Dependency Theory, Peruvian-Style

Peru may have arrived relatively late to a state-led strategy, but once the interventionist wheels had been set in motion there was no turning back, at least not at this point. Apart from the institutional weaknesses within the state and civil society that had overwhelmed policy makers in their efforts to apply the brakes on rampant public-sector expansion in 1967–68, other statist influences had been fermenting through the 1960s. At the international level was the continued ability of middle-income sovereign borrowers to access a seemingly endless supply of private bank loans. Hindsight shows that Euromarket lenders during this time, operating on the assumption that governments could not declare bankruptcy, were not at all selective in their choice of clients (Stallings 1987). Thus, despite the Belaúnde administration’s chaotic record of spend-and-borrow in the 1960s, and the vaguely anti-imperialist rhetoric of the military junta that took control in 1968, Peru was able to retain its commercial borrowing privileges and hence its profligate spending habits well into the 1980s.

At the regional level, the more radical tone of the Peruvian military was a reflection of larger intellectual debates that were now flourishing within the dependency school (Fitzgerald 1976; Evans 1979). As the phenomenon of “falling behind” was accentuated by the rising fortunes of once impoverished developing countries like those in East Asia (Balassa 1981; World Bank 1993a), academics and policy makers across Latin America were suddenly intent on more precisely isolating the causes of this delayed development. In the previous chapter, the analysis suggested that the obstacles to achieving higher levels of sustainable and more equitable growth in Peru were largely rooted in the domestic political economy. Particularly liable were the mismanagement of the country’s rich factors of endowment over time, the poor choices made with regard to the country’s integration into international markets, and a set of political and social relations that could most politely be described as stagnant. While this same diagnosis could be generalized to many Latin American countries at this time, the dependency school focused steadfastly on “systemic” explanations that placed most of the blame on the region’s position within the international economy.
No matter that the East Asian bloc had been subjected to the same set of external pressures, development debates in Peru and other parts of the region now focused on Latin America’s asymmetrical ties with the industrialized countries. In line with many of the neo-Marxist tenets that underpinned the dependency school, explanations for the region’s delayed development were now posed in the language of economic imperialism and capitalist exploitation. Class analysts still located the plight of socioeconomic backwardness in a given country’s structures of production, but the dependency school insisted that the perpetuation of backwardness on the periphery was a function of elite alliances between the owners of capital in the north and south. While the policy prescriptions varied considerably, they coincided in advocating even greater state intervention and economic oversight as a means of eradicating feudalistic class relations and enabling delayed developers in Latin America to reposition themselves internationally on much more favorable terms (Franko 1998, 52–53).

Thus, in Peru, international lending opportunities and a new development paradigm induced policy makers to persist all the more with a catch-up strategy based on higher levels of state intervention. However, the possibility of such a strategy emerging from the ranks of the Peruvian military had been unimaginable just a generation earlier. Once the staunch defenders of laissez-faire and avowed backers of the country’s oligarchic elite, the Peruvian military experienced a change of heart that was catalyzed by the teaching of courses sponsored by ECLAC on structuralist economics and through exposure to the main writings of the early dependency school in the training programs of the national war college (CAEM). Gradually, the top officers had come to see the country’s highly underdeveloped political and economic structures as the main threats to national security and as a result had begun to rethink their domestic and international political allegiances.

As the 1970s got underway, the more developmentalist market-friendly attitudes embodied in the Belaúnde administration gave way to a dependency-inspired strategy that quickly defined the state sector as the main engine of growth. The state itself became an intense object of scrutiny and debate (Quijano 1971), and although the evolving development strategy was a variation on the second-phase ISI policies witnessed much earlier in Brazil and Mexico, the Revolutionary Government of the Armed Forces (RGAF) prided itself in declaring the strategy “neither capitalist nor communist.” Yet, as the data and analysis presented in this chapter will show, the strategy was indeed capitalist. Given the serious shortcomings of this fascinating experiment in military reformism, I have adopted the term state capitalism here as a description of what was attempted under the RGAF, rather than any indication of a new dynamic role for the Peruvian state.
On this count, the heart of the RGAF’s problems lay in the transfer of the investment burden from the private to the public sector, without any improvement in the latter’s ability to finance this effort and with amazingly little initiative taken to gain access to the substantial private-sector profits that registered over this time period. Spurred partly by this failure to induce private-sector participation, an unexpectedly large portion of the state’s expansion also resulted from rescue operations and from actions frequently undertaken to achieve other goals (Saulniers 1988, 26–27). This chapter ascribes the conflicting policies and contradictory outcomes to two main problems. First, they strongly mirrored the highly conflictual nature of Peru’s social, political, and economic structures; and second, they were a realistic gauge of the country’s extremely weak position in world markets—hence the difficulty of steering a domestic course of development completely free from the exigencies of the international political economy.

This chapter elaborates on another lost opportunity at the time, which was the rapid expansion of the state sector without an equivalent extension of administrative capacities to support the state’s various new functions. As the analysis will show, the first phase of the regime did succeed in temporarily consolidating its own position within the state bureaucracy and its position vis-à-vis the country’s complicated constellation of class interests. But it fell short of any lasting effort to strengthen the capacity of the state to intervene more effectively in the economy. In the end, a main legacy of this period for Peru was the deepening of the difficult state-led dynamic identified in chapter 1: excessive external borrowing, reckless SOE expansion, heightened conflict between the state and domestic entrepreneurs, and the worsening of poverty and income distribution.

The analysis is broken down into five parts. The first section briefly elaborates on the political-economic backdrop that prompted the 1968 coup, but this time from the standpoint of the military. The second section looks at the RGAF’s state-building efforts and its attempt to use the state more explicitly as an instrument for development. The third section analyzes the policies set forth by the regime, paying careful attention to the state-investment program and resulting patterns of capital formation. The fourth section assesses the new entrepreneurial role of the state through the rise of SOEs and seeks to understand the administrative and institutional intricacies of this sector as one of the major themes of this period. The final section looks at the inability of the state to sponsor the necessary economic adjustments in the second half of the 1970s, when faced with mounting pressures from the external sector and the eruption of a number of internal contradictions intrinsic to the state capitalist experiment itself.
Enter the RGAF: Redefining the Parameters of National Security

The previous decade of divisive infighting within congress, the local press, and society at large distracted from the fact that the Peruvian military had been undergoing a quiet process of internal renewal during the 1960s. The first indication was the nature of the military’s 1962 intervention. The armed forces played its traditional role of acting against the APRA in the latter’s bid for the presidency. Yet the military’s subsequent support for Belaúnde’s reformist coalition broke with its historical pattern of arbitrating almost solely on behalf of the country’s oligarchic interests. Both traditional economic elites and foreign capital were regarded more warily by the Peruvian military of the late 1960s. The main reasons were the destabilizing standoff with investors in the extractive sectors and the winner-take-all attitudes of domestic and multinational participants who prospered greatly from state-sponsored ISI without contributing in kind to the development of local industry. The poverty-related guerrilla uprising of the mid-1960s had further reinforced the military’s perceptions that a sweeping socioeconomic reform effort had now become essential.

As the main civilian institutions were weakened by the chaotic events of the 1960s, the military, in contrast, stood out as a relatively well-developed and professional state organization. Within this setting a small cadre of enlightened officials, led by General Juan Velasco Alvarado, was able to forge the consensus around goals of development and distribution that had eluded political elites in the civilian sectors since the 1962 elections. After the civilians’ half-hearted attempts to launch a state-sponsored industrial strategy and to rectify the country’s many distributional inequities, the 1968 intervention marked the first time that these more heterodox development themes found firm institutional roots—both within the Velasco-led faction of the military and in some segments of the state bureaucracy.1

As the country’s first serious effort at political and economic transformation, the twelve-year reign of the RGAF has been referred to simultaneously in the literature as nationalist-populist and bureaucratic-authoritarian. The latter is an exaggeration, as modes of political control in Peru at this time did not compare with the more extreme forms of coercion that had begun to emerge in the Southern Cone (Foxley 1983; O’Donnell 1988). Part of the con-

1. Ironically, these more heterodox approaches had been advocated by the APRA in Haya de la Torre’s 1931 “Minimum Program” but never embraced as official government policy. Haya himself had long abandoned them in his unsuccessful attempts to capture the presidency (Reid 1985, 41).
fusion stemmed from the military’s own inability to articulate its position beyond the catchwords of “reformist” and “anti-imperialist.” Nevertheless, this era broke with the past in important ways, such as a widespread agrarian-reform program and new laws governing private investment (domestic and foreign), worker ownership, and job stability.

During its two separate administrative phases under General Velasco (1968–75) and General Francisco Morales Bermúdez (1975–80), the RGAF launched its multisectoral reforms with more than four thousand legal decrees. With all the reforms taken together, one of the most abrupt departures from the country’s liberal economic past was the intentional reorientation of the state sector from its previous ancillary position of facilitating private investment into the prime generator of economic growth (Wilson and Wise 1986, 93). Under the new state capitalist model, public ownership replaced private participation in key branches, and the state stepped up its role in organizing production in the modern sectors of the economy.

The public-investment program became a major tool for redirecting private-investment patterns so as to ameliorate the intensified disparities in income and wealth. The reforms centered on the attainment of national economic autonomy through a more integrated productive structure, according to sector and region, that would promote self-sustaining growth and a greater degree of efficiency in the use of human and natural resources. The decentralization of resources away from the more highly developed coast to the economically marginalized regions, a constant point of national contention, became an even more prominent theme under the RGAF (Salinas, Garzón, and Wise 1983).

This period, particularly the first phase under Velasco, also signified Peru’s first full-fledged attempt at constructing an insulated and autonomous policy-making apparatus within the state (Stepan 1978; Wise 1994). Given the baseline for the Peruvian state sector established in the previous chapter, the efforts of a strategically placed military cadre to act quickly in transforming the political economy led, not surprisingly, to immediate structural imbalances and to contradictory development outcomes. Most accounts of the “lost opportunities” during this period center on the failure to reconcile redistributive goals with the chosen model of capital accumulation (McClintock and Lowenthal 1983) and the regime’s ambiguous stance toward domestic and foreign capital. In the following section I elaborate on another lost opportunity, the RGAF’s failure to sus-

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2. The regime’s timeworn description of its strategy as “neither capitalist nor communist” had become almost a cliché by the late 1970s.
tain an ambitious program of institutional reform to complement and bolster the predominant role that the state had come to assume in the domestic economy.

**Building State Autonomy**

**A More Insulated Executive**

Having witnessed all the factions and infighting that had overwhelmed the president and paralyzed policy up until the 1968 coup, Velasco and his cohort moved quickly to restructure the channels of access to the executive. The political vacuum into which the junta had stepped, and the economic cushion provided by the stabilization measures of 1967–68, allowed these new military policy makers wide discretion. At least during this initial phase, the regime was able to superimpose on the executive the organizational coherence and discipline that it derived from its base in the military. Just as the armed forces traditionally insulated officials from most societal pressures, Velasco sought successfully, at first, to insulate the governing elite around the executive from these same interferences.

Under these unusual circumstances of executive freedom, the junta stylized its managerial approach into a pattern ranging from “most closed to most open” (Cleaves and Pease 1983, 224). At the closed end of the spectrum policy decisions were generated in a highly insulated advisory group known as the Council of Presidential Advisors (COAP), or generated by the ministries and passed on to the COAP, and then presented to the public as a fait accompli. In its more open policy-making mode, the regime had the COAP and the ministries collaborate with other state agencies or even submit a proposed measure to public debate. During the initial period of fostering rapid change, the regime succeeded in this vein by repressing any opposition that arose from various social and economic groups. It also proved quite savvy in coopting local intellectuals and civilian técnicos, but without letting these allies get too close to the center of state power.

The ultimate inability of government elites to realize their policy preferences under these conditions of high state autonomy can be partially attributed to the internal unraveling of the government coalition over strategic policy differences. Some members of the COAP were not entirely comfortable with the high levels of intervention and radical tone of the structural reforms and preferred to steer the economy back toward the more developmentalist course that had been attempted under Belaúnde in the 1960s. Others had become dubious of the interventions altogether and preferred to turn even
further back toward the market. Because of the utmost secrecy surrounding the junta, these nuances were not apparent until much later.3

Once internal disunity did set in within this elite working group, the regime faced a Peruvian polity that again placed more than the usual limits on state autonomy. A social network of state-dominated peak associations (to be discussed later) created by the military to gather support for its program later proved more effective for setting in motion the organized opposition to the regime (Sanborn 1991). As Alfred Stepan (1978, 302) has observed, autonomy can also “be a source of weakness because a state elite is not sustained by constituencies in civil society and therefore is almost exclusively dependent upon its own internal unity and coercive powers. The other side of the coin . . . is isolation and fragility.”

But in the regime’s loss of unity and support, some attention must also be given to the development of the capacity, outside of this insulated elite executive corps, to carry out its policy preferences. In other words, bureaucratic autonomy not only implies that officials who constitute the state have preferences that are more than the simple reflections of those expressed by powerful societal groups; in order to fully realize these preferences, autonomy also entails the cultivation of organizational cohesion, expertise, and extractive capabilities within strategic sectors of the state bureaucracy (Sikkink 1991; Geddes 1994; Knill 1999). During its installation phase, the regime went overboard on the former and did not go far enough to ensure the latter.

**Overhauling the State Bureaucracy**

One of the main steps taken toward modernizing the state was the structural reform of the central government ministries, including the creation of some new ministries after 1968 to manage the development program along closer sectoral lines. Holding the Ministry of Development and Public Works up as a symbol of graft and corruption under the civilians, the RGAF’s first move was to break this ministry up into the ministries of industry, housing, transport/communications, and energy and mines.4 In the process of redirecting the ministries and the budget and planning apparatus toward the management of specific economic sectors, the RGAF also acted to clip the wings of the Independent Public Subsector. Superfluous nonenterprise entities were dissolved, while those fulfilling functions still deemed economically worth-

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3. These comments were made by former president Francisco Morales Bermúdez in a speech given in Lima, April 1983.
while were brought under more direct ministerial control (Cleaves and Scurreh 1980, 71).

By the early 1970s the Peruvian bureaucracy was finally beginning to take the more coherent shape that other central governments in the region had assumed since the 1950s. Another aspect of this reshuffling was the emergence of new points of institutional influence. The BCRP, viewed as generally embodying the more orthodox “IMF approach” to economic management, became more peripheral to the policy process. The reorganized finance ministry had regained its composure from the internal upheaval of the late 1960s and, under the direction of Morales Bermúdez as finance minister, moved into center stage in the making of macroeconomic policy. The INP, having been nourished during the 1960s with substantial technical and training assistance from ECLAC, also ascended in the formulation and implementation of policy. The INP’s ECLAC-based critiques of Peru’s dualistic economic structures had found some favor in the finance ministry, and now the ECLAC line became the guidepost for economic policy making.

The INP brought the planning system to life in several important respects (Fitzgerald 1976, 80–84). For one, the INP had by now acquired a generally well-trained group of technocrats who embraced the more progressive side of the RGAF program concerning the necessity to reconcile economic growth with distributional equity. For this new dedicated corps of midlevel planners at INP (Hopkins 1967), the state sector was considered a socially worthwhile place to work in the early 1970s. Through its sectoral offices within the ministries and the executive branch, the INP came to play a pivotal role in drawing up development plans, prioritizing sectoral projects, and authorizing changes in sectoral investment plans (Klitgaard 1971). However, even though the INP’s resources increased substantially until the mid-1970s, it did not come to exert full control over state planning. Predictably, earlier antagonisms between the INP and the MEF again flared up, with the result that the INP never achieved the super-ministry status it sought (Cornejo 1985, 126–27).

Of all the institutions created at this time, the Corporación Financiera de Desarrollo (COFIDE) was set up with perhaps the most fanfare. Hoping to emulate the best features of such state holding companies as Mexico’s Nacional Financiera (NAFINSA) or Chile’s Corporación de Fomento de la Producción (CORFO), COFIDE was given the mandate of mobilizing and coordinating investment capital for the rapidly expanding state-enterprise

5. However, subsequent events do not bear out Fitzgerald’s (1976, 90) optimistic observation that “the national planning system in Peru appears to be the most effective in continental Latin America.”
sector. The directorship of COFIDE, assigned initially to a Harvard- and MIT-trained economist and civil engineer, represented one of the more highly qualified civilian appointments made during this period. Though it was certainly on the right track in attempting to establish Peru’s first super-entity to interface financially between the public and private sectors, the special confluence of easy external credit and a massive project portfolio overwhelmed the new agency in its attempts to properly assign and monitor the distribution of resources.

As for staffing and personnel practices within the public bureaucracy, the overriding difference from the past was the infiltration of military officers into the highest-level posts. Each of the ministries now fell under the administrative domain of one of the three branches of the armed services, and until 1975 all ministers were appointed by the president from the rank of general or admiral (Cleaves and Pease 1983, 222). Although the military presence in the bureaucracy never surpassed more than three hundred officers at any one time, these officers also prevailed over such key appointments as ministerial advisors, vice-ministers, agency heads, and directors of state enterprises.

In and of itself, this increased military influence did not bode poorly for the modernization of the state bureaucracy. For example, comparative studies of the Peruvian armed forces suggest that the Peruvian military’s emphasis on education and professional training in the post–World War Two period rendered it one of the most merit-oriented institutions within Peruvian society and the region at large (Enrique Obando 1998; Klarén 2000). However, in the process of simultaneously assuming the role of state bureaucrats, there was a lowering of merit-based standards. Even when these were upheld, the increasingly technical character of the development program did not always imply a good fit between an officer’s training and the managerial tasks at hand (Stepan 1978, 314).

Within the civilian ranks of the state bureaucracy, two changes were apparent. First was the sheer magnitude of the public-sector workforce by the late 1970s. As table 9 shows, public employment had nearly doubled over the decade (and quadrupled since 1961). Wage patterns in the table reflect the rise and decline of state employment as an economically appealing endeavor after the 1973 peak. Those working within the highest ranks saw a wage reduction of more than 50 percent by 1977, whereas the bulk of the workforce

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7. Because of considerable numerical discrepancies among sources on the Peruvian public-sector workforce, the figures cited in table 9 and throughout the text should be taken as rough estimates.
concentrated in the service sectors saw a 40 percent cut. This combination of rapid numerical expansion and deep wage erosion indicates the extent to which state employment had become a social safety net of sorts, particularly for those working at the bottom rungs.

While recruitment, hiring, and promotion practices at the middle and lower bureaucratic levels ostensibly adhered to Peru’s 1950 civil-service code, in practice the regime applied the code in the same ineffectual manner as its predecessor. Peter Cleaves and Martin Scurrah (1980, 77) provide one of the few firsthand accounts of the actual operating procedures that governed personnel expansion at these levels. Because this problem persisted as a major barrier to the building up of state capacity, they are worth quoting:

The rule covering almost all cases is that “recommendations” have preponderant influence. . . . [C]andidates secure positions via recommendations from persons outside the public sector who happen to know the

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*a1963–69.
*cRounding errors.
hirer. Previously, such influence came mainly from the legislative branch of government; after 1968, it grew out of personal contacts with military and civilian elites in upper-level posts. Here the influential party visits or telephones the vice-minister or agency head to inform him of the availability of a talented friend or relative. This step, which paves the way for employment, often precedes any direct contact between the interested party and the hiring agency.

The second change was the highly capable corps of technocrats who had been drawn into the top levels of public employment as a result of the state having assumed a more entrepreneurial role in the economy. A 1973 survey of over six thousand public managers and consultants cited by Lima’s Escuela de Administración de Negocios para Graduados (ESAN) estimates that around 75 percent of these managers had undertaken university and/or postgraduate studies, 35 percent had been working in the public sector for less than five years, and another 30 percent had been there between five and fifteen years. Cleaves and Scurrah (1980, 87) note that the increasing demand for these more specialized professionals even helped infuse a greater element of competition and merit into hiring practices at this level.

The presence of this group again raises the question of the inability of the government to more fully utilize existing talent. Some of the answers are already apparent from this brief analysis: the haste with which the development effort was launched, the lack of clarity in goals, and the built-in tensions of a strategy that merged military and civilian policy makers into a top-down relationship on the latter’s own bureaucratic turf. With congress suspended and political parties closely circumscribed during this time, the question of maximizing on these personnel resources is lent all the more significance by the fact that the state bureaucracy had become the main filter through which policy outcomes were shaped.

In line with some of the cases discussed in chapter 1, the cultivation of a greater degree of autonomy within the bureaucracy itself would have been an important first step in better harnessing this talent to the many new development tasks that had been set for the state. The Brazilian experience is instructive on this front. With Brazil faced with the unrealistic prospect of overhauling an entire public administration plagued by clientelism and inefficiency, studies of the Vargas (1930–45) and Kubitschek (1956–61) governments show that each was able to better implement its industrial-development program through civil-service reform and by creating insulated administrative...

8. Escuela de Administración de Negocios para Graduados (ESAN) 1985, 11, 16.
pockets within the state apparatus that were tied to specific strategic sectors of the economy (Nuñes and Geddes 1987; Sikkink 1991). Barbara Geddes (1994, 45–51) likens these insulated agencies to semipermeable membranes whereby information and resources flow through the agency, but like a cell, are able to maintain its organizational integrity.

During this early period in Brazil, segments of the bureaucracy were insulated across institutional boundaries (within the public enterprises, the state development banks, state economic agencies, and various executive-level policy councils), such that both patronage and efficiency criteria could prevail simultaneously within the same entity (Nuñes and Geddes 1987). Like Peru’s BCRP, some entities were completely governed by merit and competence, while organizational goals in others were preserved through these protected pockets of expertise. While insulation cannot guarantee that the correct mix of policies will be chosen, it can go a long way in securing a single-minded commitment to channeling scarce state resources to the tasks that have been designated.

The conditions that prevailed within the Peruvian techno-bureaucracy during the early 1970s were the most favorable yet for the cultivation of a more sophisticated and effective policy-making segment within the state apparatus. These were: the existence of a larger pool of administrative talent; a more established institutional framework than ever before (taking the BCRP, the INP, and the finance ministry as the bureaucratic core); a historically high level of cohesion in the office of the executive; and a tight rein on political participation. The lack of vision and leadership on this front was costly. As the central government organizational chart continued to expand, and the state-enterprise sector multiplied, so did the number of vying interests and conflicting policy goals. Cornejo (1985, 127) points to the emergence of “cells of competition,” versus pockets of competence, which characterized the expanding body of talented public-sector professionals in Peru.

Redefining the State Vis-à-Vis Civil Society

The RGAF’s approach to interest mediation during the early 1970s provides some of the most telling insights into the complexity of the program and the ambitiousness of the transformative goals. Rather than seek an explicit alliance with domestic capitalists, the Velasco administration sought to implement the state capitalist model by bringing both labor and capital together into carefully structured groups tied vertically to the state (Cotler 1975). In this quest to “overcome class struggle,” mass-based opposition movements were suppressed, as were groups such as the National Industrial
Society and the National Agrarian Society that still represented Peru’s dominant classes. Civil society was recast into a corporatist image, the idea being to eliminate detractors and win support for the massive capital-investment program that was getting underway.

These new corporatist lines were drawn in three realms. The first was within the state sector, for example, with the creation of the National System for the Support of Social Mobilization (SINAMOS) in 1971. SINAMOS was set up to organize the popular classes by functional groups (labor unions, youth clubs, professional associations, squatter settlements, etc.) and according to geographic area. The remaining reforms occurred in the private sector. First, the regime envisioned the enactment of a new social-property sector where workers would assume ownership of the firms in which they worked. Second, the regime promoted labor-community reforms in such sectors as industry, mining, and fishing that combined greater worker participation in the form of profit sharing and comanagement (Cotler 1975, 60).

Although during the Velasco period the RGAF had succeeded in attracting a contingent of technocrats and administrators that drew widely from the AP, the APRA, the DC, and even the Peruvian Communist Party (PCP), in the end this did not compensate for the regime’s total lack of a broad constituency when it assumed power. In spite of following through on a number of explicitly antioligarchic reforms, and the granting of generous industrial incentives and salary increases until the 1974 fiscal crunch, the regime faced perhaps its stiffest confrontation from those members of the working and middle classes who were the targeted beneficiaries of many of these measures. If anything, corporatist attempts to divide the opposition and quell any criticism of the government’s program fueled the intensity of political protest.

This opposition stemmed at least partially from the internal inconsistencies of the policies being implemented. Some segments of domestic capital, particularly in the auto, appliance, and fish-meal sectors, had welcomed the RGAF’s strong push for industrialization. In 1969, with the backing of a small clique of local manufacturers and financiers, Velasco was voted honorary president of the Second Congress for Industrialists (Bollinger 1987, 9). Recognizing the potential for coopting the labor movement in these sectors, some local capitalists initially endorsed the industrial communities as representing their own long-run interests. But as other crosscutting legal decrees began to proliferate from the executive, such as the 1970 Job Stability Law granting workers virtual job tenure, the enthusiasm of entrepreneurs rapidly diminished.

Having been readily handed numerous import privileges and investment incentives by the state since the late 1950s, private capitalists went into the 1970s with little experience in negotiating or protecting their interests under these more politically adversarial circumstances. This, plus the fiercely statist intentions of those within the more radical faction of the junta, worked against a more collaborative resolution of these differences with the regime. As private capitalists gradually realized that their strengths lay outside of the regime, they embarked on an effort to coordinate their opposition with other politically and economically disenchanted groups. The result was the emergence of a middle-sector bourgeois alliance by the mid-1970s that connected well with the more economically cautious faction within the military that seized power in 1975 (Cleaves and Pease 1983, 234–35; Durand 1994).

Nor did many of the RGAF measures meant to harmonize class relations hold water with the labor movement. It is here that the outcomes of RGAF policy making were perhaps the most paradoxical. RGAF strategies were geared toward cultivating a broad working-class constituency, reducing labor conflict, and thus facilitating the rapid industrialization effort. In this process, labor met with continued repression and blatant techniques of cooptation, but the RGAF also allotted organized labor a considerable degree of freedom. In its attempts to undermine the APRA’s foothold with labor, already weakened by the party’s economistic sell-out platform of the 1960s, the regime recognized the Communist-controlled General Confederation of Peruvian Workers (CGTP), chartered its own parallel union (Workers Confederation of the Peruvian Revolution), and tried to capitalize on the organizational weaknesses inherent in the Peruvian labor movement (Cotler 1975, 70).

The incorporation of the CGTP into this grand scheme to reorganize civil society along tightly controlled functional lines backfired. Most of the profit-sharing gains and wage benefits were realized in the narrow modern sector of the economy, and the proceeds did not dissuade workers from rebelling against the regime’s coercive organizational tactics. The industrial-labor communities, rather than providing a framework for mutual accommodation between labor and management, became outbacks of fierce struggle between workers and their employers (Haworth 1983, 103). The year 1975 was the benchmark for conflict between labor and capital in the economy at large. That year, nearly one-third of Peru’s wage earners went out on a total of 779 strikes, costing industry 20.3 million hours of lost labor time (Bollinger 1987, 13).

The increased repression, and the rejection by the popular sectors of the institutional alternatives handed down from the regime, set off an unprecedented flurry of organization outside the official state apparatus. This antigovernment grassroots organizing became apparent in the increased number of solidarity strikes, where whole communities supported striking
miners, teachers, and industrial workers (Sanborn 1991). These greater horizontal links between workers formed the cornerstone for the alliance of new popular parties that triggered the transition to democratic rule in the late 1970s. The result, then, of RGAF efforts to reorganize society into benign classless units was to enhance class-consciousness and conflict. Most important, through the entire array of participatory experiences inside and outside of the state, Peru’s poor and oppressed emerged from the 1970s better organized and more capable of defending their interests than ever before (Sanborn 1991).

Any semblance of state corporatist reorganization had largely disappeared by the end of the Velasco period. SINAMOS, lacking the ideological legitimacy of a political party or the participatory integrity of a civic organization not dominated by the military, was widely regarded as a failure by 1975. Similarly, other state-chartered groups had become defunct or were dissolved after the takeover by Morales Bermúdez. In his analysis of this period, Stepan (1978, 292–96) points to two more general explanations for the failure of the RGAF to better institutionalize its regime.10

The first has to do with the contradictions intrinsic to a model of governance based on an exceptionally high level of autonomy at the installation stage. Given the regime’s self-imposed limits against a Pinochet-style utilization of raw power to establish itself, it needed a more secure foothold in existing social formations and in the complex patron-client network that encircled the state bureaucracy. Without this, its functionally and territorially drawn units became hollow social structures. The second set of undermining factors was conjunctural and had to do with the rapid erosion of domestic and international resources and with this the political will of the state elite to push the development program forward. The following section examines these factors by focusing on the state-investment program and the interplay of domestic and international economic trends in determining the outcomes of state policy under the RGAF.

State Policy and Capital Formation

Beyond the general goals of achieving greater national economic integration and reducing Peru’s dependence on the world economy, the RGAF’s development aims were expressed at length in the 1971–75 National Development

10. According to Stepan (1978, 292), “Institutionalization implies that a regime has consolidated the new political patterns of succession, control, and participation; has managed to establish a viable pattern of economic accumulation; has forged extensive constituencies for its rule; and has created a significant degree of Gramscian ‘hegemonic acceptance’ in civil society.”
Plan. As the country’s first development manifesto, the plan critiqued Peru’s “disarticulated” social and economic structures and explicitly spelled out the new dimensions for state intervention in rectifying these problems. Reform was to begin with the state itself, in terms of further upgrading administrative and personnel practices. The new state-led course for the economy was then charted out sector by sector, according to growth targets, investment projects, and sources of development financing (Cornejo 1985, 60).

The themes that ran across sectors included an emphasis on faster economic growth and the generation of much higher levels of employment. Because of Peru’s obvious comparative advantage in mining and petroleum, these were given top priority, followed by industry, agriculture, and fishing. The idea was that, via “backward and forward linkages,” the proceeds from natural resource exploitation could be used to push manufacturing past the import-substitution phase and into heavy industry (Klitgaard 1971, 15). State majority ownership was called for in the key productive areas, with the expectation that more clear-cut investment and taxation laws would entice foreign capital to return in these sectors. Finally, the themes of social economic justice and regional decentralization were tied in with the sectoral surveys. The program, according to the plan, was to be financed through tax reforms, greater export profits, and a more cautious use of external financing than that witnessed in the 1960s.12

As can be seen in table 10, the state-led model was well underway by the early 1970s. In accordance with the plan, the state’s share of gross fixed investment (GFI) had jumped from 29.5 percent in 1968 to nearly 50 percent in 1975. As the table reveals, 1974 was a peak year, with the public share of GFI surpassing the private sector for the first time. In regional terms, these trends implied that Peru had joined step with its more developed neighbors in two ways. First, the state’s economic presence during the 1970s had nearly doubled, as had the percentage of GDP captured by the public enterprises. And second, as with the rest of Latin America, Peru’s state-enterprise share surpassed the central government by 1973. Because of its much larger size in the 1970s, and its significance in the public-policy process, Peru’s state-enterprise sector is dealt with separately in the following section.

It is important to note from the outset that, as in the 1960s, these dramatic increases in state intervention eventually went beyond the intentional shift in government-planning policy. Placing tighter controls on FDI in the extractive sectors did not lead, as the Velasco government had hoped, to a resurgence in private investment. A number of nationalizations and the worker profit-shar-

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<tbody>
<tr>
<td>Public investment</td>
<td>29.5</td>
<td>34.1</td>
<td>36.4</td>
<td>39.9</td>
<td>43.6</td>
<td>52.3</td>
<td>48.7</td>
<td>49.6</td>
<td>45.1</td>
<td>43.0</td>
<td>42.8</td>
<td>45.0</td>
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<tr>
<td>Central government</td>
<td>19.2</td>
<td>20.8</td>
<td>19.7</td>
<td>18.5</td>
<td>20.3</td>
<td>18.5</td>
<td>21.9</td>
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<td>Public enterprises</td>
<td>6.2</td>
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<td>13.1</td>
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<td>23.9</td>
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<td>31.6</td>
<td>24.7</td>
<td>21.8</td>
<td>17.9</td>
<td>19.4</td>
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<tr>
<td>Others</td>
<td>4.0</td>
<td>6.3</td>
<td>3.7</td>
<td>5.9</td>
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<td>1.4</td>
<td>1.1</td>
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<tr>
<td>Private investment</td>
<td>70.5</td>
<td>65.9</td>
<td>63.6</td>
<td>61.7</td>
<td>61.1</td>
<td>56.4</td>
<td>47.7</td>
<td>51.3</td>
<td>50.4</td>
<td>54.9</td>
<td>57.0</td>
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<tr>
<td>Total gross</td>
<td>100.0</td>
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*Rounding errors.*
ing measures added to an already uncertain investment climate, one that dis-
couraged foreign (especially U.S.) and local investors. As a percentage of
GDP, private investment fell from 10.7 percent in the 1965–68 period to 7.9
percent from 1969 to 1973 (Paredes and Pascó-Font 1987, 19). Given the
continued lack of dynamism in the private sector and Peru’s increased access
to international finance after 1972, by mid-decade public-sector ownership
had virtually replaced foreign and domestic capital in mining, oil, fishing,
electricity, most of the banking system, and the entire marketing of exports.
Peru’s reentry into foreign credit markets in the early 1970s was a function
of changes that had occurred on the international lending scene, as well as the
increased prospects for foreign exchange due to newly discovered oil reserves
in the jungle region. On the international side, Peru was able to circumvent a
multilateral-aid boycott related to unresolved nationalization disputes and
take advantage of the excess liquidity that had built up in the virtually unreg-
ulated Eurocurrency market. By this time, Euromarket loans had overtaken
FDI and official lending as the major source of development finance for all of
Latin America. The apparent freedom that came with Euromarket borrow-
ing, in terms of quick disbursements and few conditional strings concerning
the use of the loans or a country’s overall political-economic policy, dove-
tailed with RGAF goals of seeking autonomous solutions without foreign
interference.
Peru’s easy times of unmonitored borrowing fell between 1972 and 1974
(Devlin 1985, 75), with the 1974–75 balance-of-payments crisis throwing a
damper on bank eagerness to lend. During this easier borrowing phase,
approximately 80 percent of all credit was extended in the form of syndicated
Eurobank loans, with high interest margins and maturities of no more than
five years. The lion’s share of financing was captured by the public sector and
went toward debt refinancing (18 percent), defense (30 percent), and project
investments (50 percent). Given the ultimate destination of the Peruvian
debt, patterns of capital formation in public-investment projects held the key
to the outcomes of the development program. A complete evaluation of these
projects lies beyond the scope of this analysis.13 What follows is a look at
global investment patterns, by sector, project, and region, keeping in mind
the stated policy goals of the RGAF and these new opportunities offered up by
the international political economy at this time.

13. Detailed descriptions and operational analyses of some of the top public-investment proj-
ects undertaken during this time can be found in Hugo M. Obando 1977 and in the following case
studies from the Universidad del Pacífico’s “Gestión Pública” research project: Cruz Saco 1985;
Manuel Romero 1984; and Gustavo Romero 1985. For some interesting insights on the role and
importance of investment projects in the development process, see Hirschman 1967.
State Investment and Policy Outcomes

The RGAF’s bias toward reviving the lagging modern sector stands out in table 11, with the investment of over 50 percent of public funds into productive activities. Within the productive sector, the table reflects the emphasis placed on the major export earners—oil, mining, and large-scale agriculture. Industry, which was more an investment priority under Velasco, absorbed 15 percent of state investment from 1968 to 1975. In response to the overboard spending on roads and other economic infrastructure under Belaúnde, this sector assumed secondary importance. The correspondingly low investment in social infrastructure underlines the unavoidable conflict between distributional goals and the pressing need to generate foreign exchange to spur industrial expansion. Health and education were almost entirely neglected, with urban housing construction consuming most public outlays in the social sector.

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<tr>
<th>TABLE 11. The RGAF and State Capital Formation: Sectoral Investment Percentages (based on 1973 constant soles)</th>
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<tr>
<td>Phase I 1968–75 (%)</td>
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<tr>
<td>Productive</td>
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<tr>
<td>Agriculture</td>
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<td>Industry</td>
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<td>Tourism</td>
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<td>Communications</td>
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<tr>
<td>Electricity</td>
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<tr>
<td>Subtotal</td>
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<tr>
<td>Social Infrastructure</td>
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<tr>
<td>Education</td>
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<tr>
<td>Health</td>
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<tr>
<td>Housing</td>
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<td>Subtotal</td>
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<td>Total</td>
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*\(^*\)Rounding errors.
The last column in table 11 indicates the extent to which large productive-sector projects dominated the state-investment program. The twelve big projects that swamped the country’s portfolio during this period displayed some of the following characteristics (Hugo M. Obando 1977; Portocarrero Maisch 1982): delayed start-up periods, due mainly to the state’s inexperience in negotiating and executing technical projects of such large undertaking; particularly long gestation periods, averaging nine years in most sectors and up to sixteen years with the major irrigation schemes in agriculture; and a high import content, which can be attributed to the heavy reliance on foreign financing.

Thus, within the productive sector, mining was dominated by just two projects—a zinc refinery and the Cerro Verde copper mine. Three jungle oil projects accounted for 75 percent of the state’s petroleum investments, with the TransAndean oil pipeline representing one of the largest commitments of the decade. Industrial expansion saw the construction of three new plants, in steel, cement, and newsprint paper, as well as the maintenance of a high level of imported inputs to feed local production. Finally, agriculture was dominated by four huge irrigation projects located mainly on the coast. The giant among these, the Majes Irrigation scheme located in the south, had become one of Latin America’s classic white elephants almost before construction had begun.14

The most obvious policy oversights in this period were the kinds of small or medium-sized projects that would be most likely to revive the internal market and synchronize with the maturity schedules of external creditors. On this last point, this period underlines the inefficacy of relying on high-interest finance that is short-term in comparison to the maturation period of most of the major projects. While it is true that certain major projects of national priority in the 1970s, such as the TransAndean oil pipeline and Cerro Verde, may have benefited differentially from the rapid flows of private credit, this cannot be said for the public-investment program as a whole (Devlin 1985, 193–200). In the event of minor disequilibrium in the mid-1970s, the more likely scenario was that of stop-and-go development, with projects literally

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14. Originally designed as a complex irrigation network to tunnel fresh water through the Andes to the arid coast, Majes was calculated to cost a total of US$144 million (“Estudio de pre-factibilidad sobre el aprovechamiento hidroeléctrico del Río Siguas—proyecto Majes,” Ministerio de Energía y Minas, Dirección General de Electricidad, vol. 1, 7–4, n.d.). Despite a number of studies, which concluded that the project was not cost-effective, the government tacked on two giant hydroelectric plants to the original plan. Begun in 1973, the project cost over US$650 million, as the five-nation management consortium—considered to be the largest to have coalesced around any one project in the entire region—continued to collect exorbitant fees and interest payments, even during idle construction time. See Lawrence Wippman, “Blending Five Cultures in One Big Project,” *International Management*, Sept. 1983, 29–34.
left standing until credits could be renegotiated. Under conditions of major disequilibrium, which characterized Peru in the 1976–78 period, the entire investment program ground to a halt, and some important national objectives were sacrificed.

The 1971–75 plan had envisioned a combination of large foreign-exchange-earning projects in mining and petroleum and other more moderate endeavors in industry and agriculture aimed at increasing the supply of domestic goods and employment (Hugo M. Obando 1977, 91). Recognizing that project investments represented the cutting edge of the development program, the planning apparatus had been fairly well mobilized to manage the project portfolio. The project-appraisal system moved according to a newly established flowchart, from ministry or state enterprise, to the appropriate sectoral-planning office of the INP, to the INP’s prefeasibility study list. The INP and COFIDE then collaborated in raising the necessary mix of domestic and foreign financing, respectively.

Fitzgerald (1976, 84–86) notes some weaknesses in the INP’s cost-benefit calculations and the lack of a formal budget system to properly rank the projects within the various sectors. But the main explanation for the questionable cost-effectiveness and highly aggregated patterns of capital formation has to do with the combination of easy foreign credit and minimal public accountability or debate over the content of the public-investment program. Portocarrero Maisch (1982, 449–50) describes the underlying political dynamic that quickly superseded these newly established planning mechanisms:

Such projects . . . are typically associated with the formation of powerful pressure groups interested in their implementation. Such groups typically comprise international financial sources, the consulting and contracting firms and their local associated groups, as well as their national and international suppliers. These pressure groups develop close links with the corresponding segment of the local bureaucracy. . . . [A]s a consequence, once a large project has reached the feasibility stage, it is almost impossible to avoid its implementation. . . . [T]hrough its capability to select the projects to be supported, international finance, therefore, constitutes an important filter that determines, to a great extent, the resulting pattern of public investment.

This dynamic surrounding external financing and patterns of public-sector capital formation also worked against the regime’s expressed goals of geographically decentralizing state resources. The failures on this front come through in the sum the sierra and jungle regions together captured: less than
25 percent of all public investment during the 1970s. The heavy concentration of productive and social investments on the coast reflects the main dilemma of the RGAF’s “unbalanced growth strategy,” at least as it was applied here. While the wave of modern-sector industrial reforms sponsored under Velasco was expected to quicken the absorption of the traditional sector into the national economy, instead these groups were put permanently on hold.

Because the Velasco period and the 1971–75 plan represent the height of the thrust to transform the political economy, it would be useful to briefly review the general policy outcomes. In terms of global growth targets this first phase more or less achieved the projected goal (7.5 percent), as growth of GDP averaged 6.2 percent until 1974. But the growth projections across sectors were down. In petroleum, for example, growth expectations were wildly overcalculated (by as much as 800 percent); they were moderately so for copper, sugar, and cotton. Revenue projections from fish meal were also way off, as the fish-meal industry had run up against its ecological limits for the time being. It was the rapid expansion of the domestically oriented industrial sector that accounted for most of the high growth, and this was largely a result of Peru’s leadership and participation in the six-member Andean Common Market (Ancom).

Created in 1969 and headquartered in Lima, Ancom liberalized trade among its members and established common external tariffs, joint industrial planning, and common treatment of foreign capital (Rudolph 1992, 57; Edwards 1993). Although Peru saw some expansion of nontraditional exports within the context of Ancom, accounting for 10 percent of all exports in 1974, industrial performance overall was at best mediocre. At the base of the “new” model was the continuing dependence on foreign investment to help finance imported inputs and capital goods (Conaghan and Malloy 1994, 59). In the end, with its generous tax credits and investment subsidies, the RGAF government was supporting the development of the same capital-intensive assembly industries with imported technologies, patents, and brands, and in the same indiscriminate manner as the preceding Belaúnde administration. Relocation incentives offered to those industries considered first priority for a decentralized industrialization strategy were not sufficient to reverse market trends (Wilson and Wise 1986, 101).

The RGAF’s agrarian policy was the most ambitious, as the 1971–75 plan envisioned the completion of full land reform by 1975. Land-reform measures were geared toward equalizing the skewed property-ownership structure that existed between the large modern coastal plantations and the traditional sierra farms, most of which were smaller than five hectares. On paper, the RGAF committed itself to promoting “cooperative production” and pro-
tecting those private small and medium-scale farmers who constituted about 50 percent of the economically active population. In practice, as with the industrial-community reforms, most of the redistribution took place between landowners and workers within the modern coastal agricultural sector (Webb 1975). Pricing policies that favored urban consumers over rural producers exacerbated the neglect and decapitalization of traditional agriculture. As in the 1960s, economic stagnation in the agricultural sector led to an increase in food imports and intensified migration to the cities.

The remainder of the story is more familiar yet and has to do with policy failures surrounding the financing of the development program. In view of the long downward trend in primary-export revenues, and the rapid rise of public expenditures on social subsidies, the current account and fiscal deficits were both close to 10 percent of GDP by 1975 (Sheahan 1987, 261). Although progressive tax reform had been a constantly repeated policy goal, Webb (1972, 28) assesses the measures taken as “a mixed batch of minor adjustments, with a probable net regressive effect on the pattern of incidence.”

The government, furthermore, had overshot its planned goal of borrowing around US$1.1 billion abroad to finance its development program (Klitgaard 1971, 16), as the total external debt reached US$6.2 billion over this time period (BCRP 1984). With inflation rising and a full-blown balance-of-payments crisis erupting in 1975, any further borrowing from the foreign banks would clearly require an agreement with the IMF.

Apart from the RGAF’s many internal policy inconsistencies and contradictory political tendencies, this analysis of heightened economic disequilibrium and underlying conjunctural causes also sheds more specific light on the precedents to the palace coup that took place in 1975. When all was said and done, the main changes that emerged during this period were the advances in agrarian reform and the expansion of state ownership of the productive sector. The main continuities with the past were the heavy reliance on a primary-export-led model, the failure to adequately mobilize local resources, and hence the deepening of the debt-led pattern of state expansion that had taken hold under Belaúnde. Peru’s active participation in Ancom had provided an important source of foreign exchange during the Velasco administration; by mid-decade Ancom had virtually stalled due to ideological differences surrounding Chile’s 1973 military coup.

15. The other main tax measures were a reduction in two of the more progressive indirect taxes previously initiated on gasoline, tariffs on car parts for local assembly; and the many profit exemptions and other tax holidays designated to woo private investors (Webb 1975, 29–30).
The New Entrepreneurial Role of the State

Because the creation of a large public-enterprise sector during this period went to the heart of the state capitalist model, the purpose here is to lay out the new political-economic role of the SOEs in conceptual terms, rather than attempt an in-depth survey of the entire sector. As table 10 shows, the SOE presence in capital formation had increased fivefold by 1975. As a result of this intensely compressed expansion, which normally occurred over four or five decades in other Latin American countries, the SOE contribution to GDP jumped from 1 percent in 1968 to nearly 20 percent in 1975. In terms of the absolute number of firms, the postcoup estimates seem to be no more certain than those for the pre-1968 baseline discussed in chapter 2. Skirting a gray definitional line between firms held “directly” or “indirectly” by the state, post-1968 estimates range from 135 SOE’s (Augusto Alvarez 1992, 124–25) to 140 (World Bank 1982, 1).

The state’s increasingly entrepreneurial role came about in three basic ways (Fitzgerald 1979, 192–95). First, some firms were taken over from foreign capital for largely ideological reasons. The first to go was IPC, immediately after the coup, which was merged with the existing state oil company (EPF) to form Petroperu. Other examples in this category include Centromin, the state mining company formed from the former Cerro de Pasco company, and Entelperu, a new state telephone company consolidated from the previous holdings of IT&T and a Swedish multinational operating in Peru (Sánchez 1984, 41–42).

Takeovers in the second category were less intentional, as this category included domestically owned firms that had fallen into economic straits. The most dramatic example was the state’s assumption of control over a number of the Prado family’s assets in the wake of the fish-meal-industry crisis. Included in this transfer was the Banco Popular, whose thirty-odd holdings brought such entities as a movie theater, a small newspaper, and a textile firm into state hands with virtually no public motive (Saulnier 1988, 25). Finally, some firms that were already present in the public portfolio in 1968 were expanded to form such companies as Mineroperu (refining and export of metals), Siderperu (steelworks), and Electroperu (electrical power).

The legal and administrative framework within which this expansion took place was ambiguous from the start. Peru’s 1933 constitution was silent on

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16. The best in-depth analyses of the public-enterprise sector during this period can be found in Saulnier 1988 and Augusto Alvarez 1992. Ortíz de Zevallos (1986) speaks freely as an insider who worked at the top administrative level within this sector.
the norms and operating procedures for public entities, and the 1936 civil code relegated their regulation to special legislation. While the RGAF did begin circulating a draft version of a public-enterprise law in 1971, a comprehensive code endowing SOEs with a coherent legal and administrative structure was never passed. Oddly, the 1971–75 plan, for all its emphasis on state intervention, devoted just a few lines to SOEs in a buried section on the central government organizational structure. President Velasco’s famous “Plan Inca,” published in all the major newspapers in mid-1974, addressed the dimensions of state entrepreneurship more directly. But again, these proclamations were mainly descriptions of what the state firms should do, with no concrete strategy set forth for how to structure these activities.17

The inability to negotiate and codify an established framework for the SOEs meant that the entire sector was governed by a patchwork of ad hoc, and frequently overlapping, administrative decrees. Though nationalized, some of the previously private firms continued to operate under private law (Ley de Sociedades Mercantiles) and enjoyed considerable operational autonomy in doing so. Other firms that had been created by the state fell under direct public jurisdiction. Different rules could even apply to workers within the same job in a given firm, and for the most part, the SOEs were stripped of authority concerning appointments, contracts, and wages (BCRP 1985a, 34–35). The relevant sectoral ministry generally ran these firms, with the result that the SOEs were subjected to extensive interference in their daily operations (World Bank 1982, 11).

In recognition that the lack of uniformity and the absence of clear operational directives had become a major bottleneck in carrying out the development program, the executive-level Council of Ministers set up a multisectoral commission in 1975 to study these problems. The commission, composed of top-ranking bureaucrats, made a number of recommendations that were never implemented. Among these were a reduction in the number of state firms, the centralization of all SOE activities in COFIDE, and the transfer of decision-making authority over crucial labor practices (recruitment, hiring, promotions, and wages) to SOE managers. The inertia surrounding the first commission led to the creation of a second one in 1976, this time with the specific mandate to increase SOE efficiency and to draft a long-overdue normative law.

Under the leadership of Petroperu’s general manager, this second commission brought together prominent representatives from both the public and private sectors. The commission reiterated the call for divesting public entities of no strategic importance and criticized the chaotic relationship

between the central government and the SOEs concerning subsidies and pricing policies (Saulniers 1988, 64). The commission also noted the destabilizing effects of ministerial interference in everyday management decisions and the constant turnover in membership on the SOEs’ boards of directors. The recommendation here was to leave state managers to their own devices and to halt the chronic and politically motivated changeovers in board members and personnel.

The 1976 commission made some important analytic points regarding the problems that plagued the SOE sector, and it helped stake out a valuable common ground for public and private managers to air their concerns. Yet its recommendations met with the same fate as those of the previous commission. Nearly a decade into the RGAF program, the crucial SOE sector was still governed by an intricate uncodified institutional network encompassing the central government ministries, various oversight committees, the INP, the MEF, and the Banco de la Nación (the national treasury). As different agencies carried different weight over specific issues and policy areas, the sector as a whole was characterized by fierce conflicts. In this respect, Peru’s SOE sector embodied the classic standoff, often mentioned in the literature on public enterprises, between managerial autonomy and excessive government control (Augusto Alvarez 1985; Vernon 1981; World Bank 1995).

Meanwhile, the SOEs had come to play a pivotal role in the economy. The two major changes from the pre-1968 SOE portfolio—which had generally been characterized by poor performance and low profits—were the large share of fixed capital expenditures now undertaken by the SOEs and the greater use of the SOEs by the central government in regulating prices on domestic goods and services. Paradoxically, although the SOE sector had greatly expanded, Paredes and Pascó-Font (1987, 26) note that other policy instruments concerning investment and pricing superseded the traditional tax and budgetary policies that usually accompany such expansions. These competing policy thrusts quickly brought to the fore a second main dilemma for countries choosing to rely heavily on SOEs as development tools: the inherent tension between the pursuit of a firm’s microeconomic investment goals and the macroeconomic and social objectives of the central government (Saulniers 1988).

In the peak period of capital formation and structural reform from 1968 to 1975, Peru’s SOE sector moved on a rapid collision course between these two policy imperatives. Social spending during this time centered mainly on state-financed subsidies for oil and foodstuffs. Although this policy of holding urban prices down on food and gasoline was not at all new to Peru, the percentage share of GDP (1.2 percent) consumed by state subsidies had reached new heights by 1974. Two firms, Petroperu and EPSA (a govern-
ment-merged company responsible for financing and administering all of Peru’s agricultural imports and exports), bore the mainstay of an SOE deficit that approached 20 percent of GDP by 1975. The more serious deficit burden that appears abruptly in 1974 reflects the RGAF’s determination to battle the Organization of Petroleum Exporting Countries (OPEC) oil-price hikes and their inflationary impact through subsidies and direct price controls (Paredes and Pascó-Font 1987, 27–28). Overall, these profligate price and subsidy policies represented an integral part of the RGAF’s attempts to win popular-sector groups into its political camp.

The SOEs’ microeconomic-investment mandate formed the linchpin of the strategy, reviewed earlier, designed to kick off heavy industry through the expansion of primary exports. On this count, the tone of the 1971–75 plan appeared to emulate the Brazilian model, where SOE-sponsored infrastructure and other investments have been successfully used to foster the growth of downstream private enterprises (Sánchez 1984, 36). There, the private sector has benefited greatly from SOE output, and until the 1982 debt crisis, SOEs had succeeded in generating a financial surplus for reinvestment (Trebat 1983, 236–42). However, for starters, the Brazilian SOE sector had accomplished this by allowing SOE managers a high degree of autonomy in daily operations and in medium- and long-term planning. Furthermore, Brazilian SOEs were not burdened with providing the kinds of deficit-inducing social subsidies witnessed in the Peruvian case.

Clearly, Peru’s pricing policies were such as to prevent the SOE sector from generating the savings necessary to finance the enormous investment program. The massive increases in fixed investment, plus the fact that social subsidies were not always adequately financed by central government transfers (Paredes and Pascó-Font 1987, 28), meant that the SOEs were able to pay for less than one-quarter of their capital outlays. Thus, Petroperu, Mineroperu, and Electroperu, the three big firms that accounted for the bulk of public investments (around 75 percent) in the 1970s, also took the lead in the resort to foreign borrowing (BCRP 1985b, 195). While much of the 1974–75 fiscal crisis culminated in these SOE imbalances, there is perhaps a tendency to place too much blame on the state firms. The problem was actually a two-way street between the SOEs and the central government, as the latter ordered firms to invest without handing over sufficient capital.

Nevertheless, the weaknesses of Peru’s SOE sector at this time cannot be overstated. The symbiotic managerial and financial relationship with the central government reduced most companies to the status of public institutions,

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18. Oil subsidies alone represented 55 percent of all state subsidies in 1974 (Paredes and Pascó-Font 1987, 28).
as opposed to freely operating productive enterprises. At the same time, the SOEs had become a main conduit for the inflow of foreign investment and loans and crucial links for implementing the RGAF’s ambitious development program. This disjuncture between the SOE sector’s critical importance in the transformation of the political economy and the insufficient effort made to properly nurture it along can probably only be chalked up to inexperience and naivete. Without a more coordinated approach, SOEs were able to provide neither a solid basis for private-sector expansion nor the sound entrepreneurial nucleus necessary for the regime to generate a self-sustaining pattern of accumulation.

The Failure to Adjust

As can be seen from the mounting debts and deficits that appear in table 12, economic adjustment had become inevitable by the time of the Morales Bermúdez takeover in 1975. From the foregoing analysis, the main problems can be summarized as follows: a drop in exports related to currency appreciation and ISI; sluggish progress on new mining projects and the inability to locate additional petroleum reserves; the decline in private investment, only partially offset by the grandiose public-investment program; the chaotic management situation within the SOEs; and, the resort to expensive foreign financing to paper over the mounting deficits in the current and fiscal accounts (Thorp and Bertram 1978; Sheahan 1999). Together, these deficits and mounting structural rigidities combined with the 1973–74 oil-price shocks to produce new rounds of inflation in Peru.

The political backdrop for adjustment was an increasingly divided leadership coalition, by now completely alienated from any pretense of popular-sector support and only backed by the country’s dominant groups to the extent that the second phase of the military regime symbolized an end to the statist excesses of the Velasco period. This was the context for Peru’s three-year saga of attempted economic stabilization from 1975 to 1978, first under direct supervision from its private creditors and then under an IMF agreement after 1977 (Devlin 1985; Stallings 1987). The IMF’s usual orthodox package of expenditure-reducing (cuts in subsidies, public-sector wages, and public investment) and expenditure-switching (currency devaluation, higher taxes) policies was used to tackle the growing macroeconomic imbalances. Yet, in spite of the various reductions in public expenditure and investment (see table 10), the government deficit remained at 10 percent of GDP through 1977.

Part of the explanation for the public sector’s failure to adjust lies in the
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<tbody>
<tr>
<td>GDPGRO</td>
<td>5.8</td>
<td>4.2</td>
<td>2.9</td>
<td>5.4</td>
<td>9.2</td>
<td>3.4</td>
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<td>0.4</td>
<td>0.3</td>
<td>5.8</td>
<td>3.1</td>
</tr>
<tr>
<td>GNPPCGRO</td>
<td>4.1</td>
<td>1.9</td>
<td>0.1</td>
<td>2.1</td>
<td>6.6</td>
<td>0.5</td>
<td>-1.8</td>
<td>-2.9</td>
<td>-4.1</td>
<td>1.5</td>
<td>2.0</td>
</tr>
<tr>
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<td>5.0</td>
<td>6.8</td>
<td>7.2</td>
<td>9.5</td>
<td>16.9</td>
<td>23.6</td>
<td>33.5</td>
<td>38.1</td>
<td>57.8</td>
<td>66.7</td>
<td>59.1</td>
</tr>
<tr>
<td>PRIVGDP</td>
<td>6.9</td>
<td>9.2</td>
<td>8.7</td>
<td>8.3</td>
<td>8.4</td>
<td>8.5</td>
<td>9.7</td>
<td>12.5</td>
<td>13.1</td>
<td>12.9</td>
<td>12.6</td>
</tr>
<tr>
<td>PUBIGDP</td>
<td>8.2</td>
<td>8.4</td>
<td>8.1</td>
<td>6.3</td>
<td>5.5</td>
<td>5.6</td>
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<td>13.1</td>
<td>12.9</td>
<td>12.6</td>
</tr>
<tr>
<td>INVEST</td>
<td>15.1</td>
<td>17.6</td>
<td>16.8</td>
<td>14.6</td>
<td>13.9</td>
<td>14.1</td>
<td>17.0</td>
<td>12.5</td>
<td>13.1</td>
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<td>RER</td>
<td>207.2</td>
<td>200.5</td>
<td>195.2</td>
<td>201.7</td>
<td>205.1</td>
<td>189.0</td>
<td>204.7</td>
<td>237.7</td>
<td>301.3</td>
<td>292.3</td>
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<td>TRADEBAL</td>
<td>335</td>
<td>159</td>
<td>132</td>
<td>15</td>
<td>-403</td>
<td>-1,099</td>
<td>-740</td>
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<td>CURACCT</td>
<td>202</td>
<td>-34</td>
<td>-31</td>
<td>-262</td>
<td>-725</td>
<td>-1,541</td>
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<td>-922</td>
<td>-193</td>
<td>730</td>
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<td>-58</td>
<td>24</td>
<td>70</td>
<td>58</td>
<td>316</td>
<td>170</td>
<td>54</td>
<td>25</td>
<td>71</td>
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<td>-2</td>
<td>-2</td>
<td>-2</td>
<td>-2</td>
<td>-2</td>
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<tr>
<td>DEBT</td>
<td>3,211</td>
<td>3,308</td>
<td>3,463</td>
<td>3,891</td>
<td>5,241</td>
<td>6,118</td>
<td>7,576</td>
<td>9,171</td>
<td>9,717</td>
<td>9,269</td>
<td>9,386</td>
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</table>


Note: GDPGRO = growth of real GDP; GNPPCGRO = growth of real per capita GNP; INF = Dec.–Dec. inflation; PRIVGDP = private investment as % of GDP; PUBIGDP = public investment as % of GDP; INVEST = total domestic investment as % of GDP; RER = real exchange rate (1990 = 100), calculated using period average exchange rate, U.S. WPI, and domestic CPI; TRADEBAL = trade balance (mil$) = merchandise exports – merchandise imports; CURACCT = current account (mil$); FDI = foreign direct investment (mil$); PORT = foreign portfolio investment (mil$); DEBT = total external debt (mil$).
stop-and-go nature of the policies’ application. The income-reducing mea-
ures had unleashed fierce conflicts over who would bear the brunt of the eco-
nomic downturn, which culminated in the highly successful national strike of
July 1977. Thus, the regime backed off on some of the austerity measures.
Domestic credit was expanded, and social subsidies were increased to over 5
percent of GDP that same year (Paredes and Pascó-Font 1987, 37). State
spending was also driven by the increasing amount of the budget devoted to
debt-service payments and the explosion of arms imports as defense spending
oscillated between 20 and 36 percent of total government expenditures

The thrust for a defense buildup at this time stemmed from the perceived
threat posed by Chile’s General Pinochet, who had begun a large-scale rear-
mament after staging the 1973 coup (Encinas del Pando 1983). Velasco had
initially asked the United States for help, but the Nixon administration
decided, complaining that settlements had yet to be reached on U.S. holdings
nationalized earlier. The Peruvian military then turned to Moscow, which
obliged it with more than half a billion dollars’ worth of materiel on quite
favorable terms.19 There is no doubt that it was military spending that added
to the severity of the 1975–78 crisis. Although the banks and the IMF both
threatened to withhold loans when they discovered “hidden” outlays on
defense in the budget, the end result was little more than a slap on the wrist.
By 1980, only three other underdeveloped countries, all of them in the Mid-
dle East, devoted a higher percentage of GDP and central government expen-
ditures to defense than did Peru.20

In line with the theme of this chapter, these failures to adjust must also be
seen in the broader sense of paths not taken to preserve any advances that
had been made toward strengthening the capacity of the state to intervene
more effectively in the economy. Here, the two most detrimental trends were
the erratic cuts in public-sector personnel and the thrust toward privatizing
the SOEs before the sector had been properly prepared for sale. Up until
1978, most of the current expenditure cuts had been achieved by simply
holding wages down and not granting increases on par with inflation (Pare-
des and Pascó-Font 1987, 36). As Peru fell out of compliance with the IMF
agreement that year and a full cutoff in external financing brought the crisis

the Subcommittee on Inter-American Affairs of the Committee on International Relations, 95th

Expenditures in Countries Receiving U.S. Aid: Priorities and the Competition for Resources,”
report submitted to the U.S. House of Representatives, Committee on Foreign Affairs, Dec. 1980,
79–85.
to a head, the wage reductions were followed by substantial layoffs in public-sector personnel.

The majority of these employees were let go during the 1978–79 crisis. In their study of these personnel cuts, Silvia Vallenas and Maria Emma Bolaños (1984) emphasize the propensity to lay off those employees in the highest job grades (I–III; see table 9), with longer civil-service tenures, and in those ministries that were most germane to implementing the development targets that had been set. Thus, of a total of around 20,300 layoffs in the public sector, 36 percent were concentrated in the top professional ranks of the ministries of economy and finance, agriculture, industry, energy and mines, education, and the INP (Vallenas and Bolaños 1984, 140). The cuts meant the shrinking of a considerable corps of talent and expertise that had gradually been cultivated over at least half a generation and the disabling of the state sector to manage the unruly 1980s-style crises that had already begun to surface in Peru.

The effect of the economic crisis on the SOE sector at this time was to speed up the calls for divestment and privatization that had surfaced earlier within the various multisectoral commissions. The policy debate post-1975 centered on improving the financial solvency of the SOEs, and a number of companies were proposed for sale. Yet no bidders came forth. The lack of enthusiasm was due partly to the recessionary atmosphere and to the poor financial terms being offered by the government. The divestment procedure also required the review of yet another commission, which was no doubt a deterrent to potential buyers (Ortíz de Zevallos 1986, 133).

The SOEs were pared down to some extent by the same kinds of personnel cuts that had been carried out in the central government. Although there is less information available about who was laid off in this sector, the SOE workforce was reduced by about 8 percent overall in 1978 (see table 9). Because of the more technical demands inherent in this sector, SOE professional staff were generally more highly paid and in scarce supply from 1968 on (BCRP 1985b, 97). Thus, the lost opportunities here probably had less to do with erratic personnel cuts at the top levels than with the revolving door for man-

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21. Of those top-level workers let go at this time, 22 percent had been holdovers from the first Belaúnde administration, 34 percent had entered public service during 1968–69, and 34 percent had been hired in 1972–73 during the heyday of the structural reforms under Velasco (Vallenas and Bolaños 1985, 140).

22. As an example of the kinds of divestment options coming forth at this time, Ortíz de Zevallos (1986, 133) describes one of the government’s stock-option plans: “The income generated by the sale of stocks held by a public enterprise was to be transferred to the Treasury and matched by a corresponding transfer to the company of ten-year government bonds paying only 10 percent interest with a two-year, no-interest grace period. With inflation running over 70 percent a year, this mechanism was very unattractive.” Also see “Peru to Hive Off State Companies,” Latin American Economic Report, Apr. 9, 1975, 1.
agers and directors that had been in effect all along for almost purely political reasons (World Bank 1982, 5).

With the arrival of a high-power civilian economic team under the leadership of Finance Minister Javier Silva Ruete in 1978, the rationalization of the SOE sector received “top priority” (Saulniers 1988, 67). The civilians submitted what amounted to the fifteenth draft of the normative law of public enterprises to the COAP, where it was once again buried. As policy statements became more concise about the need to reorganize and consolidate the SOEs, the implementation process became more inert. Meanwhile, the propensity toward privatization and the embracement of market-oriented reforms had begun to spread throughout the policy-making apparatus.

This period ended with an upswing in ideological attacks on statism and a general turning away from state-led strategies. The mood among political elites at the close of the RGAF era was one of going back to business as usual. In this sense, the central government ministries regained control of the capital-investment program, the INP’s political influence quickly waned, and the BCRP and MEF reasserted themselves institutionally in the policy-making process (Cornejo 1985). The military, discredited and anxious to cut its own losses, called for a Constituent Assembly to draw up a new constitution in 1978, to be followed by national elections in 1980. The way in which this convergence of political liberalization, orthodox stabilization, and the rapid turnaround in the external sector shaped the policy agenda in the 1980s is the subject of the next chapter.

**Conclusion**

Overall, this chapter has argued that Peruvian-style state capitalism, as a development strategy proper, fell short of generating the intended transformations in growth, savings, investment, and distribution. Furthermore, the strategy was hampered by the fact that those crucial bureaucratic, institutional, and administrative supports that would be mandatory for its effective implementation were being built up simultaneously with the launching of the program. Ultimately, although it is difficult in this case to separate out the choice of faulty policies from their weak implementation, it is clear that the

23. The 1975–78 National Development Plan (Instituto Nacional de Planificación, Plan nacional de desarrollo 1975–1978, Lima, junio 1975) defined the sectoral objectives and activities of the SOEs more explicitly, although the plan was never actualized as a result of the 1975 coup.

state’s poor political capacity converged negatively with the internal inconsistencies intrinsic to the strategy itself.

If we step back from the twelve-year experiment and examine this period in the light of trends within the state sector that had been set in motion during the 1960s, two longer-term conclusions can be drawn. First, in line with the interventions of the 1960s, the RGAF’s program further hastened the process of political and economic diversification in Peru. With the nationalizations, land reform, and various worker-promotion laws, the country’s oligarchic groups met their final demise. Although this had been one of the military’s most explicit objectives, much less headway had been made in strengthening Peru’s position vis-à-vis foreign investors. Other attempts to redraw class lines met with uneven success. The RGAF’s effort to cultivate a buoyant domestic bourgeoisie proved more elusive than ever, and the most dramatic effect of many of the industrial- and labor-community reforms was to bring workers and other popular-sector groups out into the open to an unprecedented extent.

Thus, entrepreneurs certainly emerged no stronger from the experience of the 1970s, and workers emerged much better organized and able to articulate their interests. But the terrain for mediation and consensus was still ill defined. By the end of the 1970s, political and economic elites found themselves united against the military and what was widely perceived as the “crowding-out” effect of state expansion, but not at all unified in the pursuit of a coherent alternative. And although organized labor approached a level of militancy and outward cohesion that had been virtually unthinkable in the 1960s, it was still plagued with internal divisions and sectarian splits from emergent new-left forces that had risen up during the turmoil of the post-1975 period (Haworth 1983, 112). Thus, for all its attempts to do so, the RGAF was not able to carve out an effective role for the state as a mediator of pivotal societal interests.

The second longer-term conclusion concerns the solidification in Peru of the problematic dynamic related to state-led development in Latin America that was identified in chapter 1. As in most of the other countries in the region, Peru’s strengthened ties to European and North American private capital markets in the 1970s enabled it to maintain domestic consumption while postponing key decisions concerning monetary, trade, and fiscal policy. In the process, the RGAF employed the state as a means of improving the country’s position in the international economy. Ultimately, the analysis showed that the Peruvian state was not able to use foreign loans to accomplish this goal; important sectors of the economy had been nationalized, but because of the ad hoc nature of many of the interventions, Peru found itself, ironically, in an even more adverse position with respect to global markets.
Other problematic aspects of state activity, including the heightened reliance on SOEs as major policy instruments, the state’s increasingly ambiguous relationship with domestic entrepreneurs, and the difficulty in coordinating long-overdue social policies with the development program, were also solidified at this time. Regarding the SOEs, after the massive interventions of the early 1970s, Shane Hunt (1975, 348) cautioned that Peru’s future economic success or failure would depend on the effectiveness of management practices “in every new sector with every state enterprise.” The links among the management failures in the SOEs, reckless Euromarket borrowing, and the drop in private investment are certainly not as cut and dried as subsequent administrations in Peru would have it. Yet it is safe to say that this period represents a critical juncture in the sense that the private sector, both domestic and foreign, had simply not rebounded to anywhere near the investment levels witnessed in Peru prior to the 1960s.

Finally, it would be difficult to overlook the distributional shortcomings of the military’s program, including the propensity of social subsidies to favor town over country and the near exclusion of the jungle and sierra regions from the capital-investment program. From the standpoint of the dualistic structures of the Peruvian economy discussed earlier, the cumulative effects of the RGAF’s many reforms are also disheartening. The informal sector still constituted 75 percent of all workers, while its value-added contribution to GDP had dropped below 40 percent; modern-sector employment was up slightly to 25 percent, while that sector’s share of value-added had risen to 64 percent. While vigorous human-capital investments would have been one of the most powerful tools for countering these adverse distributional trends, these were sharply curtailed after 1975. It was the persistence of almost ancient forms of poverty, and the new avenues of participation inadvertently offered up by the military regime, that set the stage for the continued political and economic volatility that would haunt coastal bureaucrats through the 1980s.