In Search of a Competitive Strategy

The Argument Revisited

In this book I have analyzed patterns of economic strategy and institutional change in post–World War Two Latin America from the standpoint of the changing role that the state has played in shaping development outcomes. Three main phases of state intervention were examined: (1) the developmentalist phase that prevailed from the early postwar years up until the 1982 debt shocks, an era in which protectionism and government regulation flourished; (2) the period following the 1982 debt crisis, during which chronic financial insolvency and fiscal retrenchment prompted a retreat from statist strategies over the course of the 1980s; and (3) the revival of the state’s economic presence in the 1990s, but in a more arms-length manner, as opposed to the direct modes of participation that had prevailed up through the 1980s. On the basis of this historical analysis I argued that, as much as Latin America’s economic doldrums of the 1980s reflected a deep crisis of the state, it was the reform of state institutions that provided the springboard for economic recovery in the 1990s. A main task here has been to specify the ways in which the region has turned this corner, from an all-encompassing statist model to one in which the state has assumed a more market-supporting role in the economy.

On this point, the dramatic external shocks of the early 1980s marked a critical juncture in at least two respects. First, the magnitude and longevity of the crisis forced a rethinking—within the multilateral organizations and the academic community and on the part of Latin American policy makers themselves—about the role of the state in the development process. From the dire fiscal deficits and high levels of government-backed debt that appear in the database presented in chapter 1, there was little doubt that state-led development had gone completely astray by the 1980s. Yet, despite some visible progress at public-sector downsizing, the decade-long recession that ensued also confirmed that it was not enough simply to cut back the state. In fact, by the mid-1980s, Latin America’s overall levels of state participation as a percentage of GDP were much lower than those of the OECD bloc and roughly on par with the newly industrializing countries of East Asia (Amsden 1989; Wade 1990; Slemrod 1995). The latter region’s higher levels of growth, investment, and real wage gains, as well as its comparatively lower levels of inflation and
government debt (World Bank 1993a), suggested that quantitative indicators of public-sector activity revealed little about the remedial measures that would be required to restore growth and investment in Latin America.

At the outset of this study I tackled this question by identifying a cluster of state-related problems that had accumulated over the post–World War Two period in the region and that largely account for the severity and duration of the crisis that exploded in 1982. This pattern consisted of an increasing dependence on foreign loans to support the state’s endeavors, which until 1982 allowed for a lax approach to fiscal and monetary policy; a heavy reliance on SOEs to provide infrastructure support and manage the productive sectors of the economy, but with insufficient regard for developing the necessary technical and administrative capabilities to insure the state’s entrepreneurial success; the perpetuation of an ambiguous relationship with private investors, who benefited handsomely from the state’s debt-backed expansion pre-1982 but who also claimed to lack confidence due to the state’s weak administrative structures and the ad hoc nature of public policy making; and the continued neglect of social policies, as concerns about poverty reduction and income distribution consistently took a back seat to the periodic balance-of-payments crises that characterized the developmentalist era.

Through a comparative analysis of the reform record among five emerging-market countries in the region (Argentina, Brazil, Chile, Mexico, Peru) and a more in-depth examination of the Peruvian case, I argued that the resolution of this cluster of state-related problems had become a necessary condition for achieving economic stabilization in the wake of the debt crisis. Again, however, the track record also showed that the rationalization of the state sector was not an entirely sufficient condition for triggering a sustainable reactivation or anywhere near the levels of growth that would be necessary to revive regional economies. As the 1980s wore on, it gradually became evident that institutions, regulations, and the state’s overall organizational culture would also have to be reformed. Moreover, as the pillars of corporatism collapsed in the absence of the whole web of subsidies, benefits, and tax preferences that tied civil society to the state under ISI, institutional reform also came to mean a transformation in state-society relations. In short, political leaders, state officials, and the representatives of a wide range of societal interests were forced to mediate their respective concerns in a more transparent and consistent manner.

Thus, a second way in which the 1982 shocks constituted a critical juncture for Latin America was the extent to which the debt crisis underlined the importance of institutional reform as an equally necessary condition for spurring a full economic recovery. In this study I have treated institutions in the classic sense, as those formal and informal rules that shape the behavior
of individuals and organizations in civil society (Oliver Williamson 1985; North 1990; Burki and Perry 1998). At the same time, I have relied on a more concrete approach to institutional analysis that considers the coherence of the bureaucracy, the delegation of decisional and operational authority, and the kinds of instruments that policy makers have at their disposal (Ikenberry 1988; Sikkink 1991; Keefer 1995; Graham and Naím 1998). From the political-economy literature and the actual experiences of the five countries at hand, I constructed an analytical framework comprising four key variables that capture the kinds of institutional change that has occurred over the past two decades in Latin America. These include the creation of autonomous agencies within the public bureaucracy, the consolidation of state economic and planning institutions, the stability and character of the leadership coalition, and the nature of the state’s ties to organized interests in civil society.

As concerns for institutional reform took center stage in the early 1990s, these state and societal institutions emerged as intervening variables in a couple of ways. First, institutional renovation became the main conduit through which the countries considered here were able to address the cluster of state-led problems identified earlier. I attribute this to the considerable headway that has been made in modernizing institutions along all four of the variables just mentioned. Across the five countries, economic ministries and central banks were overhauled, and the latter have been granted more leeway in executing monetary policy without political interference (Corrales 2000b; Boylan 2001). Within state bureaucracies, autonomy has come to mean much more than simply insulating technical staff to pursue specific policy mandates; increasingly, this also refers to the creation of more output-oriented autonomous agencies that are responsible for the delivery of public services according to performance-based criteria (Bresser Pereira 1999, 6–8). Similarly, while never entirely free from clientelist pressures, executive leadership has assumed a more managerial and professional stance. For the most part, interest intermediation has also become more pragmatic, as representatives on both sides of the negotiating table—state and societal—have settled their differences in a more strategic and levelheaded manner.

Apart from addressing the numerous problems that had accumulated from the past, institutional reforms also emerged as intervening variables in the sense that they were essential for pushing forward an ambitious agenda of market reforms. But this involved much more than the implementation of the neoliberal prescriptions (e.g., liberalization, privatization, and deregulation) offered up by the Washington Consensus. Rather, reform of the state in the post-1982 period also involved the redefinition of what it is the state should actually be doing (Przeworski 1999), as well as the revival and con-
ncetration of the state’s presence in those areas that have traditionally been regarded as crucial for defending the public good. These include, for example, the regulation of natural monopolies; the protection of property rights; the correction of externalities; and the more careful targeting of investments in education, health, and various other endeavors that directly promote human-capital development. In essence, deep institutional reforms were instrumental for bringing the state back to life, both quantitatively and qualitatively, and for instilling an ethos of constructive state action in a region where the state had long been regarded as a predatory intruder.

Having said all this, it is important to keep these gains in perspective. While the turn-of-the-century prognosis on the capabilities of the Latin American state is certainly more favorable than it was a decade ago, the bar has also been gradually raised on definitions of state effectiveness. In the initial stage of reform post-1982, public policy was considered a success if it met the formidable need for macroeconomic stabilization. This task having been accomplished by the end of the 1980s, the benchmark for effective intervention shifted to the state’s ability to foster a sound economic recovery. As continued macroeconomic stability laid the groundwork for higher levels of growth and investment in the 1990s, measures of state effectiveness have come to focus increasingly on a number of unresolved microeconomic challenges in the areas of income distribution, efficiency, and competitiveness. In sum, although I have argued throughout this study that the Latin American state has largely reinvented itself over the past two decades, these lingering microeconomic weaknesses suggest that policy makers have been perhaps too literal in following neoliberal dictums for a minimalist state. The microeconomic data presented in table 18 confirm that rather than doing too much, the state still must do considerably more to rectify these microlevel problems.

The remainder of this chapter elaborates on these themes—first, by reviewing the more specific ways in which they have played out in the Peruvian case; and second, through a discussion of the kinds of direct and indirect policies that could enable state intervention to better supplement domestic markets. Again, the challenge now is not one of further minimalizing state intervention but rather of finding the proper interaction between state institutions and particular market situations. As Alice Amsden has observed from the East Asian setting, the lesson is to cultivate institutions “that use the impetus of the market but restrain its full impact. . . . [W]ithout institutional guidelines and vision, freer markets will only squelch the ability to compete, and at greater social cost.”

Peru in Retrospect

For a study of the dynamics and outcomes of state intervention in Latin America, the Peruvian case provides some rich insights. The five case-study chapters here were approached from the two perspectives mentioned earlier—focusing on the cluster of state-led problems that had crystallized in varying degrees across the region and on the kinds of institutional arrangements within the state and civil society that framed these trends. Having identified a general post–World War Two pattern in Latin America of state expansion based on external borrowing and weak institutional structures on the domestic front, the analysis drew out the ways in which Peru had con-

### TABLE 18. Macro versus Micro Performance in Five Countries: 1990–2000

<table>
<thead>
<tr>
<th></th>
<th>Argentina</th>
<th>Brazil</th>
<th>Chile</th>
<th>Mexico</th>
<th>Peru</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (growth) 1991–2000</td>
<td>4.7</td>
<td>2.7</td>
<td>6.6</td>
<td>3.5</td>
<td>4.7</td>
</tr>
<tr>
<td>GDI (gdi/gdp) 1990–98</td>
<td>17.7</td>
<td>20.8</td>
<td>25.3</td>
<td>22.9</td>
<td>21.3</td>
</tr>
<tr>
<td>EXGDP (exp/gdp) 1990–2000</td>
<td>9.2</td>
<td>8.8</td>
<td>30.0</td>
<td>22.9</td>
<td>13.6</td>
</tr>
<tr>
<td>INF 2000</td>
<td>–0.9</td>
<td>7.0</td>
<td>3.8</td>
<td>9.5</td>
<td>3.8</td>
</tr>
<tr>
<td>RW 1990–2000</td>
<td>0.0</td>
<td>0.4</td>
<td>3.7</td>
<td>0.8</td>
<td>0.9</td>
</tr>
<tr>
<td>EMP 1990–99</td>
<td>1.3</td>
<td>1.7</td>
<td>2.1</td>
<td>3.0</td>
<td>2.9</td>
</tr>
<tr>
<td>LPRO 1990–95</td>
<td>4.1</td>
<td>–0.1</td>
<td>3.3</td>
<td>–2.2</td>
<td>2.2</td>
</tr>
<tr>
<td>URUN 1990–2000</td>
<td>12.2</td>
<td>5.8</td>
<td>7.7</td>
<td>3.5</td>
<td>8.7</td>
</tr>
<tr>
<td>EDGAP 1994</td>
<td>1.9¹</td>
<td>4.7</td>
<td>1.5</td>
<td>3.1</td>
<td>2.6⁵</td>
</tr>
<tr>
<td>DIST: poorest 40% 1986</td>
<td>16.2</td>
<td>9.7</td>
<td>12.6</td>
<td>12.7⁶</td>
<td>14.1</td>
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<tr>
<td>DIST: poorest 40% 1990</td>
<td>14.9</td>
<td>9.6</td>
<td>13.4</td>
<td>11.7⁷</td>
<td></td>
</tr>
<tr>
<td>DIST: poorest 40% 1994</td>
<td>13.9</td>
<td>11.8</td>
<td>13.3</td>
<td>10.8⁸</td>
<td></td>
</tr>
<tr>
<td>DIST: richest 10% 1986</td>
<td>34.5</td>
<td>44.3</td>
<td>39.6</td>
<td>34.3⁹</td>
<td>35.4</td>
</tr>
<tr>
<td>DIST: richest 10% 1990</td>
<td>34.8</td>
<td>41.7</td>
<td>39.2</td>
<td>39.0⁹</td>
<td></td>
</tr>
<tr>
<td>DIST: richest 10% 1994</td>
<td>34.2</td>
<td>42.5</td>
<td>40.3</td>
<td>41.2</td>
<td>34.3</td>
</tr>
<tr>
<td>DIST: richest 10% 1998</td>
<td>35.8⁶</td>
<td>44.3⁶</td>
<td>39.1</td>
<td>42.8⁶</td>
<td>35.4⁶</td>
</tr>
</tbody>
</table>


**Note:** GDP = gross domestic product; GDI = gross domestic investment as % of GDP; EXGDP = ratio of exports of goods and services to GDP; INF = percent change in consumer prices over previous year; RW = real wages, average annual growth rate; EMP = employment, average annual growth rate; LPRO = labor productivity, average annual growth rate; URUN = urban employment, average annual rate; EDGAP = average years behind in school for ages 15–18; DIST = % of national income accruing to groups.

¹1996.
²1989.
³1984.
⁴1995.
⁵1997.
formed to this pattern. Peru’s similarities with the other four countries in table 18 had to do with the poor management of macroeconomic policy and other indirect interventions, a luxury largely afforded by the government’s easy access to foreign savings until 1983; the increasingly conflictual relationship between the state and the private sector; and the inability to effectively use state intervention to mitigate the country’s highly skewed patterns of income distribution.

The difference between Peru and the other four countries is related to the later start with which the country embarked on the state-led path, the intensity with which the state expanded once the catch-up effort had gotten underway, and the near absence of much of the necessary bureaucratic machinery to back up the state’s endeavors. The drawbacks of the Peruvian state-as-entrepreneur became acutely evident once the sources of external financing evaporated. On the one hand, a discussion of the subtext of the developmentalist era in Peru could easily be entitled “the limits to state action.” On the other hand, this study revealed the extent to which these limits were largely self-imposed. In taking a step back from the details of the case study, what stands out is the paucity of hard decisions that were made up through the heterodox meltdown of the late 1980s and the lack of any follow-through on those steps that had been taken to strengthen the Peruvian state as a viable actor in the development process. In other words, the story up to 1990 is largely one of opportunities lost and paths not taken.

On this count, several critical junctures come to mind concerning the formation of the Peruvian state sector—its financing and the administrative and institutional evolution of the state. Concerning the financing of the state sector, of note is the passivity with which domestic policy makers approached the problem of shoring up the state’s resources. The three main options for public revenue have traditionally been taxation, user fees, and borrowing. Since the early 1960s, when Peru’s state-sponsored industrial strategy first got underway, the country saw just one serious tax overhaul. This occurred at political gunpoint in 1968, when it became clear that the state’s severe fiscal crisis was a threat to the survival of civilian rule. Fiscal policy subsequently consisted of a long series of piecemeal indirect measures that, over time, gradually eroded what had started out as a comparatively diverse and progressive tax base in the 1950s.

Policy makers were more energetic about utilizing external debt to finance the state’s undertakings but not so when it came to ensuring that those funds be put to productive use. The track record on managing the debt was poor. Throughout the 1963–90 period, the external debt had been successfully renegotiated in 1967–68 and in 1971. The very difficult 1977–78 debt crisis was “solved” by the 1979 mineral price boom, and the 1982–83 crisis was not
fully dealt with until the finalization of Peru’s Brady debt-restructuring deal more than a decade later. While the formal unilateral moratorium on debt payments declared by García in 1985 represented a legitimate attempt to strengthen the country’s position vis-à-vis the international financial community, the prolongation of this policy and the failure to negotiate at all with foreign lenders ultimately placed the country in the weakest position possible. That is, a do-nothing stance on the debt front affected the flow of other crucial forms of development finance, like import financing, multilateral loans, and bilateral aid.

A good part of the case study was spent arguing that the passive policy stance stemmed largely from the country’s weak administrative and institutional apparatus. Yet there were some attempts to reverse this situation, including the design of strategic pockets within the state bureaucracy where a fairly educated policy-making segment had been cultivated at one time or another. The period during the early 1970s, for example, saw the first massive administrative overhaul of the state, the creation of some new development institutions, and the strengthening of others like the INP. In retrospect, this stands out as a valiant effort at upgrading and modernizing the state apparatus. Some institutions, such as the BCRP, had developed highly professional recruiting and entry standards by this time and had brought together a large pool of technical and intellectual talent. In other words, in some measured ways, the state had begun to come into its own during this period.

The problem was one of continuity and of the inability to gather any lasting momentum in the direction of state reform. For the most part, and in contrast to Brazil, Chile, and Mexico, political and economic elites in Peru had not shown any sustained interest in building up the capacities of the state. The only other serious set of administrative changes, undertaken in 1978, went in the opposite direction. It took well into the 1990s for the central government to regain its footing from the massive layoffs of top public-sector personnel that took place at that time. Apart from a basic disregard for the importance of the inner workings of the state, elite executive policy makers shared a longstanding distrust of state agencies. The tendency had been to circumvent the considerable talent that had been gathered within major state institutions like the MEF and the BCRP and to rely heavily on patronage and the meager expertise of those who came up through the ranks of the political parties. Both the second Belaúnde administration and the García administration refined this practice to an art.

This brings us to the current period, analyzed in chapter 6, where hyperinflation and a full-blown civil war erupted against the backdrop of Peru’s international financial isolation and its failure to stick to any stabilization plan at all. By 1990, the traditional political parties had collapsed, as had
state finances, and large segments of the hinterland were governed de facto by guerrilla bands and drug traffickers (Webb 1991, 4). Longstanding entities like the BCRP and the MEF, overrun by domestic politics, had bungled monetary and fiscal policy so badly that both had lost all credibility. The 1990 dark-horse presidential victory of a little-known and inexperienced politician like Alberto Fujimori did not appear at the time to be a recipe for success. Yet hindsight shows that the crisis—surely the worst the country had faced in more than a century—had a paradoxical outcome. The demise of the ancien régime, and the loss of control over domestic politics and the state’s resources by an entrenched criollo elite, paved the way for new actors who brought with them new approaches to the country’s enormous backlog of problems.

The Fujimori administration has been rightfully criticized for relying too rigidly on the neoliberal mandates of the Washington Consensus (Kay 1997; Gonzáles 1998) and on an authoritarian political style to achieve its programmatic goals (Mauceri 1996; Maxwell Cameron 1997). But despite these negatives, Peru’s economic turnaround in the 1990s has been such that it now ranks with the emerging-market countries in table 18, as opposed to the still-struggling Andean Community nations that remained the more appropriate point of comparison in 1990 (Vial and Sachs 2000). Rather than dismiss these economic gains out of hand because of their association with other less savory features of the reform effort, as some authors have, this study has instead sought to identify the sources of policy success. I attribute this success to a quiet process of state reconstruction and renovation that has underpinned the country’s market transformation. Not only does Peru’s macroeconomic performance in the 1990s reflect the biggest turnaround of any of the countries in table 18, but Peru is also the one case where the reform path was almost entirely state-centered through the decade.

In spite of the rhetoric of a minimalist state that prevailed under Fujimori (Boloña 1996), this study revealed an ongoing pattern of deep internal state reform that began at the outset of his administration (Ugarte 2000). Given that the renewal of blue-chip economic entities like the MEF and the BCRP was absolutely essential for purging the economy of hyperinflation and rebuilding international financial ties, both were restored to the super-agency status that they had historically occupied. Similarly, other mandatory tasks related to the modernization of state finances and the construction of a market-assuring regulatory framework required the creation or overhaul of an additional ring of state agencies. Under “normal” circumstances, the more common practice has been for executives to postpone the creation of autonomous public entities until the end of their terms, so as to avoid losing discretionary control over the policy process (Boylan 2000). In Peru of the early 1990s, with insurgencies proliferating and the military circling the pres-
idential palace, the executive’s time horizon was so uncertain that a slew of autonomous agencies was crafted at the start of Fujimori’s first term in order to quicken the pace of stabilization and adjustment.

Thus, the flip side of the 1988–90 hyperinflationary crisis was the emergence of a broad consensus that major reforms could no longer be postponed. In turn, the growing social demand for reform fostered strong incentives for institutional renovation, as the very survival of the first Fujimori administration hinged on the ability of the state to deliver on the basic services and economic necessities that had been promised. In relying so strongly on state-centered reforms, the Peruvian case confirms that there is more than one route to economic recovery. Peru’s experience does not, however, take away from those who have argued that the long-term success and sustainability of market reforms will also require that they be firmly grounded in cohesive political-party systems and coherent state-society relations (Haggard and Kaufman 1995; Mainwaring and Scully 1995; Bresser Pereira 1999). If anything, this last point is confirmed by the remarkable scandals that led to the unexpectedly quick unraveling of Peru’s ruling coalition and to the calling of new presidential elections just months after Fujimori’s contrived reelection to a third term in May 2000.

As Przeworski (1999, 16) reminds us, the task of state reform is “to equip the state with instruments for effective intervention and . . . to create incentives for public officials to act in the public interest. Some of these incentives can be generated by the internal organization of the government, but structure alone is not sufficient. If the government is to perform well, the bureaucracy must be controlled by elected politicians who, in turn, must be accountable to citizens.” In Peru, the heavy reliance on structure alone allowed for the longevity of an incumbent president who had clearly lost sight of the public interest after a decade in office. As the faltering of Peru’s civil-military alliance suddenly threatened the hard-fought victory of economic recovery, it became apparent that no amount of internal state reform could halt the damage to the credibility of the ruling coalition. At the very point when other state-centered reformers like Chile and Mexico faced this same dilemma, political elites effectively advanced the reform process by modernizing party systems and by more authentically incorporating citizen input into the reform agenda. While Fujimori’s inclination had been to move in the opposite direction, the president and his military cronies were again reminded—by international actors, foreign investors, other political leaders in the region, and Peruvians themselves—that there is simply no sympathy or support for modern-day caudillos in Latin America.

As the country quickly regrouped with the 2001 election of President Alejandro Toledo, in a contest subject to strong OAS monitoring and hence the
kinds of transparency and competitive rules that were completely lacking in the 2000 race, the next chapter in the evolution of the Peruvian political economy is already underway. Although too incipient to tackle at any length here, there is every indication that this next development phase will entail the revival of civil society and efforts to modernize state-society ties in ways that coincide with the reform trajectory of the other emerging-market countries considered here. A main purpose of this study has been to elaborate on how the Peruvian state, once an obstacle to such goals, has been reinvented to the extent that it is now capable of forging a productive partnership with civil society. The tasks of internal state reform are far from complete, but the state is no longer the missing actor in the formulation and implementation of sound development policies.

What tasks await the Toledo administration in terms of further promoting the reform of the Peruvian state? Given the inordinate role that the control of state resources and the manipulation of the country’s legal apparatus played in prolonging Fujimori’s incumbency, both problems require immediate attention. First, there is a need to install mechanisms that allow for greater oversight and accountability in the allocation of public expenditures and that reduce the considerable redundancy and overlap in state outlays, particularly in the social sectors. Equally important is the need to restore the rule of law—within congress, the courts, and the electoral system (García 2000; Mosquiera 2000). The capture and incarceration of Montesinos, and the disbanding of his sinister SIN in October 2000, represented important steps in this direction.  

In the medium term, there are three interrelated challenges that the next generation of policy makers must grapple with in order to maximize on the state’s potential for playing a constructive role in this transition.

First, the completion of internal state reform will require that the central government’s line ministries be subjected to the same organizational overhaul and professionalization of personnel that has characterized the reform of the autonomous agencies discussed in chapter 6 (Ugarte 2000, 406–12). This mandate is now underway with the passing of a new state-modernization law by the Peruvian congress in January 2002, to be backed up by a US$150 million loan from the IDB.  

Simultaneously, the autonomous agencies must be more firmly rooted in administrative law and integrated into the national budget, precautions that would render them a more permanent feature of the state regardless of who occupies congress or the executive office. Second, with Fujimori’s undue emphasis on short-term social spending to secure political support, the country still lacks the kinds of targeted investments in human

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capital that are crucial for reducing inequality and enabling Peruvian workers to find their niche in the market economy. On the human-capital front, this tendency for microeconomic dynamism to lag behind the macroeconomic gains that have been realized is portrayed in table 18. In Peru, a main bottleneck has been the neglect of those social ministries like education and health that are ostensibly the main venues for promoting human capital. In the absence of a major modernization effort within these ministries, any further reallocation of expenditures toward these social categories would likely be offset by internal disarray.4

Finally, although Peru now ranks highly on specific competitiveness indicators related to government spending and domestic investment (Vial and Sachs 2000), it still trails in the bottom third of a developing-country sample (N = 62) in crucial areas like infrastructure, technology, and the overall quality of management. Throughout the region these low rankings in matters related to efficiency and competitiveness have increasingly become the focus of public policy. When viewed against the intractable patterns of income inequality that have prevailed in the wake of sweeping economic reforms, countries like Chile and Mexico have come to treat these tenacious trends as concrete instances of market failure. As such, state policy has risen to the occasion in designing compensatory incentives to bolster markets where they have faltered. In the following section I elaborate further on this competitiveness gap with a focus on the data in table 18. I then review where Peru stands with regard to formulating a set of macro- and microeconomic strategies that could more forcefully address these competitive challenges.

In Search of a Competitive Strategy

While the reform strategies of most Latin American countries conform closely to the neoliberal prescriptions of the Washington Consensus, table 19 also reflects the diversity of those policies that have been pursued under the banner of market reform. The “standard” approach depicted in the table signifies the basically hands-off management style that prevailed in Chile up until the 1982 debt shocks, in Mexico until the 1994 peso crisis, in Argentina until the meltdown of the Convertibility Plan in late 2001 (Pastor and Wise

<table>
<thead>
<tr>
<th>Trade</th>
<th>Exchange Rates</th>
<th>Finance</th>
<th>Fiscal</th>
<th>Human Capital</th>
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<tr>
<td>Standard:</td>
<td>Competitive:</td>
<td>Standard:</td>
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<tr>
<td>Chile 1974–82</td>
<td>x</td>
<td>Until 1982</td>
<td>x</td>
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<tr>
<td>Chile 1983– present</td>
<td>x</td>
<td>x</td>
<td>From 1983 on, pegged; 1999, float</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Mexico 1985–95</td>
<td>x</td>
<td>Until 1994</td>
<td>From 1995 on, float</td>
<td>x</td>
<td>x</td>
</tr>
<tr>
<td>Brazil 1990–present</td>
<td>x</td>
<td>Partial</td>
<td>Until 01/99 on, float</td>
<td>Partial</td>
<td>x</td>
</tr>
<tr>
<td>Argentina 1989–present</td>
<td>x</td>
<td>Special trade regime for autos and sugar</td>
<td>1991–2001</td>
<td>From 01/02 on, float</td>
<td>x</td>
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<tr>
<td>Peru 1990–present</td>
<td>x</td>
<td>“Dirty float”</td>
<td>x</td>
<td>x</td>
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</table>
2001), and that characterized Peru’s policy framework until Fujimori’s resignation. Under the standard or minimal approach, policy makers have purposefully assigned the task of economic development to comparative advantage while leaving microeconomic adjustment to market forces. The “competitive” strategy characterizes the more hands-on, market-supporting approach that Chilean policy makers adopted in the mid-1980s, that Mexico embraced in 1996, and that Brazil has applied sporadically since the onset of market reforms in the 1990s. First, the competitive strategy recognizes a more active role for public policy in the face of adjustment stress or outright market failure; second, it actively embraces an export-led development model. In doing so, the competitive approach combines sound macroeconomic management with strategic institutional interventions and human-capital upgrading.

What accounts for the policy shifts that appear in table 19, whereby countries such as Chile and Mexico have been compelled to adopt a more proactive stance with regard to trade, monetary, fiscal, and social policy? Given the complexity of each case there are no simple answers to this question. However, a shorthand explanation would have to take into account the timing and magnitude of international shocks, as well as the interplay between external pressures and the different domestic institutional configurations discussed throughout this book. The political-economic forces that propelled Chile’s policy shift are perhaps most relevant to Peru, because both are small, open, resource-based economies and because Peruvian economic policy makers expressed an affinity for the Chilean model (or at least their interpretation of it) at the outset of Fujimori’s first term (Agenda 2000, 1991). The Toledo administration, moreover, has revived this notion of emulating the best of the Chilean experience.

In the case of Chile, it was the hyperinflationary shocks of the early 1970s that triggered a military coup and hence a first wave of standard market reforms. When a second crisis of equal magnitude hit less than a decade later, this served as the catalyst for switching to a more hands-on approach to economic adjustment. Although the first wave of market restructuring had set the stage for a relatively quick turnaround in the 1980s, the policy reforms implemented in the mid-1980s helped to bolster this economic recovery while also correcting for past errors—all within the parameters of the market model. In brief, Chile’s impressive turnaround since the mid-1980s has been

5. I borrow these “standard” and “competitive” categories from John Sheahan (1997, 9–11).
based on a combination of internal state reform and the modernization of government-business relations. Together, these served as the springboard for a major macroeconomic overhaul and for the formulation of a microeconomic strategy proper (Bosworth, Dornbusch, and Labán 1994; Meller 1997; Schmidt-Hebbel 1999).

At the level of economic institutions, the most important changes concerned the professionalization of the state’s regulatory activities and management practices; the consolidation of changes in tariff policy and budgeting procedures that helped limit the impact of special-interest lobbies; and the creation of an autonomous central bank (Velasco 1994; Boylan 2001). Against the backdrop of these institutional reforms, key macroeconomic adjustments were made—for example, in the shift from a fixed to a flexible exchange-rate regime, in the lowering of interest rates, and in the placing of new restrictions on short-term capital inflows (Sheahan 1997; Edwards and Lederman 1998). At the same time, policy makers declared an explicit commitment to a trade-led development strategy geared toward the promotion of nontraditional products that offered higher value-added returns to the economy (Meller 1997; Pastor and Wise 1999a), as it had long been recognized that this was the quickest way to boost a country’s competitive position in world markets and to foster more dynamic patterns of job creation and wage gains (Edwards 1995; Sheahan 1999).

It was also during this period that a more clearly defined microeconomic strategy began to materialize, as the severe crisis context post-1982 opened up new avenues for broader private-sector input into the policy-making process. In fact, and in contrast to the 1970s, when the interests of the big conglomerates prevailed, government ministers actively sought the collaboration of wider segments of Chile’s well-organized business community (Eduardo Silva 1996; Schneider 1998). By the time of the transition to civilian rule in 1990 a competitive strategy had become clearly defined, largely as a result of the combination of state reform, institutional innovation, and more cohesive interaction between the government and business groups.

Chile’s microeconomic strategy included some of the following policies (Schurman 1996; Marcel 1999; Kurtz 2000): (1) well-designed incentives geared toward export promotion and diversification through the use of value-added tax exemptions, nontraditional-export subsidies, reduced-rate loan programs, marketing assistance, and a sharply devalued currency; (2) the investment of the state development corporation (CORFO) in research and human capital in the export sectors and the granting of special subsidies and credits to strengthen the market position of smaller producers of nontraditional (mainly industrial) exports; and (3) the maintenance of low labor
costs through the use of repressive labor practices (Eduardo Silva 1996)—a trend that subsequent civilian policy makers have worked hard to reverse.7 By the late 1980s the “distributional moment” had arrived in Chile in terms of the glaring gap between macroeconomic recovery and distributional stress (Boylan, forthcoming, 2003). The long-run viability of market reforms came to depend, first, on the reincorporation of civil society into a management model that could no longer sustain itself through the disproportionate reliance on state coercion; and second, on more vigorous efforts to follow up this competitive export-led model with targeted social investments in such areas as primary education and health care. As table 18 shows, although these social policies have yet to fully pay off on the distributional front, they have delivered solid returns to the real economy (Schmidt-Hebbel 1999). Moreover, while never entirely free of patronage, the dispersal of social resources in Chile is handled through decentralized institutions that have risen above the fray of Fujimori-style opportunism. Societal demands for social capital are ever present, but increasingly these demands have been mediated through political parties and organized interest representation in Chile.

Where does Peru stand in comparison with this more competitive Chilean-style strategy? While Peru has advanced light years in the overhaul of frontline autonomous state agencies and the modernization of government-business relations, policy makers have still not gone the extra mile in articulating a competitive development model that can sustain high growth and income gains over the long term. Peru’s tendency to stand by a hands-off management strategy based on traditional exports and comparative advantage can be attributed, first, to the ideological blinders worn by some within Fujimori’s economic team, regardless of the failure of markets alone to infuse more dynamism into the microeconomy.8 Moreover, an overly insulated leadership coalition, and the peculiar circumstances that led to the vetting of executive access by the military, have deterred debate about the proper role for public policy in facilitating innovation and microeconomic adjustment (Sagasti 1996).

7. Carlos Alvarez, Strategic Development Division head, CORFO, interview with the author, Santiago, July 8, 1996; Juan Morales, Director of Enterprise Development, Confederación Nacional de la Mediana y Pequeña Industria, Servicios, y Artesanado de Chile, interview with the author, Santiago, July 9, 1996.

8. In late 1998, when Peru was in the throes of adjusting to the Asian shocks and interest rates had skyrocketed, I asked a top policy official at the Ministry of Industry (MITINCI) in an off-the-record interview about the kinds of adjustment support available for smaller companies with burgeoning debt burdens. The response: “None . . . the private sector just doesn’t get it, this is a generation that still clamors for protectionism . . . [W]e are fully committed to relying on comparative advantage.” Back in 1995, MEF policy advisor Iván Rivera had used the same argument to justify the lack of a development plan during the first Fujimori administration: “When markets are free, there is no need for planning.” Iván Rivera, interview with the author, Lima, July 18, 1995.
Admittedly, the Peruvian economy went far in the 1990s under a purist market approach backed by deep institutional reform, and it did so despite an increasingly dysfunctional political backdrop. But to date, Peru’s economic turnaround falls short of the kind of takeoff or breakthrough that Chile has registered from 1986 on. Prior to the political crisis that finally brought Montesinos down, and the president with him, the prospect of another five years of Fujimori meant, at best, that the political economy would continue to hover at the same turnaround point that appears in table 18. This is because the reform gaps that still need to be filled in such areas as human-capital investment, restructuring and modernization of small and medium-sized firms, export promotion, and further overhaul of the state had succumbed to a political gridlock that was not likely to dissipate with the prolongation of the Fujimori presidency. Now, quite unexpectedly, a new cohort of political and economic actors has been given a chance to put aside the authoritarian baggage of the Fujimori era and to articulate a competitive strategy that reflects critical thinking about the country’s market failures, as well as the need for greater political accountability in initiating changes.

While Peru’s takeoff is far from certain, the reform inroads that were made on multiple fronts over the past decade mean that the country is now better positioned than ever to break through those growth, trade, and investment barriers that define Chile’s breakthrough as shown in tables 18 and 19. But this will entail the shift to a competitive strategy, which now seems as much a matter of decision makers’ vision and fortitude as it does the particular policies and expertise that are brought to bear on such a project. In the post-Fujimori era domestic-policy debates have centered on these very questions, and a rich base of local social-science research has emerged to inform public discourse concerning the future of the Peruvian political economy. According to these diagnoses, a competitive strategy would entail a more dynamic role for public policy in at least three areas: (1) the completion of first-phase market reforms that are still pending; (2) the adoption of an explicit export-led development strategy; and (3) the depoliticization of social policy in favor of more targeted human-capital investments. Following I highlight the unfinished business within each of these categories.

**Market-Completing Reforms**

Apart from the remaining challenges concerning the reform of the state reviewed in the previous section, there are three other issues still left on the

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10. See, for example, Gonzáles 1998; Abusada, Du Bois, Morón, and Valderrama 2000b, vols. 1 and 2; Boza 2000; Parodi 2000; Portocarrero Súarez 2000; Vásquez 2000; and Webb 2000.
table from the first Fujimori administration. All have to do with the need to adjust policy approaches in ways that would render market reforms more dynamic. The first challenge lies in the macroeconomic realm. As table 19 shows, both Argentina and Peru have adhered to a standard policy approach with regard to trade, monetary, and fiscal policy. The result for both has been comparatively lower levels of trade as a percentage of GDP in the 1990s, a pattern underpinned by exchange-rate appreciation and unfavorable tax and credit incentives for domestic firms. Other problems related to these trends concern the higher levels of urban unemployment that each country has registered over the past decade, as in both cases the hands-off strategy has encouraged capital-intensive investments in nontradable services and natural resource development. It is interesting to note that this was the very plateau that Chile had reached in the mid-1980s when policy makers responded with the shift toward the competitive approaches detailed in table 19, and Peru would do well to follow suit. More ominously, this is the same critical juncture at which Argentina’s currency board imploded, forcing a sloppy devaluation and President De la Rúa’s resignation just two years into his term.

There is also considerable work left to do on the privatization front. Peru’s track record in selling off the state’s assets is considered to be one of the more transparent and professional in the region (Manzetti 1999). However, the impulse for privatization stalled midway into Fujimori’s second term, placing in limbo earlier goals for further public-sector downsizing and the auctioning off of those state concessions (e.g., highways, seaports, airports, and sanitation services) that are essential for promoting greater competitiveness (Franco, Muñoz, Sánchez, and Zavala 2000). The delicacy with which privatization must be treated in the post-Fujimori era was made evident by the rioting and looting that occurred in June 2002 in the southern Andean town of Arequipa in response to the government’s sale of two small electricity generators to a Belgian company.11 Although a court mediator later ruled the US$167 million sale sound, the lesson for the Toledo administration with regard to further privatization was twofold.

First, such deals can no longer be made behind closed doors, as in the past. In hindsight, Peru’s overall privatization program looks squeaky clean, especially when compared with Mexico’s scandalous sell-off of the state banks or Argentina’s blatant insider trading on any number of public assets. For Peruvians, the issue is how the privatization proceeds were disbursed, including some US$1.5 billion that went toward arms purchases under Montesinos and Fujimori, not to mention the millions in apparent kickbacks that have since

surfaced in foreign bank accounts tied to that administration. Hence, any future political luck with privatization will require the utmost of transparency, serious dialogue with the affected parties, and straight talk from the Toledo administration about its plans in this area. Second, the role of privatization in promoting the success of the export-led strategy must be made explicit. Obviously, in the case of electricity generation, this particular privatization could greatly enhance efficiency and productivity in this southern regional economy. However, it is up to the current team to connect these dots and to articulate how privatization can complement the country’s development strategy in ways that outweigh the perceived costs.

On the question of further downsizing the state, Roberto Abusada and others (2000b, 48–52) have put forth the bold but plausible proposition that the central government should be streamlined to include just seven ministries and no more than twenty autonomous agencies. This would entail a cut of at least 25 percent of the public workforce in those productive-sector ministries (agriculture, mining, and industry) that find it harder to justify their existence under a market model. Other black boxes, such as the Ministry of the Presidency and the Ministry of Defense, could no doubt use a similar housecleaning. The lesson from the recent past, where reform opponents effectively deterred the president from forging ahead with the Program to Modernize the Public Administration, is that the Toledo administration should move quickly in completing these necessary tasks. In contrast with the earlier reform failures in the realm of public sector streamlining, this time around there is considerable multilateral support to finance state reform.12

The remaining reform gap in this category is the overlapping problem of stagnation in the rural sector and the age-old challenge of decentralization in Peru (Lizárraga 1985; Wilson and Wise 1986). Both are still common themes that unite all of the countries considered here. In Peru, however, the trauma of a twelve-year civil war fought largely in the more remote rural areas has compelled policy makers to tread lightly with reform implementation in the regions. To its credit, the Fujimori administration refrained from making the grandiose promises that every other government since 1963 had made concerning the decentralization of national resources, the modernization of agriculture, and the reduction of ancient patterns of rural poverty. It was, after all, the chronic failure to deliver on such promises that inspired the numerous guerrilla movements of the 1980s. Instead, by transferring unprecedented social resources to the country’s twenty-four provinces via his powerful Ministry of the Presidency, Fujimori simultaneously provided poverty relief and

won the support of regional voters. Especially after the dismal performance of the president’s coalition in the various elections held in 1993, the link between regional social transfers and the president’s political survival was solidified (Graham and Kane 1998).

Thus, whereas the multilaterals had touted decentralization in the 1990s as the route to greater efficiency, accountability, and transparency in the delivery of public goods (World Bank 1997; Peterson 1997), Peruvian-style decentralization in the 1990s offered just the reverse. Highly discretionary expenditures on local infrastructure (especially schools), social services, and municipal employment in the regions provided short-term relief but few institutionalized mechanisms to guarantee this support beyond the Fujimori administration (Palacios and Roca 2000). And in defiance of those political science theories that paint Latin American decentralization in the 1990s as “a political bargain involving presidents, legislators, and subnational politicians” (Willis, Garman, and Haggard 2000, 7), in Peru “decentralization” over the past decade has been a tenuous pact between the president and his mass of regional constituents (Roberts 1995; Kay 1997). Clearly, although the data show that they had little lasting distributional impact, these vertical ties and goodwill gestures created a sense of political inclusion for a group that had long been excluded from the national political economy (Seddon 1997).

However, Fujimori’s early departure and the lack of fully institutionalized channels for the delivery of social resources to the regions create a precarious situation that the Toledo administration is currently seeking to address. The Chilean experience with decentralization over the past twenty years has shown that, despite the difficulties and pitfalls intrinsic to decentralization, the process can be greatly enhanced by the institutionalization of the flow of transfers from the central government such that the provincial managers can credibly supply the quality and quantity of services demanded; the design of organizational incentives that enable local communities to effectively convey their concerns to municipal authorities; and the democratic election of regional and municipal officials (Marcel 1999, 293–99). To its credit, the Toledo administration wasted no time in scheduling competitive nationwide municipal elections for late 2002, confirming that the reintroduction of decentralized institutional mechanisms and democratic checks is a priority for this next generation of state managers.

### A Trade-Led Development Strategy

By definition, the sweeping liberalization that has occurred implies a commitment to an export-led strategy along Chilean or Mexican lines. This option for Peru is especially compelling in light of the country’s proven suc-
cess in promoting both traditional and nontraditional exports with higher value-added content during a brief period in the late 1970s (Schydłowsky 1986a, 1986b; Sheahan 1999). And although economists are known to disagree more often than not, one point of consensus is the crucial role that such higher value-added exports can play in spurring growth, productivity, jobs, and income gains (Edwards 1995; Londoño and Szekely 1997; Meller 1997). But for Peru such a strategy at this stage would require a more downwardly flexible exchange rate, not to mention an explicit set of incentives and planning guidelines to bring it to life. In the absence of such a strategy, Peru’s exports as a percent of GDP have leveled off since 1990 (see table 18), as privatization incentives have pulled FDI into nontradable services (e.g., electricity and telecommunications). Moreover, while all five countries in table 18 continue to struggle against exchange-rate appreciation in the era of high capital mobility, the value of Peru’s currency throughout the 1990s has not been particularly favorable to exports (Abugattas 1998).

In a recent ECLAC study published by Barbara Stallings and Wilson Peres (2000), Peru emerges as an aggressive reformer but a laggard performer with regard to the efficiency of investment, the dynamism of trade in relation to other market reformers, and the impact of both on employment and equity. Under the impulse of a standard approach to market reform, Peru’s sectoral contribution to value-added followed a regional trend: a decline in manufacturing, a growth spurt in services, and a pattern of output in agriculture and mining that is more or less a continuation of prereform trends. Similar to its neighbors, the Peruvian economy also saw an increase in patterns of heterogeneity within these four main sectors during the 1990s, as economic liberalization ushered in new investors who brought with them first-best production practices (Carrillo and Hernández 2000; Shimizu 2000). Thus, the underside of market transformation for Peru and others has been the worsening plight of those smaller producers and less-skilled workers who have yet to reap the benefits of or integrate into international markets for investment and trade.

Where Peru stands out, according to Stallings and Peres (2000, 160–70), is in its disproportionate decline in investment in potentially dynamic manufacturing or semimanufacturing sectors (foodstuffs, metal products, pharmaceuticals, chemicals, pulp and paper) and in the exceptional growth of non-agricultural low-skilled rural employment in the 1990s (also see Escobal 2000). Meanwhile, in the urban setting, the bulk of employment creation came from those microenterprises and small firms operating in the largely informal service sector, while big capital-intensive firms have continued to dominate in their contribution to GDP. Outside of telecommunications, banking, and mining, Peru has also lagged in attracting investments that pro-
mote the greater application of technology to productive structures. This is not to take away from the productivity and wage gains that appear in table 18, or the trends in social mobility that have clearly occurred, but the fact is that the old dualist tendencies that have long plagued the Peruvian economy are still present.

Another point of consensus is that these shortcomings in the way of innovation and dynamism are amenable to public policy. Other countries have countered these trends by promoting higher value-added exports in both the traditional (mining, agriculture) and the nontraditional sectors of the economy (Hausmann and Rodrik 2002). Chile’s strategies have already been addressed here. Other approaches include Mexico’s incentives to promote business clusters and strengthen production chains for companies that have been weakened by trade liberalization (Pastor and Wise 1997); Brazil has similarly offered a range of tax and credit incentives to foster outward-oriented production (Stallings and Peres 2000). These efforts differ from the heavy-handed industrial policies of the past in that they are designed with an eye toward fostering horizontal cross-sectoral links and toward supporting firms in the market through training, support services, and access to know-how (Chudnovsky 1997). Whereas such interventions were unthinkable in Peru in 1990, particularly in light of the excesses of the García era, the magnitude of reform is now such that they are advisable for infusing greater dynamism into domestic markets.

The Human-Capital Frontier: Back to the Basics

Peru’s continued lack of a cohesive social policy has been an overriding theme of this study. Contrary to the developmentalist era, when human-capital investments were promised but never sufficiently delivered, or the crisis-ridden 1980s, when policy makers groped in the dark for ways to stabilize the economy without further exacerbating poverty, the 1990s have produced an impressive body of data and research on both the sources of inequality and the most direct ways to address it.13 This last statement holds for the policy community at large and for the impressive array of social-sector research that has been produced locally in Peru by think tanks and the academic community (e.g., Velarde and Rodríguez 1998; Abusada, Du Bois, Morón, and Valderrama 2000b; Parodi 2000; Portocarrero Suárez 2000; Vásquez 2000). The four main areas of research emphasis have been education, health care, pensions, and housing. The track record shows that Peru has made headway

13. See, for example, Birdsall and Londoño 1997; Londoño and Szekely 1997; Sheahan 1997; Stallings and Peres 2000; and World Bank 2000.
on the first three fronts, although education and health care stand out as the
most progressive and direct means for alleviating poverty and bridging the
equity gap that appears in table 18.

Although the struggle for greater upward social mobility is regionwide,
Peru’s social policy has been hampered in three ways. First, while the data
show that social expenditures have increased by at least a third in the 1990s,
such increases started from a very low base (Stallings and Peres 2000). Sec-
ond, the siphoning off of the social-expenditure budget into the Ministry of
the Presidency, and the executive’s heavy reliance on social-capital expendi-
tures to keep his incumbency alive through the 1990s, distracted from the
more targeted human-capital investments that will be essential for sustaining
poverty reduction in Peru (Vásquez 2000). Third, as a result of these first two
trends, the will for reforming those frontline social ministries like education
and health never gained momentum. Hence, education reform faltered very
early on (Graham 1998; World Bank 1999), and health care has seen some
isolated pockets of success, but nothing near the overhaul that current trends
call for (Ewig 2000; Pollarolo 2000). Once the dust settles on the Fujimori era,
hindsight will show that the failure to articulate a social policy that more
directly linked human-capital investments with the new market model was a
strong factor in the president’s loss of popular support.

Again, contrary to the past, Peru’s next generation of policy makers brings
with it a high level of expertise and a whole arsenal of sound research to
inform a revamped social policy. The success of such endeavors will depend
on the modernization of those frontline ministries involved in the poverty-
reduction effort, the clarification of responsibilities to be assumed by the var-
ious state agencies involved, and a much stronger coordination of policy
making among entities. In retrospect, the failure to clear up the overlap and
redundancy among public-sector institutions, or to harness the professional
talent within the public sector to this larger set of social-policy goals, leads
back to the authoritarian bottlenecks that built up around the office of the
executive over the course of the 1990s.

**Politics, Markets, and Competitive Strategies: Two Possible
Transition Scenarios**

Until the year 2000, the implementation of deep market reforms appeared to
have laid the groundwork for economic recovery and the eventual transition
to more competitive politics in all but the Peruvian case. As Peru now joins
step with this trend, it helps to remember that these transitions have been
anything but the smooth interplay between markets and democracy that had
been hypothesized by an earlier generation of modernization thinkers (Sheahan 1987; Franko 1998). Under authoritarian regimes in Chile and Mexico, the lag between economic liberalization and authentic political opening was nearly twenty years. In Argentina and Brazil, chaotic political transitions in the early 1980s led eventually to hyperinflation, which in turn paved the way for new political actors with market-reform agendas in the 1990s (Cardoso 2000; Wise 2000). In both cases, the interaction between market reforms and domestic politics continues to challenge executive coalitions every step of the way—again, as witnessed by the December 2001 resignation of Argentine president Fernando De la Rúa just two years into his term and the political-economic chaos that ensued.

Peru has been the outlier here, in at least two respects. First, as in Argentina and Brazil, politics drove economics to the point of hyperinflation in the late 1980s, and market reforms thus became the only rational response to a highly irrational situation. Yet, in contrast to the situation in these two countries, the interplay between politics and economics in the Peru of the 1990s produced anything but democratic outcomes (Tanaka, forthcoming, 2003). Whereas economic recovery provided the potential for a more stable political opening in Peru, politics instead took an authoritarian turn. Second, in all four of the other cases, political parties were the key institutional catalysts for rendering market reforms and democratic transition more compatible. Certainly some party structures were more coherent and effective than others, but in all four countries parties were the locus for political-economic change in the era of market reform (Haggard and Kaufman 1995). In Peru, the complete collapse of traditional political parties by 1995, and the failure of new organized representative mechanisms to take their place, are unexpected departures from the reform trajectory of these other emerging-market countries.

At the same time, a main theme of this study has been Peru’s tendency to move forward at a slightly different pace than that of its neighbors. By regional standards, Peru’s embrace of ISI came late, and a populist military experiment was launched at the very moment when highly dictatorial military regimes were touting neoconservative shock treatments in other parts of South America. Although all of those programs had gone up in flames by 1982, new civilian leaders in Peru would espouse the same neoconservative strategy until it gave way to García’s heterodox shock in 1985. In terms of economic strategy, Peru finally joined step with regional trends in the implementation of market reforms in the early 1990s. As Fujimori’s economic advisors told it, they envisioned the Chilean path as the most viable option for Peru. But the Peruvian economy has yet to reach the development niche that Chile occupied in the mid-1980s. With regard to Chile, policy ana-
ysts are already pointing to the maturation of those export sectors linked to the processing of natural resources (e.g., mining, fishing, forestry, agroindustry) and to the need to generate a new business cycle based on more dynamic investments, higher levels of value-added, and the more sophisticated use of technology (Moguillansky 2000). Peru, again, has some considerable catching up to do.

A second theme of this study has been the quiet process of state reconstruction and renovation that has underpinned Peru’s market transformation, and this constitutes another area in which Peru has caught up with the regional trend. That political-economic progress has been made over the past decade is indisputable, yet a third theme of this study has been the need to forge ahead with another round of state-sponsored reforms that offer more in the way of microeconomic dynamism and distributional equity. In the absence of a competitive strategy that assertively pursues these goals, it is doubtful that Peru’s market-reform program will unravel or be reversed—there are now too many stakeholders to permit a massive reallocation of resources back toward protectionism and rampant statism. However, by sticking with the standard market strategy, Peruvian policy makers do risk settling for a more mediocre set of returns. Growth forecasts for the medium term still fall short of the annual 6 to 7 percent growth rates that are considered necessary for the expansion of employment and higher sustainable wage gains, and the same goes for gross investment projections.14

In Argentina, Chile, and Mexico, societal demands for more distributionally oriented policies have resulted in the election of proreform coalitions that built their entire platforms around such policies. This was the case with the 1999 victory of the Democratic Alliance in Argentina and the electoral successes of Chile’s Coalition of Democratic Parties since 1990, as well as the oppositional triumph of Mexico’s National Action Party in that country’s July 2000 presidential contest. The previous chapter showed that, in Peru, the “distributional moment” has clearly arrived; regardless of incumbent Fujimori’s generous social spending in the poorest districts of the country during his entire second term, the president’s bid for reelection was challenged to the extent that he and his military cronies resorted to massive voting fraud in order to be assured a victory.

In other countries discussed here, the original architects of market reforms, for example, the PRI in Mexico or the Peronists in Argentina, proved incapable of generating second-phase follow-up reforms to correct for the failures and shortcomings of the first round. Despite the intention of each to stay in office indefinitely, hindsight shows that the inability of these

parties to attend credibly to new kinds of distributional demands proved to be their ultimate undoing. In line with his wily pragmatism, Fujimori had already begun to promise the kinds of political reform and distributional policies that now characterize the economic program of President Vicente Fox of Mexico. To further bolster his sagging credibility, Fujimori had also rehired his popular former economics minister, Carlos Boloña, and stacked his new cabinet with an impressive lineup of technocrats, most of whom came from the private sector.

But too much damage had already been done, in terms of the violation of democratic procedures and the manipulation of public resources and the country’s institutions of justice. The president and his military cronies finally fell prey to their own devices, and Toledo has secured yet another chance to liberalize politics and to restore the rule of law. This next generation of politicians and policy makers has also been given the opportunity to initiate another wave of economic reforms. In the event that they are unable to catalyze a coalition that can usher in the kinds of competitive adjustments discussed in the previous section, one medium-term scenario would be for Peru to simply hover at or slightly below the growth and investment rates that appear in table 18 (Abusada, Du Bois, Morón, Valderrama 2000b, 55–58). Again, while respectable, these figures are mediocre in the sense that they still fall short of the 6 to 7 percent annual growth rates that would signify a more dynamic takeoff (ECLAC 1997b). Thus, to stick with the same hands-off market strategy that has prevailed since 1990 is to relegate the Peruvian political economy to the same underachiever status that it occupied prior to 1990.

However, while mediocre economic returns once appeared to be almost structurally determined by the country’s weak institutions and chaotic policy apparatus, this is no longer the case in contemporary Peru. The depth and breadth of the reforms that have been implemented in the 1990s constitute a necessary, although not entirely sufficient, condition for generating higher levels of growth, investment, and income gains. What’s needed now is a more hands-on strategy that directly tackles the numerous reform gaps reviewed in this chapter, while also committing more firmly to an export-oriented development model that reaches beyond old-fashioned notions of comparative advantage based on primary exports.

Whereas the prospects for another wave of reform—within the state, the economy, and civil society—looked dim in the wake of the May 2000 election, the opposition has now been offered the same political opportunity structure that prompted the shift to a competitive strategy in Chile and Mexico. In chapter 6 I argued that, more than ever before, the institutional incentives in Peru are stacked in favor of policy success. Should this next generation of Peruvian decision makers seize the opportunities at hand, a second
scenario could be Peru’s successful shift to a competitive strategy, which, in these other countries, turned out to be a catalyst for greater societal participation and the transition to democratic rule. Even so, and keeping with the overriding theme of this book, there is no escaping the fact that “positive state activities have played quite a considerable part in the historical process of economic development” (Sen 1997, 4–5). Amartya Sen further reminds us that a complete turnaround for a country such as Peru will inevitably entail “deliberate patronage of particular types of economic activities,” and the provision of “suitable social and economic preparation for the seizing of economic opportunities by the people.”