private Sector	44	12	10	11	14	34	32	40	56	63	61	65	65	100	70	68	45
V:	TOTAL	700	730	812	1033	1908	2427	2016	2148	1668	1954	3090	3802	3722	2722	2140	1806	2525
	Public Sector	338	334	459	639	1111	1271	1144	1317	832	786	1352	1412	1421	1342	858	703	805
	Private Sector	362	396	353	394	797	1156	872	831	936	1168	1738	2350	2301	1380	1282	1103	1720

MEMORANDUM ITEMS

Principal Foods	69	72	123	159	243	313	218	181	153	223	423	503	371	431	295	204	386
Wheat	32	44	53	55	89	137	105	87	77	136	141	167	156	151	143	104	114
Maize and Sorghum			29	55	81	57	34	25	14	18	65	50	55	61	18	32	33
Rice	2					33	14			40	93	60	17	40	11		31
Sugar											32	99		63	34		46
Dairy products	5	7	14	22	28	39	26	29	16	15	44	55	60	39	29	22	50
Soya	5	2	11	14	31	40	35	34	45	14	35	44	39	55	39	33	40
Meats	25	19	16	13	14	7	4	6	1		13	28	44	22	21	13	72

Source: Banco Central de Reserva del Peru, Department for the External Sector

Table A:4 Terms of trade 1975-86

.....								
(1975=100)								
=====								
Year	Index of traditional export prices (a)		Index of traditional export volumes (b.)		Index of import prices (c)		Index of terms of trade	
	I		II		III		I/III	
	Index	% change	Index	%	Index	%	Index	%

1975	91.1		81.3		76.2		119.9	
1976	89.3	-2.3	83.0	2.1	79.9	4.9	111.8	6.9
1977	102.3	14.8	90.8	9.4	67.3	9.6	117.0	4.7
1978	100.9	-2.4	100.0	10.1	100.0	14.2	100.0	-14.5
1979	149.1	49.1	117.3	17.3	110.8	10.2	134.6	34.6
1980	189.3	27.1	100.9	-14.0	124.1	12.0	152.7	13.5
1981	160.4	-15.4	99.9	-2.1	128.3	3.4	125.0	-18.1
1982	133.0	-17.1	117.3	16.7	129.2	0.7	102.9	-17.7
1983	143.0	9.8	104.3	-11.1	132.0	2.2	110.6	7.4
1984	134.6	-7.8	109.8	5.3	133.1	0.9	101.1	-8.6
1985	119.2	-12.2	118.1	7.6	136.2	2.3	86.8	-14.2
1986	102.7	-14.8	113.3	-4.1	131.5	14.9	77.3	-25.9
=====								

a. Export deflator.

b. Base weighted.

c. Weighted by imports.

Source: Banco Central de Reserva del Peru, Department for the External Sector.

Table A.5 Peru: Exchange rate 1970-86 (Intis per US\$)

End December	Official or central rate	Financial rate	% difference
1970	0.03870	---	---
1971	0.03870	---	---
1972	0.03870	---	---
1973	0.03870	---	---
1974	0.03870	---	---
1975	0.04937	---	---
1976	0.05576	---	---
1977	0.08423	---	---
1978	0.15635	0.17168	9.8
1979	0.22472	0.27771	23.6
1980	0.28885	0.29508	2.2
1981	0.42232	0.42617	0.9
1982	0.69757	0.70657	1.3
1983	1.62859	1.65919	1.9
1984	5.20053	5.31905	3.4
1985	13.94000	17.38000	24.7
1986	13.95000	17.45000	25.1

Source: Banco Central de Reserva del Peru, Department for the External Sector.

Table A:6 Total external debt 1970-86 (\$m.)

	1970	1971	1972	1973	1974	1975	1976
I. LONG-TERM	2190	2242	2370	2709	3441	4352	5250
Public a)	945	997	1121	1491	2162	3066	3554
Central Bank b) c)	41	34	67	17	0	0	535
Private	1204	1211	1182	1201	1259	1286	1311
II. SHORT-TERM b)	1491	1450	1462	1423	1796	1905	2134
III. TOTAL	3681	3692	3832	4132	5237	6257	7384

a) Until 1982, includes effect of revaluation.

b) Includes revaluation effects.

c) Includes IMF gold tranche.

Source: Ministry of Economy and Finance, Credit Department; Bank the External Sector.

1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
6263	7226	7941	8126	8090	9197	10925	11976	12629	13173
4311	5135	5764	6043	6127	6825	8256	9648	10462	11048
626	751	869	710	455	707	1089	862	825	788
1326	1340	1308	1373	1508	1665	1580	1466	1342	1337
2304	2098	1393	1469	1516	2268	1520	1362	1124	1323
8567	9324	9334	9595	9606	11465	12445	13338	13753	14496

10. Central de Reserva del Peru, Department for

TABLE A-7

EXTERNAL PUBLIC DEBT, 1970-85

[illegible]

III: LOANS BY SOURCE OF FINANCE

Official agencies	39	50	89	139	270	359	236	260	306	384	257	149	138	315	193	208
Commercial banks	15	22	87	397	541	417	260	32	240	683	648	895	838	745	272	5
International orgns	26	32	34	24	41	35	38	79	56	96	177	186	237	200	260	198
Socialist countries			14	28	100	143	113	417	207	65	191	156	180	364	218	241
Supplier credits	110	80	62	84	83	123	149	279	266	395	307	314	650	930	582	207
TOTAL	190	184	286	672	1035	1077	796	1067	1075	1623	1580	1700	2043	2554	1525	859
	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----

IV: CREDITS AGREED BY DURATION

1-5 years	43	61	126	100	110	421	336	396	169	547	149	299	140	163	102	1
5-10 years	96	27	174	555	446	292	313	155	91	169	201	343	1168	692	116	74
10-15 years	13	67	92	228	662	212	457	311	92	735	935	957	738	446	217	270
more than 15 years	74	66	108	142	76	59	277	146	113	305	354	440	540	624	310	97
TOTAL	226	221	500	1025	1294	984	1383	1008	465	1757	1539	2039	2586	1925	745	442
	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----

V: CREDITS AGREED BY SOURCE OF FINANCE

Official agencies	53	77	163	151	561	188	139	287	264	282	294	203	254	276	255	133
Commercial banks	33	3	185	478	461	461	394	50	57	579	304	921	685	1056		
International orgns	80	38	40	67	88	54	250	116	64	177	233	484	540	463	232	214
Socialist countries		69	26	28	112	198	414	159	5	293	87	139	23	16	1	10
Supplier credits	60	34	86	301	72	83	186	396	75	426	621	292	1086	564	297	85
TOTAL	226	221	500	1025	1294	984	1383	1008	465	1757	1539	2039	2588	2375	785	442
	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----	----

Source: Banca Central de Reserva del Peru

Table A:8 External debt service 1977-86

Year	Amortisation	Interest	TOTAL SERVICE	Exports of goods & services	Debt Service/ Exports (%)
	(1)	(2)	(3) = (1)+(2)	(4)	(5) = (3)/(4)
1977	402	220	622	2101	29.6
1978	432	270	702	2404	29.2
1979	441	384	825	4188	19.7
1980	831	492	1323	4626	28.6
1981	1314	525	1839	4015	45.8
1982	945	551	1496	4076	36.7
1983	308	442	750	3731	20.1
1984	333	330	663	3210	17.4
1985	347	270	617	3785	16.3
1986	274	221	495	3300	15.0

Source: (5) BCR, Memoria 1986, p.179.

(1)-(3) BCR, Analisis de largo plazo del sector externo de la economia peruana, 1975-1986, Lima, June 1987; p.59.

Table A:9 Peru: Net international reserves of the banking system
1970-86

	Jan	Feb.	March	April	May	June	July	Aug
1970	182	193	228	252	305	393	408	426
1971	413	392	378	363	376	346	346	371
1972	342	355	372	380	395	395	409	416
1973	384	385	389	380	425	430	443	518
1974	386	215	237	285	272	276	388	406
1975	707	712	699	451	270	131	198	146
1976	14	-58	-94	-239	-355	-553	-601	-580
1977	-821	-843	-907	-924	-1012	-1046	-1052	-1101
1978	-1085	-1084	-1110	-1155	-1197	-1222	-1197	-1151
1979	-1050	-1010	-917	-844	-813	-603	-539	-394
1980	334	567	717	845	1006	1005	1128	1105
1981	1270	1106	1041	628	527	616	673	683
1982	773	650	561	487	497	774	795	781
1983	645	502	636	549	602	939	767	766
1984	830	757	795	737	772	893	911	991
1985	1036	1067	977	990	991	973	868	905
1986 *	1434	1417	1446	1395	1359	1178	1223	1127

* PRELIMINARY

1/ The stock in December 1969 was \$166m.

Source: Banco Central de Reserva del Peru, Monetary Sector

Change by Quarters

Sept.	Oct.	Nov.	Dec.	Qt I	II	III	IV	By Year
434	432	420	423	11	62	165	41	257
356	357	347	347		-45	-32	10	-76
393	382	389	398		25	23	-2	51
506	478	521	411		-9	41	76	13
490	534	563	693		-174	39	214	282
178	177	125	116		6	-568	47	-577
-615	-671	-660	-752		-210	-459	-62	-868
-1115	-1139	-1165	-1101		-155	-139	-69	-349
-1120	-1092	-1043	-1025		-9	-112	102	76
-153	61	239	554		108	314	450	1579
1097	1076	1116	1276		163	288	92	722
-584	-607	-560	-772		-235	-425	32	-504
929	882	880	896		-211	-213	155	-124
848	852	852	856		-260	303	-91	-40
1041	1089	1137	1103		-61	98	148	247
1043	1287	1349	1383		-126	-4	70	280
1177	1175	1026	924		63	-268	-1	-459

Table A-10

Real GDP by productive sectors, 1974-86 (000 intis, 1970 prices)

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
Agriculture	39422	39106	40241	40684	38934	40219	38536	43269	44740	41222	44856	45905	47623
Fishing	3093	2623	3189	3013	3920	4292	4073	3572	3500	2699	4028	4332	4461
Mining	21026	18251	19638	26023	29976	32807	31330	29822	32363	29910	31838	33773	32930
Manufacturing	26965	80582	83966	78508	75682	78634	82802	82719	80496	66601	68474	71257	83969
Construction	15927	18603	18082	16671	13986	14503	17230	19126	19566	15368	15603	13560	16438
Government	23076	24114	24596	25285	25159	25033	25420	26015	26535	27066	27066	26931	27519
Others	124370	127852	131771	130456	127312	133039	138594	143796	144292	127051	132063	134514	145524
GDP	303879	311131	321483	320640	314969	328527	337979	348319	351422	309317	323823	330860	358464

Source: Banco Central de la Republica del Peru, Income and Output Department.

Table A:11 GDP per capita 1975-86

	GDP (000 Intis, 1970 prices)	Population (000)	GDP per capita (1970 Intis)
1975	311131	15161	20.52
1976	321483	15573	20.64
1977	320640	15990	20.05
1978	314969	16414	19.19
1979	328527	16349	19.50
1980	337979	17293	19.54
1981	348319	17755	19.62
1982	351427	18226	19.28
1983	309317	18707	16.53
1984	323958	19192	16.87
1985	330272	19692	16.77
1986	358464	20207	17.74

Source: Banco Central de la Republica del Peru, Income and Output Department.