The Rise of the Peruvian State and the Quest to Industrialize

**Latin America in the Early Postwar Period: From ISI to Developmentalism**

From the standpoint of twentieth-century Latin America, the response of individual countries to two world wars and the Great Depression was basically twofold. Early on, a first group of countries that included Argentina, Brazil, Chile, and Mexico explicitly embraced state-sponsored inward-looking industrial policies (ISI) in hopes of cushioning themselves from further external shocks. For a second group of countries, including Bolivia, Paraguay, Peru, and others, the ISI trajectory was nowhere near as viable—first, because this second group’s historical status as small, open primary exporters left them ill-prepared for such a venture and hence any pre–World War Two efforts at fostering an industrial base had quickly faltered; and second, because social infrastructure, factors of production, and overall economic activity were so tightly tied to just a few commodity exports in each of these countries that the costs of diversifying into manufacturing industries were deemed to be too high. Thus, although some incipient ISI strategies were maintained in the light durable-goods sectors, this second group of countries basically cast their fate with the sale of commodity goods on foreign markets.

Obviously, neither of these two strategies was without pitfalls. For example, the first group of ISI countries had succeeded in reducing their imported share of finished consumer goods to well below 20 percent by 1950 (Bulmer-Thomas 1994, 276–78). This meant that the “first phase” of substituting imports for domestic production based on local demand had been completed over roughly two decades in these countries. Yet, despite the demonstrated ability of ISI to spur growth and employment in light manufacturing, mounting macroeconomic and balance-of-payment pressures also underlined the need to deepen the industrialization process into more sophisticated sectors that could generate foreign exchange and compete abroad.

In the economic-development literature this attempted shift from light manufacturing (textiles, foodstuffs, hand tools) to heavy industrial produc-

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1. This first section borrows from Bulmer-Thomas 1994; Franko 1998; and Thorp 1998.
tion (autos, steel, petrochemicals) has been broadly referred to as “developmentalism” (Hirschman 1968; Sikkink 1991; Franko 1998). In terms of economic policy, developmentalism marked a transition from the blanket subsidies and protection granted by the state to a more targeted and selective set of government incentives geared toward the promotion of heavy industry and manufactured exports. By definition, the private sector—both domestic and foreign—was expected to play a more prominent role by investing in this “second phase” of ISI, and some countries went so far as to grant foreigners the same tax treatment that national investors received (Gereffi and Evans 1981).

As for the advisability of pursuing the outward-looking strategy based on primary exports, this approach remained vulnerable to the same volatile price fluctuations and unfavorable shifts in the terms of trade that the ISI group had sought to avoid; moreover, in political terms, the social structures and political coalitions that had evolved around these “enclave” primary-export economies were far too rigid and narrow to properly navigate the political economy into calmer waters when such shocks inevitably occurred (Cotler 1975). Comparatively speaking, developmentalism signaled an effort to modernize domestic politics, as it brought an end to the unwieldy multiclass social coalitions that had underpinned populist governments and ISI programs in these countries. In their quest to industrialize, political and economic elites regrouped to forge smaller and more manageable alliances, invariably with the backing of the armed forces. In Argentina, Brazil, and Chile, hyperinflationary crises and consequent efforts at fiscal streamlining and private-sector accommodation ultimately led to military rule. Although leaders in the ISI countries embellished their development plans with promises of greater equity and social spending, in fact, hindsight shows this policy shift to have been highly exclusive in economic terms and thus anything but distributive (O’Donnell 1988; Cardoso 2000; Pastor and Wise 2002).

As early post–World War Two economic history would have it, the ISI/developmentalist group opted for an inward-looking industrial strategy at the very moment when East Asian reformers were gearing up to make their fortunes as exporters of manufactured goods on an incredibly buoyant international market. As developmentalist policy makers failed to meet their ambitious export targets in the 1960s and 1970s, it is difficult to exaggerate the lost export opportunities for Latin American industrializers during this period. At the same time, those countries that pursued an outward strategy with commodity exports met with a more erratic set of price trends and a slower pattern of growth than those witnessed in world markets for industrial goods. The upshot: erstwhile developmentalist countries in Latin America saw their share of world trade plummet from 8.9 percent in 1946 to 3.5 percent in 1960. The decline of world share for Latin American primary
exporters over this same time frame was more modest; nevertheless, they accounted for the same meager share of world trade in 1960 as did the first group (Bulmer-Thomas 1994, 290–91).

Thus, for similar but different reasons, both groups found themselves coping with increasingly difficult challenges in the way of macroeconomic instability and an inhospitable external environment. When domestic politics were factored in to the equation, the tasks of economic management were further complicated. Turning more specifically to the case of Peru, this chapter details the efforts of politicians and policy makers there to launch a catch-up ISI strategy once the primary-export-led model ran up against seemingly insurmountable bottlenecks. Even though the administration of President José Luis Bustamante had failed miserably in its efforts to shift economic activity inward toward manufacturing production in the mid-1940s (Thorp and Bertram 1978; Bulmer-Thomas 1994, 290), the apparent exhaustion of primary-export-led growth by the early 1960s prompted another try. As in the first group of countries mentioned earlier, Peru found itself relying ever more on government spending and public investment in order to accomplish these goals.

The following sections analyze the renewed attempt at salvaging primary-export production and diversifying into manufacturing and other nontraditional economic activities from the standpoint of state sponsorship. After briefly reviewing the broader political-economic backdrop to state intervention, the chapter draws on the institutional framework developed in chapter 1 as the main frame of explanatory reference. Given the incipient nature of state institutions at this time, and the lack of cohesive organizational ties between the state and key groups in civil society, the chapter shows how fairly moderate intentions to launch an ISI strategy in Peru quickly escalated into a more encompassing and developmentalist role for the state. Although equivalent levels of state sponsorship had evolved gradually over the first half of the twentieth century in countries like Argentina, Brazil, and Mexico, in Peru this same trend was compressed into a decade. While even the most optimistic observer would be hard-pressed to declare this first bout of full-fledged statism a success, it is all the more remarkable that policy makers in the 1970s sought to redress these early missteps through a strategy that would basically amount to much more of the same.

**The Political-Economic Backdrop to State Intervention in Peru**

Perhaps the most striking feature of early postwar Peruvian development is the country’s late start in terms of industrialization and the resort to statist policy
approaches. Peru’s historical registering of low rates of industrialization, and a passive role for government, particularly in comparison to the other leading Latin American economies, stand out in the data on this period. The country’s share of manufactured products was just 1 percent of all exports, and its average tariff on imports was by far the lowest in South America (Sheahan 1987, 87, 91). Apart from the adverse economies of scale and high entry barriers mentioned earlier, the two most common explanations for Peru’s status as a late industrializer focus on the country’s relatively diverse natural resource base, which helped to postpone any pressing need for a state-sponsored industrial strategy until the 1960s, and the overriding influence of transnational economic linkages. The latter consisted of a steady flow of U.S. FDI into the primary-export sectors and the greater success of U.S. policy advisors in prescribing liberal economic measures in Peru (Hunt 1975).

Thus, like many of the countries in the second group of primary-commodity exporters discussed earlier, Peru conformed to the dependency stereotype of a dominant-export oligarchy on the domestic front that joined effectively with foreign investors in imposing a liberal economic policy regime. Much has been made of the influence of the Alliance for Progress and the developmentalist programs simultaneously underway in Argentina and Brazil in swaying policy toward manufacturing and higher levels of state intervention during the 1960s (Levinson and de Onis 1970, 148; Fitzgerald 1979, 43). Certainly each played a role in the policy shift that occurred at this time, but it is also important to examine how such factors worked to reinforce subtle interventionist tendencies that had already been set in motion. The brief spurts of interventionist policy that had occurred prior to the 1960s reveal that a number of complex trends had evolved over time to contribute to an increasing economic and political presence of the Peruvian state by the 1960s.

In economic terms, the Peruvian state’s first significant role was underwritten during the Leguía administration, which ruled from 1919 to 1930. Although Leguía’s foreign-financed program of public spending became best known for its corruption, it did represent the initial attempt in Peru to promote capital accumulation with massive state backing (Stallings 1987, 249–58). With its emphasis on providing traditional infrastructure support for private capital and attracting foreign investment and loans, the orienta-

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2. Thorp and Bertram 1978 remains the best full economic historical account of Peru, along with Fitzgerald 1979 and Sheahan 1999 for the post–World War Two period. This first section draws broadly from these sources.

3. Hernando De Soto’s (1989, xvi) historical characterization of the Peruvian state as “mercantilist” does not rule out the successful maintenance of a liberal economic policy regime. Underpinning De Soto’s account of a burdensome bureaucratic state, which granted favored status to a small domestic elite, was the triumph of that elite in preventing macropolicy and government economic regulation from being turned against it.
tion of this first statist program was that of bolstering the primary-export-led model. Subsequent interventionist phases, as under the Prado and Bustamante administrations, which reigned consecutively from 1939 to 1948, followed this same basic pattern.\(^4\) Up until World War Two, the sporadic but growing economic presence of the state was still that of an indirect backup for the private sector and was geared mainly toward promoting and defending the position of Peru’s primary exports on world commodity markets.

Public expenditure had also been put to fairly wide political and social uses by the post–World War Two period—first, to fend off what domestic elites perceived as the “socialist” threat of the mass-based American Popular Revolutionary Alliance party (APRA); and second, to address Peru’s highly skewed patterns of income distribution and dualistic economic structures, which had become implacable by the 1940s. Dualism refers to the rift between modern industry and traditional agriculture, whereby the former contributed nearly 50 percent of GDP by 1950 but only employed 20 percent of the workforce, while the reverse pattern held for the latter (Webb 1975). Over time, this polarization of national production and income became a glaring factor in the country’s rising patterns of inequality (Fitzgerald 1979, 91). Thus, social and political spending prior to the 1960s in Peru was tied not to an ISI-type populist coalition but to the effort to maintain political harmony in the face of these extreme disparities that had been fostered and aggravated over time by the primary-export-led model.

Up until the late 1950s, each interventionist spurt had been followed by the successful reconstruction of a liberal economic policy regime. For example, after the interventionist experiments of the early 1940s, a 1957 report by the U.S. Department of Commerce boasted of Peru’s offering the most open and favorable investment conditions in the region. The report referred to the policies undertaken by the Odría administration, which had seized office in 1948. These consisted of the adoption of a freely convertible exchange-rate regime; the elimination of licenses on imports; and the enactment of new pro-foreign-capital laws in mining and petroleum, the latter of which had been enshrouded in conflict and uncertainty over the direction of government policy. The strongest calling card for foreign capital, according to the report, was the Peruvian government’s rapid reduction of public expenditures, subsidies, and price controls in 1953–54 and its ability to put the brakes on inflationary credit expansion (U.S. Department of Commerce 1957, 3).

Toward the end of the 1950s, declining opportunities in primary exports,

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\(^4\) An Industrial Promotion Law of 1940 was passed, authorizing a more direct and discretionary role for government in granting incentives. But Thorp and Bertram (1978, 390) note, “Despite its title, the law was not specifically designed to promote industry, and was in fact used to benefit enterprises in commerce and agriculture as well as manufacturing.”
particularly mining and petroleum, along with a drop in FDI in these sectors, made the liberal economic policy mix less appealing and more difficult to maintain. The changing composition of the export economy (see table 7) called up, for the first time during this century, a stronger imperative to industrialize and with this more direct forms of state support. Although social demands from the working classes and popular sectors had heretofore been too weak to extract substantial subsidies from the state, increasing urban migration and the transformation of the economy toward manufac-

### TABLE 7. Sectoral Composition and Growth of GDP in Peru: 1950–70

<table>
<thead>
<tr>
<th>Sectoral Composition (%)</th>
<th>1950</th>
<th>1955</th>
<th>1960</th>
<th>1965</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>20.4</td>
<td>19.3</td>
<td>18.5</td>
<td>15.3</td>
</tr>
<tr>
<td>Fishing</td>
<td>0.4</td>
<td>0.6</td>
<td>1.4</td>
<td>2.1</td>
</tr>
<tr>
<td>Mining</td>
<td>6.8</td>
<td>7.5</td>
<td>10.4</td>
<td>8.5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>16.7</td>
<td>18.0</td>
<td>20.0</td>
<td>22.2</td>
</tr>
<tr>
<td>Construction</td>
<td>6.3</td>
<td>7.5</td>
<td>5.0</td>
<td>5.2</td>
</tr>
<tr>
<td>Utilities</td>
<td>0.6</td>
<td>0.6</td>
<td>0.8</td>
<td>1.0</td>
</tr>
<tr>
<td>Government</td>
<td>9.1</td>
<td>3.2</td>
<td>8.0</td>
<td>8.3</td>
</tr>
<tr>
<td>Finance</td>
<td>2.3</td>
<td>2.6</td>
<td>2.8</td>
<td>3.0</td>
</tr>
<tr>
<td>Transport</td>
<td>3.9</td>
<td>4.6</td>
<td>4.3</td>
<td>4.5</td>
</tr>
<tr>
<td>Commerce</td>
<td>11.4</td>
<td>11.1</td>
<td>12.1</td>
<td>15.1</td>
</tr>
<tr>
<td>Services</td>
<td>22.1</td>
<td>20.0</td>
<td>16.7</td>
<td>14.8</td>
</tr>
<tr>
<td><strong>Total GDP</strong></td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Rate of Sectoral Growth (%)</th>
<th>1955–60</th>
<th>1960–65</th>
<th>1965–70</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>3.6</td>
<td>2.7</td>
<td>4.0</td>
</tr>
<tr>
<td>Fishing</td>
<td>25.5</td>
<td>15.9</td>
<td>10.4</td>
</tr>
<tr>
<td>Mining</td>
<td>11.4</td>
<td>2.4</td>
<td>3.8</td>
</tr>
<tr>
<td><strong>Total primary sector</strong></td>
<td>6.6</td>
<td>3.4</td>
<td>4.5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>6.7</td>
<td>8.9</td>
<td>5.9</td>
</tr>
<tr>
<td>Construction</td>
<td>−3.7</td>
<td>7.7</td>
<td>−0.3</td>
</tr>
<tr>
<td>Utilities</td>
<td>13.8</td>
<td>9.7</td>
<td>6.7</td>
</tr>
<tr>
<td><strong>Total secondary sector</strong></td>
<td>4.3</td>
<td>8.7</td>
<td>4.8</td>
</tr>
<tr>
<td><strong>Total tertiary sector</strong></td>
<td>3.3</td>
<td>7.6</td>
<td>4.0</td>
</tr>
<tr>
<td><strong>Total growth of GDP</strong></td>
<td>4.5</td>
<td>6.7</td>
<td>4.4</td>
</tr>
</tbody>
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*Source: Fitzgerald 1979, 69. All data are based on BCRP, “Cuentas Nacionales” and “Memorias,” various years.*

*aRounding errors.*
turing industry converged to create further pressures for state spending on this front.

Although it would take more than three decades before Peru would see another liberal economic regime characteristic of the Odría era (1948–56), domestic elites and policy makers by the late 1950s were far from ready to embrace a full-fledged statist program. Vestiges of the developmentalist influence from other parts of the region began to crystallize in Peru under the second Prado administration, which was elected in 1956. That influence, which prevailed in Peru up through the military coup of 1968, still favored a leading role for private initiative but accepted a moderate increase in state support and planning (Sikkink 1991). A 1962 quarterly analysis from Lima’s Banco Continental summed up the attitude toward development as Peru entered that decade:

Within the context of a market economy, the principal objective of capital formation by the government is to create the basic conditions under which private enterprise can best fulfill its productive role to the benefit of the community-at-large. This implies that public works are not necessarily an end in themselves but rather perform the function of a structural cornerstone. . . . [I]t is to be hoped that the next government will pursue a course of action consistent with [these] foregoing financial principles.5

The “next government” referred to Fernando Belaúnde and his Popular Action party (AP), which won the civilian elections in 1963. With its strong emphasis on modern infrastructure and generous incentives to both foreign and domestic private capital in promoting industry, the Belaúnde government brought Peru more closely into step with the regional developmentalist trend. Yet this period in Peru was also reminiscent of the broad-based middle-class industrializing coalitions that had emerged in Latin America during the 1930s. Whereas other states such as Brazil and Mexico had moved into an intermediate capital-goods stage of industrialization by now, Peru was still in a primary (consumer-durable) stage of ISI and applying protection and other industrial perks indiscriminately across sectors (Beaulne 1975). And, contrary to these other developmentalist efforts, income distribution and long-overdue reforms in health, education, and the agrarian sector now ranked near the top of the development agenda in Peru.

This intense period of catching up during the 1960s was accompanied by fairly sound performance of the major exports listed in table 7, with the result

that annual average GDP grew at about 4.5 percent over Belaúnde’s five-year term (Paredes and Pascó-Font 1987, 4). But there were mounting disputes between the government and foreign investors in the major minerals sectors, and the attraction of both local and foreign private capital toward manufacturing required generous subsidies and tax concessions. Thus, Peru’s first phase of ISI became rapidly swept up in a well-intentioned but misdirected nationalism, as the state increasingly took on the massive infrastructure and industrial drive with insufficient regard for the sources and supply of financing. While economic liberalism remained the dominant ideology throughout this period, state expenditure ultimately tipped over into much higher levels than had been expected or intended. As table 8 shows, the total investment coefficient steadily declined over this time period, but the private sector’s share fell disproportionately.

These trends were aggravated, furthermore, by the highly disarticulate and competing coalitions surrounding the executive and by the outright inability of the state sector to rise to the tasks that were chaotically set for it—which is to say, Peru’s resort to statism in the 1960s was ultimately not the result of a broad-based ISI coalition, as in Argentina, Brazil, or Chile, but rather of the absence of one. It is, then, the structure of the economy and society, as much as the intentions of the relevant political actors, that most explains the Peruvian state’s mounting presence at this time (Topik 1987, 23). These themes are elaborated on in the following sections. By examining the institutional setting and the attempts at coalition building that framed the development effort of the 1960s, the remainder of this chapter traces the haphazard nature of state intervention and how, toward the end of the 1960s, a state-led strategy had evolved mainly as a matter of policy by default.

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</thead>
<tbody>
<tr>
<td>Private sector’s gross capital formation</td>
<td>15.0</td>
<td>19.6</td>
<td>17.7</td>
<td>14.6</td>
<td>10.7</td>
</tr>
<tr>
<td>Public sector’s gross capital formation</td>
<td>3.7</td>
<td>4.5</td>
<td>2.6</td>
<td>3.6</td>
<td>4.6</td>
</tr>
<tr>
<td>Total gross capital formation</td>
<td>18.7</td>
<td>24.1</td>
<td>20.3</td>
<td>18.2</td>
<td>15.3</td>
</tr>
<tr>
<td>Public sector’s current surplus</td>
<td>2.6 (1960–63)</td>
<td>1.2</td>
<td>1.7</td>
<td>2.0</td>
<td>–3.0 (1966–68)</td>
</tr>
</tbody>
</table>

Source: Thorp and Bertram 1978, 288–91; BCRP, “Cuentas Nacionales,” various years.
The Institutional Setting

The themes of foreign influence and ad hoc interventions by the Peruvian state underpin the ways in which some of the major government institutions came about. Of the four institutions most responsible for economic policy in the 1960s—the Ministry of Economy and Finance (MEF), the Development and Public Works Ministry, the National Planning Institute (INP), and the Central Reserve Bank (BCRP)—the INP and the BCRP were explicitly created in response to outside pressures. Kindleberger (1985, 278) notes the establishment of the central bank in the 1920s as a condition set by Peru’s foreign creditors for the further issuance of private loans (Stallings 1987, 255). Similarly, the INP was made the organizational foundation of the planning system installed by the military junta that ruled from 1962 to 1963, as this was required in order for Peru to become eligible for the large amounts of Alliance for Progress funding it had hoped to attract at the time. At the request of the government, ECLAC designed a series of ISI blueprints that the INP took up in line with its new mission (Rossini and Paredes 1991, 277).

This pattern of letting the state sector passively evolve, as opposed to the purposive institution building characteristic of Brazil under Vargas and Kubitschek (Nuñes and Geddes 1987), for example, signaled a deeper problem for the Belaúnde administration: Peru marched into its first major modernization effort without any one planning or financial entity capable of taking the lead in generating and realizing the state’s policy goals.6 With the creation of the INP and the launching of this development effort simultaneously, the former failed to come into its own during the 1960s. The INP staff took some steps toward overhauling the national budget, and they produced two mammoth studies that critiqued the dualistic structures of the Peruvian economy in terms of the related social and economic problems (Cornejo 1985, 34–42). In the end, President Belaúnde’s insistence on involving himself personally in almost every aspect of the infrastructure program, and the unwillingness of technocrats within the more established MEF to permit newcomers into their policy network, left the INP isolated from the planning process.

It was the BCRP that produced the government’s first formal development plan in 1962 (BCRP 1962). While the task departed from the bank’s usual

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6. Victor Bulmer-Thomas (1987), in analyzing the Central American experience, suggests that export-led growth based on primary products led to the neglect of state financial institutions. Yet Kindleberger (1985, chap. 18) points to numerous historical instances of similar neglect where primary products did not dominate the composition of trade. The explanation for institutional neglect in Peru lies somewhere in between the natural resource–endowment argument and the preferences of domestic elites.
mandate of coordinating macroeconomic policy, the development plan represented another funding stipulation laid out by the Alliance for Progress. The BCRP, at the time, was the only institution capable of generating a development plan proper. In his colorful insider account of this period, Pedro-Pablo Kuczynski points to the BCRP as Peru’s one “fairly autonomous institution” (Kuczynski 1977, 16). This assessment rests on the fact that the bank, with the help of a program set up by the Ford Foundation in the early 1960s, had established a relatively sophisticated recruitment and hiring system based on merit.\(^7\) Policy making, however, still centered in the MEF, where no comparable accumulation of talent or sound recruitment practices had been established. The bank, while embodying the orthodox policy current that appealed to Peruvian elites, held less operational sway than the MEF, whose director tended to change frequently with the whims of congress and the executive.\(^8\)

Historically, the lack of interest on the part of domestic elites and a distrust of economic decisions made outside of private hands suffice as explanations for these comparatively meager efforts at state building.\(^9\) These observations apply as well to the broader institutional context that had evolved by the 1960s, which included the executive, the central government, and state bureaucracy at large, as well as an array of independent and semiautonomous state entities. In hindsight, as problematic as the major economic and planning institutions proved to be in executing state policy, the design of the balance of power between congress and the national executive emerged as an equally debilitating factor. Still operating under Peru’s 1933 constitution, congress was basically empowered to go about its business irrespective of the wishes of the president. In the event that the political opposition won a majority, the president’s hands were virtually tied in the legislature.\(^10\) At the same time, outside access to the executive went virtually unregulated. This setup reinforced the circumvention of established state channels, the penetra-

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7. Each year the best economic students within the country were selected and put through an intense training course taught by U.S. economists.

8. The BCRP, furthermore, lacked ultimate authority until the 1970s in such matters as reserve requirements, foreign-exchange policy, and monetary and credit affairs. See U.S. Department of Commerce 1957, 15.

9. Perhaps the most telling aspect of this pro-private-sector bias was the delay until 1963 in creating the Banco de la Nación, which acted as revenue collector and treasurer for the state. These responsibilities had heretofore been in the hands of a private agency controlled by the commercial banks.

10. In the epilogue to his detailed history of this period, Kuczynski (1977) suggests two reforms that could have equalized the balance of power between congress and the executive, thereby strengthening the latter. These are the adoption of staggered midterm elections for congress to place some reliability check on the opposition and reform of the electoral system from one based on proportional representation by party to one based on geographical representation by district.
tion of executive decision making by private parties, and the tendency toward widespread political patronage.

The “small-state,” pro-private-sector ethos that prevailed up to this point is evident in the institutional evolution of the Peruvian central government. Though small in the 1960s, the central government was theoretically the hub of the state sector. On paper, each ministry (there were seventeen in all) was linked to the INP through a sectoral planning office and an increasing number of decentralized public agencies (universities, social security offices, etc.) that depended on the flow of funds from the central government. In practice, with its many overlapping mandates and fierce competition between ministries, the central government still conformed heavily to a black-box metaphor (Cleaves and Scurrah 1980, 68–69). Most notorious was the Ministry of Development and Public Works, which became a main entry point for private parties seeking the lucrative construction contracts that marked the early Belaúnde years.

Much of the blame for the chaos within the central government during this time has been placed on the state bureaucracy itself. As in many Latin American countries, state bureaucrats had been cast as unproductive parasites who gained their positions through nepotism (Topik 1987, 21–22). With a fragmented and confused budgetary process that facilitated the use of public funds for private purposes, these images of favoritism and corruption are not far off. Peru was further hampered by the fact that it had never had a strong tradition of public service, in contrast to Chile, Colombia, or Brazil pre-1964. At best, the state sector was considered an unprestigious and low-paid place to be. While there is no doubt about the lack of “modern administrators” in the Weberian sense, profiles of the upper echelons of the Peruvian bureaucracy at this time suggest that there were certain pockets of strength that could have been much better tapped by the Belaúnde administration.11

Of the small central government workforce in existence in 1961 (around 120,000 employees out of a total national population of about 10.5 million), a tiny elite corps of senior functionaries spanned positions at the general-director and subdirector levels of the bureaucracy. Though technically recruited by competitive examinations according to Peru’s civil-service code of 1950, it was widely recognized in the 1960s that the code was not being fully implemented. Although political patronage and family connections may have taken precedence in the making of official appointments, a survey taken in 1965 of 380 of these top government executives working across the civilian

11. In their analysis of the conditions underlying effective state intervention, Rueschemeyer and Evans (1985) place most stress on the importance of a well-developed bureaucratic apparatus and collectivities of career officials carefully cultivated over time.
ministries indicates that a fairly capable group was in place (Hopkins 1967, 46). Over 36 percent of those surveyed had completed some postgraduate studies, 75 percent were college graduates with degrees primarily in law or engineering, and 91 percent had undertaken some college training. More than 80 percent of top management within the ministries of justice, education, and public health—and even within the unwieldy Ministry of Development and Public Works—held college degrees.

Given the existence of a comparatively well-educated “policy-making segment” within the state bureaucracy (over 40 percent of Peru’s adult population was illiterate in 1961), the question remains as to why the Belaúnde administration failed to harness this talent to the development tasks at hand. The most obvious explanation rests on financial incentives and the substantial salary differential that had built up between executives working in the public and private sectors. But the privileged social and educational status of this group also implies that they had other alternatives and thus were there, to some extent, by choice. The rampant inefficiency appeared to stem partly from the much less qualified group of bureaucrats working at the lower rungs of the central government and from Belaúnde’s heavy reliance on party faithfuls, who were not necessarily a part of this elite corps. The determination to keep strategic posts filled with loyal party sympathizers is reflected in the frequent changeover in high-level staff. From 1963 to 1965 alone, the Ministry of Development and Public Works saw four ministers, each with an average tenure of six months (Hopkins 1967, 64).

The independent and semiautonomous state entities represent the last major aspect of the institutional backdrop of the 1960s. Listed technically in the national budget as the Independent Public Subsector, this category encompassed a whole group of agencies that ranged from the regional-development corporations to the national universities (Rothrock 1969, 110). By the 1960s, as many as 250 entities existed in this legally separate subsector, which also included Peru’s state enterprises. Although each entity was formally tied to a ministry, these institutions depended on specially marked taxes and other direct transfers from the central government. Analysis of this sector of independent entities, and its role in the policy process, is difficult because of its very diversity and its vague organizational ties to the central government. The state enterprises, because they went on to play such a

12. Hurtado and Robles (1985, 37, 56) note, for example, that the public/private salary ratio in 1961 ranged from 147 for top state technocrats to 138 for government managers and administrators.

13. In his 1964 budget message, the treasury minister complained of having received only 20 percent of the budget proposals from these 250 entities, mainly because it was not clear where the proposals should be submitted (Hopkins 1967, 27).
strong role in public-sector capital formation in subsequent periods, are of most interest here.

Although the state firms suffered from equal definitional vagueness during this period, Saulniers (1988, 204–9) has made headway in distinguishing between two groups. Using the most basic criteria of legal autonomy—a level of government equity sufficient to guarantee control and sales accounting for more than 50 percent of current income—he estimates that seventeen of these entities in the Independent Public Subsector qualified as public enterprises by the end of the first Belaúnde era. Using a more expansive definition, which assigns state-enterprise status to firms operating in productive activities with 50 percent public ownership, he estimates that Peru’s public portfolio could have surpassed seventy-five separate entities by 1968. Working from either definition, it is safe to say that, at least in institutional terms, Peru’s state-enterprise sector had begun to take off well before 1968.

By the post–World War Two period, Peru’s public firms had expanded in fits and starts, in response to the economic needs and political demands of both foreign and domestic capital and to fill the revenue requirements of the state itself. For example, the Corporación Peruana de Vapores began in 1944 as a joint shipping venture that merged public and private interests in an attempt to bolster state income. Development banks in housing, agriculture, mining, and industry had been created a decade earlier. Together, these entities reflected the continued need for state support in the productive sectors, the thrust toward urbanization, and the increasing demands for industrial goods and modern services. The Empresa Petrolera Fiscal (EPF), reorganized for the third time in 1948, was mainly a symbolic exertion of national sovereignty in the petroleum sector. Lacking explicit bylaws until 1968, the circumstances surrounding the creation of EPF proved to be a precursor to the more ideological motives that would come to dominate policy making in the state-enterprise sector post-1968 (Saulniers 1988, 16).

The gulf between development theory and managerial practice was more frequently the rule than the exception in the state-enterprise sector, and the vague budget-appropriation process made the public firms susceptible escape valves for hidden revenues and expenditures (Rothrock 1969, 106). Of note here is the fairly steady trajectory of state intervention that had already been established in this independent subsector by the 1960s. In retrospect, the more explicitly statist policy shift that would occur with the military coup of

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14. These firms consisted, for example, of the port and air authorities; the BCRP; development banks in agriculture, housing, and industry; and a range of miscellaneous state-held companies in petroleum, fertilizer, food-supply, and coca-leaf production (Saulniers 1988, 206).

15. Rothrock (1969, 188–98) provides a detailed account of the ups and downs of this endeavor.
1968 was more a deepening of than a departure from this trend. Already by the late 1960s, one of the government’s main dilemmas was shaping local elite opinion to conform to the increasing necessity of state intervention, as exemplified by this sector.16

Overall, in institutional terms, although this brief introduction points to a more prevalent state presence than usually recognized for Peru, when compared to the periods analyzed in subsequent chapters of this book, the 1960s still stand out as an early phase of state formation. As such, the institutional setting did not add up to a coherent springboard for state action. Three separate dynamics served to steer policy off course. First was the making of policy almost independently of institutional life, and not necessarily by those most capable of doing so; second was an almost self-perpetuating instability brought on by the many changes in ministers and personnel; and finally was the ineffectual position of the executive vis-à-vis congress, making it even more difficult to deliver on political promises through those institutional routes that had been established. What basis may have existed to begin cultivating a more autonomous and far-sighted bureaucracy and a cohesive set of state institutions was lost in this shuffle. Into the void stepped an array of competing groups and actors, to which the analysis now turns.

The Development Coalition, or Lack Thereof

While Peru’s predominant alliance between domestic elites and foreign capital in the primary-export sectors remained unshaken until the 1960s, the rapid growth and economic transformations over the entire post–World War Two period had converged to create a more socially stratified and complex set of groups and subclasses. The dualistic economic structures that the INP had begun to critique in its early reports remained largely intact, but class lines could no longer be cast in simple terms. With industrialization, a small domestic bourgeoisie had splintered from the oligarchic elite, and a more visible middle class had emerged in the form of bureaucrats, technical managers, and some military professionals (Jaquette 1971, 44–46). The “traditional sector” still referred largely to peasants and agricultural workers, although the intense migration of this group into urban informal employment forced a redefinition of the term to include this growing contingent. Finally, as industrialization proceeded under the thrust of ISI in the 1960s, the blue-collar

16. Interestingly, the very first locally published report on state enterprises in Peru was an indictment against the encroachment of the state and an early call for the reduction and reform of the public firms (Centro de Documentación Económico-Social 1965).
workforce expanded proportionately. Although technically a notch above the traditional sector in social position, at least wage-wise, these workers were holding their own next to white-collar workers (Hurtado and Robles 1985, 37, 56).

In short, class lines were being quickly redrawn in Peru. These rapid socioeconomic changes crystallized in the 1962 and 1963 elections, where the major political parties sought to win over these emerging groups without entirely alienating the old oligarchic guard. The participation of seven parties in the turbulent 1962 presidential campaign reflected the more pluralistic nature of the Peruvian electorate; the controversial presidential victory of APRA party boss Victor Raúl Haya de la Torre, and the subsequent decision by the military to nullify the elections, indicated that elite consensus was becoming increasingly fragile. This was confirmed in the elections rescheduled for the following year: as the candidate preferred by the military, Belaúnde captured the presidency through a coalition of his AP party and the Christian Democrats (DC). But the congressional seats divided three ways between the AP-DC coalition, the APRA, and former president Manuel Odría’s National Union Party (UNO).

At face value, the platforms of these three main factions were not particularly distinguishable, and because the country’s large illiterate underclass was still denied the vote, the following of each was just slightly more so. It was mainly through the UNO party that traditional elites still maintained their foothold. Haya de la Torre had by now abandoned most of the left-wing anticapitalist positions upon which he had founded the APRA in 1924 and that had for so long aggravated Peru’s ruling civilian and military groups. The APRA party image had been recast into a middle-of-the-road, pro-free-enterprise, fervently anti-Communist mold by the early 1960s. In his campaign, Odría had capitalized on the prosperity and long-term economic expansion that had characterized his administration in the 1950s. Setting ideology aside, the UNO program pushed foreign investment, a fair deal for both business and labor, and further extension of the impressive public-works effort that Odría had sponsored earlier on. All of the candidates and parties agreed on the need to geographically decentralize the nation’s resources away from the wealthy power bloc that prevailed on the coast and the need for the closer integration of the sierra and jungle regions into national life.

17. The historical enmity among the APRA, the military, and Peruvian elites is dealt with in Sanborn 1991 and Graham 1992.
The Belaúnde program offered the overlapping goals of allowing greater representation for Peru’s middle classes and promoting the socioeconomic status of the traditional sectors and working classes. An architect by profession, Belaúnde also emphasized public works and advocated an extension of the various housing and construction programs he had successfully legislated during his tenure as a congressman in the 1940s. Upon election, the AP-DC coalition immediately sought to cement this apparent convergence of interests and goals into a formal political pact with one or both of the other opposition parties. Although the offer included the prospect of incorporating representatives from all three parties into the president’s cabinet, the pact was rejected out of hand by the APRA and the UNO on the grounds that this would compromise the political independence of the opposition. Even before Belaúnde’s inauguration, Odría and Haya de la Torre—both clearly with an eye toward the slated 1969 presidential race—had formed a separate APRA-UNO pact, setting up a formidable opposition in congress from day one.

Thus, it was the shadow of the past and opportunistic considerations for the future that sorely divided elites in the 1960s, as opposed to any substantive differences over development ideology or programmatic strategy. The combination of having been put so quickly on the political defensive and the president’s own inability to clearly articulate the AP-DC program fostered a general mood for promoting economic progress and social welfare, but no concrete strategy for achieving these goals. In this respect, the first Belaúnde period resembled the early policy phase of the Alliance for Progress, prior to the death of President Kennedy, which was long on well-meaning development platitudes but short on the ways to finance and execute the ambitious goals of the alliance (Levinson and de Onis 1970).

In this context of highly polarized party politics and weak executive authority, the development program more or less lurched forward. An elaborate agrarian reform law was passed in 1964, and the government expanded tax exonerations and investment subsidies for industry, placing special emphasis on the automobile industry and its related components.20 The president also launched a massive construction program and put forth his “road philosophy,” which sought to unite the country from north to south by creating a highway to span the entire eastern slope of the Andes. A companion scheme was the jungle-colonization program. Despite its shortage of arable land and ecological vulnerability, Belaúnde insisted that the Amazon basin could be Peru’s next frontier. The last major feature of the program was

20. The agrarian-reform law was one of the first major battles between the AP-DC and the APRA-UNO factions in the legislature. As each side tacked on its own biases, the final law was virtually impossible to implement. Astiz (1969, 105) and Cleaves and Scurrah (1980, 40–41), in particular, note the bias in favor of landowners.
Cooperación Popular, the main organization designed to promote administrative decentralization and the absorption of marginal labor.

The absence of a winning coalition in congress, and the AP-DC’s definition of policy along such broad lines, fostered the familiar populist dynamic of groups stampeding the state in pursuit of narrow economic interests. As the president moved to meet these conflicting claims, policy tended to “happen.” In the discussion on interest mediation in chapter 1, it was suggested that the political economy can still perform reasonably well on all of the major indicators, even in the midst of a large number of competing groups and parties, as long as some stable framework is in place for mediating the interests of the state, capital, and labor. Implicit in this analysis of Peru in the 1960s is the lack of such a framework to help counteract the destabilizing political and economic trends that were set in motion almost immediately. From the standpoint of the state, the reasons are evident from the foregoing discussion. The organization of business and labor in the 1960s, and the relationship of each to the state, require brief elaboration.

From the business angle, interests had reached a fairly sophisticated level of articulation. Some long-standing groups, such as the National Agrarian Society and the National Industrial Society, represented specific sectoral interests, whereas others, like the Chamber of Commerce, represented clusters of commercial interests at large. Encompassing traditional producers and some more recent entrants, Peru’s various business groups had become astute at translating their interests into national policy. In his classic study of Peruvian entrepreneurs, Carlos Astiz (1969, 192) points to their mastery of unofficial channels of influence as the most institutionalized aspect of the policy process in the 1960s:

> These organizations fulfill some of the functions which have become characteristic of interest groups throughout the world: they lobby; they handle public relations on behalf of their members; they try to convince the rest of the population of the righteousness of their positions. . . . What makes these pressure groups—or some of the more effective ones—rather different from their counterparts in the Anglo-American systems and in other advanced European countries is the degree to which they resort to personal and private connections to gain access to policy-makers and their success in obtaining positive responses from them.

Private interests were highly articulated, but mediation between the state and capital amounted to what Astiz (1969, 262) calls a “nonconsensual structure of coercion.” In other words, they were not mediated at all. With direct access to the top levels of government and control over most of the media and
over certain factions within all three of the major political parties, special interests felt no compulsion to support even the very open-ended political pact that the AP-DC had offered up in the beginning. An official government coalition representing the interests of capital and the state was still not seen as a necessity by the private sector or as something that participants on either side would take all that seriously. Although rapidly increasing its role in the economy, the state was still viewed by the private sector as a passive partner for promoting business as usual among domestic capital and its foreign counterparts.

Labor, on the other hand, was becoming a force to contend with in the 1960s. As mentioned earlier, the structure of the workforce was undergoing rapid differentiation. Although figures on the number of organized workers at the outset of the Belaúnde administration vary, Payne’s (1965, 129) estimate of 329,000 is the most widely cited. The number of unions registered with the Ministry of Labor peaked in 1964 at 325 (Sulmont 1980, 212–13), with manufacturing, agriculture (mainly sugar workers), mining, and transportation representing the most highly organized sectors. Most of this organization had advanced during the post–World War Two period of economic expansion, under the auspices of the APRA-dominated Confederation of Peruvian Workers (CTP). Even with the boost of the Korean War price boom, these inroads were significant given the high levels of unemployment still present in the economy, as well as the challenges from the burgeoning pool of unorganized labor in the informal sectors.

Though labor was more highly organized by the 1960s, labor’s rights were still closely circumscribed. The broader legal framework had evolved in bits and pieces over the twentieth century. The result was a patchwork of laws concerning collective bargaining, social security, minimum wages, and conflict resolution, but no coherent negotiating processes (Bollinger 1987, 1). The lack of a unified labor code, and the highly successful lobbying by groups such as the National Industrial Society on behalf of management, meant that the law could be easily twisted to favor the employer.21 The labor movement was further hampered by its fragmented union structure. The law separated locals, working conditions, and social benefits for the white-collar workers (bank employees, public school teachers, commercial and industrial employees) and the blue-collar contingent (mine workers, petroleum workers, and coastal plantation workers), leaving each group with a narrowly defined set of goals (Astiz 1969, 205).

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21. The Belaúnde administration did attempt to put forth a unified labor code in the mid-1960s, the final product containing over seven hundred articles. The legislation quickly stalled over differences between organized labor and the trade associations representing management (Bollinger 1987, 1).
Organized labor, nevertheless, did throw its weight around in the 1960s. Labor struck 820 times during Belaúnde’s first two years alone, compared to 1,200 strikes during the entire six-year Prado presidency (1956–62) that had preceded (Sulmont 1980, 212–13). Since the 1940s, government-labor relations had been marked by the granting of economic concessions along with the simultaneous exercise of severe political repression against labor. But as the economic concessions became more difficult to uphold after a balance-of-payments crisis in 1958–59, the pattern of labor-government interaction became more erratic. The Belaúnde administration fluctuated between brutal tactics against the CTP unions, as employed during the 1964 strike wave, and the granting of extraordinary concessions. The most famous example of the latter was the 100 percent increase awarded the public school teachers in 1964. Although labor strife was just one of many problems facing the Belaúnde government when it fell in 1968, surely the expansion of organized labor in this context of highly conflicting interests and ineffectual mediation helped hasten the fall.

**Fiscal Crisis and the End of Civilian Rule**

Most accounts of the antecedents to Peru’s 1968 military coup focus on Belaúnde’s failure to effectively resolve the country’s long-standing dispute with the International Petroleum Company (IPC) over taxes and property rights and the destabilizing fiscal imbalances that had reached crisis proportions in 1967. Each explanation was a symptom of two larger interrelated economic trends that had set in during this period and that would prevail well into the 1990s. The first concerned the failure to maintain an adequate rhythm of exploration and investment in the primary-export sectors, mainly mining and petroleum. The second trend was the rapid transformation of the public economy from a small state sector with solid financial backing into a much larger government apparatus that lacked the necessary fiscal supports (Paredes and Pascó-Font 1987, 3). This section examines how these political-economic constraints converged to provoke a military takeover in 1968.

Structural rigidities had been building up in the primary-export sectors since the 1950s. Prior to this, Peru had been able to surmount the usual bottlenecks that have plagued primary-exporting economies because it had ample resources for switching to another crop or mineral when the need arose. By the mid–1960s, Peru’s export mix was diversified (sugar, coffee, cotton, silver, lead, zinc, fish meal, and copper), but the economy had become increasingly dependent on fish meal and copper as the big foreign-exchange earners (Kuczynski 1977, 5). Fish-meal production, which had begun to peak
during the Belaúnde years, would be depleted by ecological mismanagement within a decade. This left mining as the one remaining dynamic sector, and here the road forward had come to depend on the large-scale exploitation of low-grade copper deposits (Thorp and Bertram 1978, 255). Most of these deposits were held by a handful of large multinational firms that had traditionally made out extremely well in Peru in terms of tax breaks and profit repatriation.

The increasingly nationalistic mood aroused by the 1962 and 1963 presidential campaigns no longer looked favorably on these generous concessions to foreign capital in the primary-export sectors. As the Belaúnde government moved to increase profit taxes on the big mining companies, foreign investors adopted a wait-and-see stance toward any further commitments in Peru. The result was that the Southern Peru Copper Corporation had undertaken no new major projects since the completion of the Toquepala mine in the south in 1960. Although local mining investment had shown some dynamism in the 1950s, the larger economies of scale and capital requirements of this new project phase were prohibitive for domestic capitalists. Buoyant copper prices throughout this period helped obscure the fact that Peru had hit a serious roadblock in the only export sector with any potential for economic expansion. As foreign firms continued to hold back in the face of harder investment terms, it was the state mining bank that began stepping in to fill the investment gap (Thorp and Bertram 1978, 221).

The Peruvian government’s dispute with the IPC went back much further, although the repercussions for not resolving this conflict in the 1960s were felt more immediately. At question was the government’s claim on some US$600 million in back taxes and its challenging of the right of IPC, a wholly owned subsidiary of Standard Oil of New Jersey, to own the La Brea y Pariñas oil field in the north. While Peruvian law held that all subsoil mineral deposits were the property of the state, IPC retained the deed through a series of property transfers dating back a century. In fact, oil’s significance as an export had completely declined at this point, as no new deposits had been located and oil production mainly serviced the local market. But because of strong foreign control and the historically high profit margins, the oil industry had a bad image with the Peruvian public in the 1960s.22

The predicament for the president was that a successful agreement with IPC would depend on congressional approval. The opposition had pushed

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22. Similar to the pattern in mining, local investors had been squeezed out of the petroleum investment portfolio by this time due to the large economies of scale and high capital costs of project development in this sector. The only successful nonforeign participant by the 1960s was EPF, the state oil company (Thorp and Bertram 1978, 226).
hard to inflame the issue, and the APRA-UNO coalition was not anxious to hand Belaúnde a victory. As the dispute became swept up in petty political infighting and nationalistic rhetoric on the home front, all sides failed to grasp that the disbursement of Alliance for Progress funds to Peru ultimately hinged on the resolution of the IPC problem. From the standpoint of the U.S. State Department, Peru’s confrontation with the IPC represented a potential security threat on par with the Cuban uprising of the late 1950s (Levinson and de Onis 1970, 156). Looking back now, there is some consensus that the United States erred in never stating this stipulation more explicitly to the Belaúnde administration. In light of Peru’s strong historical reliance on U.S. aid, the oversight was a costly one for the AP-DC.

In the end, having received over US$200 million in loans from the United States and the multilateral agencies from 1950 to 1952 (Stallings 1987, 245), Peru’s total aid authorization under the Alliance for Progress from 1962 to 1968 was just US$74.5 million. The figure stands in stark contrast to the amounts of alliance aid allocated for neighboring states such as Chile and Colombia, which received around US$400 million and US$500 million respectively (Levinson and de Onis 1970, 155). Just one of the many ironies of the alliance was its inability to see past the domestic political gridlock surrounding the IPC case and come to the aid of a candidate like Belaúnde who had originally embodied the moderate modernization platform on which the alliance was founded.

The Industrial Promotion Law passed in 1959, which triggered a more determined push toward ISI, was both a response to these increasing export constraints and another manifestation of the nationalist trend. As the figures in table 7 show, manufacturing grew by nearly 8 percent a year from 1950 to 1965, and it accounted for over 20 percent of GDP by 1965. Compared to the growth of primary exports during this period, manufacturing was second only to fish meal. Yet Peru’s ISI drive had also succumbed rather quickly to all of the classic pitfalls associated with this development model (Hirschman 1968; Rossini and Paredes 1991, 227). While manufacturing output had increased sixfold, over half of this output was under foreign control. Manufacturing jobs did double over this time period, but employment generation certainly did not occur in proportion to the very rapid expansion underway in this sector.

Furthermore, the actual investment dynamic behind the high growth rates was a shallow one. As Fitzgerald (1979, 75) notes, about one-fourth of manufacturing output was related to the processing of primary products for local consumption and export. Such was the case with the processing of paper and chemicals from sugar by the WR Grace Company (Reid 1985, 35), as well as fish-meal processing and mineral concentration. Food, clothing, and the local
production of industrial inputs and consumer durables dominated the remainder of the manufacturing sector, which frequently amounted to assembly operations for foreign firms. The infant-industry argument had apparently been lost on policy makers in the 1960s, as the industrial law lavished incentives on all industries, old and new, domestic and foreign (Beaulne 1975).^{23}

With the foreign-investment boycott in mining and the aid cuts mentioned earlier, the state’s multiple giveaways to the manufacturing sector quickly took a toll on the fiscal balance, which had turned negative by 1964–65. The strains on the current and capital account were twofold. First, though laudable, the much greater commitments to education and health were not sustainable without garnering additional tax revenues. Public school teachers, for example, never saw half of the 100 percent wage increase they had won in 1964. Second, the ambitious public-works program had in some respects become an end in itself. The project portfolio addressed important needs in housing, irrigation, rural development, and road construction. But infrastructure investments were not well linked to the export sector or to the manufacturing drive.

As fiscal pressures mounted in 1966, the government had three not necessarily exclusive choices: cut public expenditures, raise taxes, or borrow. Because the legitimacy of the AP-DC platform rested so heavily on the development program, public-expenditure cuts were considered taboo. Although progressive tax reform had been one of Belaúnde’s main redistributive promises during the presidential campaign, the administration’s tax proposals met with a fierce uphill battle in congress from the very beginning. Peru’s fiscal structure in the 1960s included taxes on international trade, as well as a broad range of indirect taxes on sales, turnover, and value-added. The original AP-DC plan called for more direct taxes on wealth and property and a general overhaul of the tax structure in a more equitable direction.^{24} But the first tax measures to get through congress in late 1963 were mainly indirect taxes on sales, import duties, and fish-meal exports (Webb 1972, 22). After conceding on those revenues that were least visible in a political sense, the opposition then took an adamant position against further taxes.

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23. Exemptions granted to the foreign-dominated auto industry, where protectionist barriers jumped from 13 percent in 1963 to 214 percent in 1965, illustrate the extent to which the law went overboard in its attempt to appease private capital (Thorp and Bertram 1978, 266).

24. Data on the Peruvian tax system at this time varies widely according to source, as do the interpretations on tax incidence. Taylor (1967), who headed an Organization of American States (OAS)–IDB tax mission to Peru in the 1960s, argues unequivocally that the tax structure was regressive, while Webb (1972) argues that because of the dualistic nature of the economy, the pattern of incidence was more ambiguous but also more progressive than other authors have allowed.
The APRA-UNO’s tax veto was an extremely effective maneuver for undermining the AP-DC program. It was not until the severe fiscal crunch of 1967 that the opposition relented with more piecemeal levies on trade and some ad hoc corporate property taxes. Rather than risk their 1969 electoral ambitions with further tax hikes, the APRA-UNO congressional bloc delegated special legislative power to the executive for a period of sixty days in mid-1968. During the respite, the president’s team was able to push through a wide range of direct taxes, a gasoline tax, and a number of administrative reforms. Though they were mainly progressive in nature, Webb (1972, 27) notes the failure of the 1968 measures to fully compensate for the erosion of the tax burden on the top income groups that had occurred during the previous five years of policy stalemate.25

With current expenditures increasing at a rate of about 22 percent annually between 1960 and 1965, the long tax interim and the aid blockade forced the government onto private capital markets to finance its large capital budget. In 1965, the economic team secured US$40 million in loans from a small consortium of U.S. banks, which was renewed in the same amount in 1966 and 1967 (Stallings 1987, 266). The ease with which Belaúnde had been able to obtain external financing was offset by the short terms and high rates attached to these loans. Government borrowing, furthermore, went on in a fairly uncoordinated manner. On the disbursement side, the dilemma of debt control was exemplified by the pattern in project spending, where three-fourths of the loans went toward transportation and the bulk for one project, Belaúnde’s Carretera Marginal (or jungle highway). This resort to commercial financing meant that Peru emerged from the 1960s with the most highly privatized debt in the region. Private external loans accounted for 56 percent of all obligations, against a regional average of 49 percent (Devlin 1985, 62).

The need for debt refinancing was one of the highlights of the 1967–68 economic crisis. The entire mix of macroeconomic policies related to ISI had also taken a toll on the balance-of-payments. An overvalued exchange rate, which had been frozen since 1959, encouraged currency speculation, capital flight, and a flooding of imports. The neglect of agriculture over industry prompted an additional rise in food imports. The fiscal and trade deficits together brought a loss of confidence and a further drop in private investment. Finally, recession and inflation each worked their way simultaneously through the financial system. Another main irony of this period is that the core management team at the BCRP had been quite capable of prescribing the necessary macroeconomic adjustments all along. But it was not until

25. In 1969 indirect taxes, which are generally considered to be more regressive, accounted for about 60 percent of total revenues as opposed to 40 percent in 1950 (Taylor 1967).
1967–68, when the office of finance minister rotated seven times, that the bank team was admitted to the president’s inner policy circle (Kuczynski 1977, 283).

By tapping this talent, Belaúnde was finally able to bypass an intransigent political opposition and rectify some of these problems. By mid-1968, the government had finessed a difficult currency devaluation, and a debt-refinancing agreement had been negotiated with the foreign banks in conjunction with an IMF stabilization plan. Conciliatory talks had also gotten underway with the Southern Peru Copper and Anaconda Copper companies to begin developing the rich deposits at the Cuajone and Cerro Verde mines in the south. And, though belated, the necessary tax measures had finally been instituted more or less along the lines Belaúnde had promised during the electoral campaign. The remaining obstacles were the dispute with IPC and the president’s conviction that a mutually satisfactory resolution of the problem would open the door for the large amounts of multilateral and U.S. aid that other countries in the region had been receiving all along (Kuczynski 1977).

It was a hastily put together agreement with the IPC during the sixty-day period of rule by executive decree in mid-1968 that invoked the wrath of the opposition and the military and caused a major split within Belaúnde’s own coalition. An attempt earlier the same year to appease the military with the purchase of Mirage supersonic jets from France had backfired in the sense that it prompted the United States to rescind aid before it had actually been reinstated.26 Once the debt rescheduling came through in late September 1968, it became clear that the military had not been deterred at all. With the economic house in order for the first time since the early 1960s, the military took it upon itself in October 1968 to solve the country’s increasingly complex development problems. In the end, while Belaúnde made headway in implementing some of his shorter-term reformist goals, he was simply not able to reconcile his program with Peruvian-style democracy as it had evolved in the 1960s.

Although most Peruvian elites have subsequently held the military reformers who intervened accountable for the flaws related to state intervention in Peru, this analysis confirms that the problematic state-led dynamic identified in chapter 1 had already taken root before 1968.27 To review, that pattern had to do with an overreliance on external borrowing, which substituted for the tough macropolicy management necessary to garner domestic

resources; the increasing use of state firms as policy instruments, without laying the adequate administrative foundations; the fostering of an approach-avoidance relationship with private investors, who invariably benefited from external credit flows and the output from state firms but held back due to poor macro policy and administrative management; and a neglect of social policy in the effort to spur higher levels of capital accumulation.

Peru, in fact, had fallen somewhat neatly into the mold just described. State policy makers during the 1960s were able to postpone the necessary fiscal and monetary adjustments by resorting to foreign loans on private capital markets. With this cushion, private investors came to rely increasingly on direct state intervention in both manufacturing and the primary-export sectors. The latter, particularly mining and petroleum, saw a marked increase in the role played by public firms. Yet state development banks and public enterprises embarked on their mission with the most minimal effort at building up the managerial and policy-making capacities within these institutions. The decline of FDI and the mounting presence of an administratively weak state reinforced the ambivalence of domestic capitalists. Although quite receptive to the state’s protection and economic support in the 1960s, local capitalists had become increasingly reticent to put their own investments on the line.

Despite the Belaúnde administration’s greater emphasis on social welfare, and the new economic opportunities that the program attempted to deliver for underprivileged groups, Peru’s socioeconomic matrix consisted of the same inequitable structures that had divided Peruvians historically. The enormous gains in value-added per worker in the modern sectors were accompanied by a negligible rise in employment; conversely, while employment mushroomed in the urban informal sector, the net value-added contribution of this sector was paltry. At the heart of this scenario was the working population’s inadequate access to the levels of education and skills acquisition that would allow for greater social mobility. Despite an annual average growth rate of 11 percent in education expenditures through the 1950s and 1960s, by 1970, 47 percent of the Peruvian workforce had obtained less than three years of schooling (Sheahan 1999, 21).

These economic trends are both an indictment of the failures of the reformist effort under Belaúnde and a confirmation that social lines were still rigidly drawn, by class and by geographic location. That 80 percent of the population still active in the rural and urban informal sectors by 1970 represented a multiethnic majority largely divorced from official state benefits (Matos Mar 1984). The social, political, and economic marginalization of this group became a rallying cry for violent protest with a guerrilla-led insurgency.
in the sierra in 1965 (Reid 1985, 40). Although put down readily at the time by the military (Klarén 2000, 330), the outbursts held alarming implications for future patterns of violent popular protest in Peru.

Conclusion

The purpose of this chapter has been to set a baseline for analyzing economic strategy and institutional change from the standpoint of the Peruvian state sector once it began to take off in the early 1960s. In chapter 1, four institutional variables were identified as contributing most to effective state intervention in the developing areas: (1) political structures that insulate technocrats and economic decision makers from outside pressures and clientelistic exchange; (2) the consolidation of a few powerful economic and planning institutions that closely link decisional and operational authority in strategic policy areas, with institutional continuity and efficacy resting on a technically skilled civil service governed by merit procedures; (3) stable leadership with the support of a manageable coalition of dominant groups that can legitimize the policy changes they initiate; and (4) the organization of societal interests such that policy is mediated through peak organizations that are sanctioned by the state.

Using this framework as a broad reference point, it becomes clear that the Peruvian state of the 1960s, with its incipient institutional and bureaucratic structures, was poorly prepared to assume the more active stance it had been almost inadvertently assigned over the course of the decade. In fact, rather than a development tool, it seemed that Belaúnde used statism as a way to compensate for his problems in the legislature and at the executive level. Given the state’s inability to act constructively in its own right, the task of forging a more balanced and integrated pattern of economic development was more or less relegated to domestic politics. Here, too, statism backfired: although it was meant to unify an unruly political system, political parties and interest groups further splintered. In essence, the abundance of new political actors and parties that came onto the scene in the 1960s lacked any semblance of organizational cohesion by the end of that decade.

The one organizationally cohesive party, the APRA, set a zero-sum pace for party politics out of historical frustration and future presidential ambitions (Sanborn 1991; Graham 1992). The strategy was, in a sense, too effective. All of the various coalitions—the AP-DC, the internal party apparatus of the AP, and the APRA-UNO itself—had unraveled by mid-1968. Finally, Peru’s oldest alliance, that between foreign investors and domestic elites in the primary-export economy, had also been seriously weakened by the events
of the 1960s. With the decline of the traditional primary-exporter model and the more conscious effort to industrialize, these groups had begun to lose their grasp over local politics. In other countries in the region, some reconstituted combination of state, domestic, and foreign capital had stepped in at similar junctures to carry the industrial effort forward (Evans 1979; Gereffi and Evans 1981). This chapter has demonstrated the weaknesses of the first two potential actors and the counterproductive role of the third in the Peruvian case.

Not unlike their oligarchic predecessors, those factions of domestic capital most likely to participate in a more sophisticated industrial program preferred to do so with the backing of foreign investors. Although the composition of the latter was diversifying into the manufacturing sector, it had only been willing to back domestic capital under almost classically dependent terms (a high level of imported technology and inputs and low levels of local reinvestment). Politics, the economy, and society had reached an impasse, and given the very weakness of the Peruvian state, no one civilian group or combination of groups was able or willing to take the initiative to break through it (Cotler 1975). It was ostensibly with the goals of social unification and state consolidation that a reform-minded military intervened in 1968. What followed proved to be one of the more anomalous efforts at state building in the region, particularly given its military sponsorship. Ostensibly, the coup of 1968 launched Peru’s first explicit attempt at enhancing the capacity of the state to intervene more effectively in the economy along the lines discussed earlier.