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THE PERUVIAN STRATEGY OF ECONOMIC DEVELOPMENT

Larry N. Willmore

Current Comment 4

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Larry N. Willmore

Hasta el comienzo de la Revolución Nacionalista, el Perú fue un país sometido a la doble y paralizante presión del subdesarrollo y el imperialismo . . . El imperialismo no es otra cosa que el dominio ejercido por el capital y la tecnología extranjeros sobre una sociedad de economía, incipiente y larvaria. . . Y el subdesarrollo es fundamentalmente el conjunto de intensos desequilibrios en la distribución de todas las formas materiales e inmateriales de riqueza entre los miembros de la sociedad . . . Esta revolución se está haciendo para que el Perú deje de ser un país dependiente y subdesarrollado . . .

Discurso del Presidente del Perú en la Clausura de la Conferencia Anual de Ejecutivos (CADE), Paracas, 15 November 1970.

For the first time in Peruvian history, a government is initiating a broad program of structural change designed to transform Peru into an industrial nation. The military junta which took power on October 3, 1968, has promised a "revolution without chaos and without death"^{1/} which will curb the economic power of foreign interests, achieve a more equitable distribution of wealth and income, and mobilize resources for rapid industrialization. This paper attempts to review the development goals of the Peruvian regime and the policy instruments by which these goals are to be attained.

Long-Range Development Goals

Peru's twenty year development plan, known as Bases for a Programme of Long-Range National Development, sets forth as basic objectives the integration of the population into the economic and social life of

^{1/} Mensaje a la Nación del Presidente del Peru, con Motivo del 149^o aniversario de la Independencia (Lima, 28 July 1970).

of the nation, the creation of a large domestic market, a more equitable distribution of national income and a doubling of per capita income, a more balanced distribution of the population within the "economic space" of the country, and a reduction of economic dependence through the promotion of exports with a higher value-added.^{1/} The strategy to attain these goals emphasizes the creation of "poles of development" in areas outside of Lima and social reform in the agricultural, mining, industrial, and public sectors of the economy.^{2/} Throughout the plan, emphasis is on structural reforms conducive to rapid industrialization.

It is the crucial problem of the marginados, of unemployment and underemployment, which has caused Peru to favour industrialization as a long-range strategy of development. An estimated 42 percent of the labour force is currently unemployed or underemployed, with the result that six million Peruvians do not participate in the economy of the nation.^{3/} Within the next twenty years, the population of Peru is expected to double, making the productive absorption of manpower a problem of even greater dimensions. Furthermore, whereas today slightly more than half the

1/ Peru, Instituto Nacional de Planificación, Bases para un Programa de Desarrollo Nacional a Largo Plazo (Lima, April 1969), pp 16-7. A summary of the twenty year plan is in Instituto Nacional de Planificación, Informe del Peru al Comité Interamericano de la Alianza para el Progreso (June 1969), pp 4-15.

2/ Bases para un Programa, op. cit., pp. 38-9.

3/ Peru, Ministerio de Economía y Finanzas, Plan Económico Anual 1970 (Lima, May 1970), Vol. II, p. 33. On the subject of unemployment and underemployment in Latin America, see Raul Prebisch, Change and Development, Latin America's Great Task (Washington, D.C., Inter-American Development Bank, 1970), especially Chapter 2.

population lives in urban areas, by the year 1990 Peruvian cities will hold two-thirds of the country's population.^{1/} The planners do not intend to halt this urbanization, but rather to direct the migration to new growth centres outside of Lima, a city which already contains a quarter of Peru's population.

Although mining is of traditional importance in the economy and particularly the exports of Peru, this sector has not been able to absorb any significant amount of the redundant labour from the rural areas. Between 1961 and 1967, mineral production increased at an annual rate of 2.6 percent, while the numbers employed in mining remained largely unchanged, due to the introduction of labour-saving machinery and equipment.^{2/} The mining sector thus accounts for more than 7 percent of the GNP, but employs only 2 percent of the economically active population. The mining decree of April, 1970, which gives the state sole commercial rights to all extracted minerals, is not intended to increase mineral production per se, but rather to encourage processing and refining within Peru, so that employment opportunities will be created and exports will have a higher value-added.^{3/}

In agriculture, as in mining, there is little possibility of substantially increasing opportunities for productive employment. The extent of underemployment in agriculture is illustrated by the fact that

^{1/} Bases para un Programa, op. cit., p. 19.

^{2/} Plan Económico Anual 1970, op. cit., Vol. II, p. 29.

^{3/} Decreto Ley Normativo de la Industria Minera, Decreto Ley No. 18225, 14 April 1970.

while the labour force employed in agriculture grew at an annual rate of 1.9 percent from 1967 to 1969, production increased by a rate of only 1.4 percent. ^{1/} This implies that the productivity per person employed declined at a rate of 0.5 percent per year. A more rational system of land tenure could, of course, allow agriculture to provide productive employment to more persons. But disregarding the jungle region, which requires massive expenditures on infrastructure to make the area habitable, there would still be a pool of redundant labour in agriculture, even if all water and land resources were efficiently utilized and there were no increase in mechanization (see Table 1).

TABLE 1

Employment in the Agricultural Sector

	1965 Labour Force	1965 Actual Demand ^a	Potential Demand ^b
Peru	1,719,200	801,300	3,886,000
Sierra	1,224,300	446,000	784,000
Coast	280,900	253,100	520,000
Jungle	214,000	102,000	2,582,000

^a Numbers which could have been productively employed with no change in technology or the system of land tenure.

^b Assuming efficient utilization of all land and water resources, but no investment in mechanization of agriculture.

Source: Peru, Instituto Nacional de Planificacion, Bases para un Programa de Desarrollo Nacional a Largo Plazo (Lima, April 1969), p. 137.

^{1/} Plan Economico Anual 1970, op. cit., Vol. II, p. 27.

Rural underemployment is particularly prevalent in the Sierra, a region which supplies most of the migrants to the barriadas of Lima. In 1965 there was an excess supply of 900,000 agricultural workers in the Sierra. Even had a radical agrarian reform rationalized the system of land tenure without changing the existing labour-intensive technology, there would still have been an excess of 440,000 workers in that year.

The long-range development strategy thus calls for a net reduction in the population of the Sierra over the next twenty years. By dividing the latifundios and eliminating minifundios, introducing fertilizer, and reducing the size of the agricultural labour force, it is estimated that the total product of agriculture could be doubled and five times more produce per worker could be marketed.^{1/} The expenditures for investment in agricultural would be minimal, but the problem of the absorption of the redundant manpower is phenomenal. With improved irrigation, some of the displaced workers can be employed in agriculture on the arid coast; but most will have to seek urban-industrial employment. If the trend toward mechanization in agriculture continues, the number of people who can be productively employed in agriculture will be even less than that indicated in Table 1 above.

In short, if Peru is to efficiently utilize the relatively abundant human resources, there must be an increase in the demand for labour in the manufacturing sector of the economy: and investment in manufacturing must be increased if that sector is to expand and absorb

1/ Bases para un Programa, op. cit., pp. 141-2.

an increasing portion of Peru's growing labour force. In a recent address, the Minister of Economics stressed that "investment is one of the fundamental strategic variables of our development" and explained that it is internal rather than external resources which must supply the needed funds for capital formation:

To bring about investment we have two alternatives: recourse to foreign savings or an increase in domestic savings. Foreign aid has been tardy, insufficient, and granted on an inadequate scale and unsuitable terms . . . Private foreign capital has been interested in investing in Latin America when it has obtained privileged terms, and its contribution to well-being has not been the desirable one. The most appropriate and sensible approach is thus to consider foreign capital as only a complement to domestic savings, and to base socio-economic programming on our own forces and resources.^{1/}

The decision to rely on domestic rather than foreign savings to finance the expansion of the manufacturing sector marks a definite change from the policies of previous governments.^{2/} The military regime is relying primarily on its industrial and agrarian reforms to encourage the mobilization of domestic savings for industrial development.

Structural Changes in the Agricultural and Manufacturing Sectors

The Agrarian Reform Law of June, 1969, and the General Law of Industries of July, 1970, affect different sectors of the Peruvian economy,

^{1/} Statement by General Francisco Morales Bermúdez, Minister of Economy and Finance, at the Joint Annual Discussion of the Boards of Governors of the World Bank and the International Monetary Fund, Copenhagen, Denmark, 22 September 1970 (mimeo).

^{2/} Official government figures for 1960 and 1963 indicate that 80 percent of all new industrial investment in those years was foreign in origin. Anibal Quijano Obregon, "Tendencies in Peruvian Development and Class Structure," in James Petras and Maurice Zeitlen (eds.), Latin America, Reform or Revolution? (Greenwich, Conn., Fawcett, 1968), p. 295.

but both laws are intended to achieve a more equitable distribution of wealth, restrict the activities of foreign firms, and stimulate new investment in the manufacturing sector. Manufacturing now contributes more to the GNP than does agriculture, and it is expected that the value of manufacturing production will be three times that of agriculture within twenty years (see Table 2).

TABLE 2

Percentage Distribution of Net National Product
(=National Income) at Factor Cost

	1950	1968	1990 ^a
Agriculture and Fishing	35	16.8	10.9
Mining	5	7.4	9.0
Manufacturing	15	20.2	29.1
Construction	3	3.6	5.4
Services	41	52.0	45.6
	99	100	100

^a Projection based on the twenty year development plan.

Sources: -1950 - United Nations, Yearbook of National Accounts Statistics 1969, Sales No. E.71 XVII 3, Vol. II, table 3.
 -1968 - Peru, Ministerio de Economia y Finanzas, Plan Economico Anual 1970 (Lima, May 1970), Vol. II, p. 9.
 -1990 - Peru, Instituto Nacional de Planificacion, Bases para un Programa de Desarrollo Nacional a Largo Plazo (Lima, April 1969), p. 23

The Peruvian generals are critical of the land-owning oligarchs, whom they refer to as "enemies of the revolution." But their enemy is the traditional latifundista elite, not the industrial entrepreneurs. "When we speak of the oligarchy," explained President Juan Velasco Alvarado, "we are definitely not referring to the industrialists and entrepreneurs

who contribute to the wealth of this country.^{1/} In fact, when Velasco announced the Agrarian Reform Law, he emphasized that the legislation was to stimulate industrialization by channeling funds to industry and by creating effective demand for industrial products.^{2/}

When the military took power in 1968, 99 landowners owned 40 percent of the cultivated land on the coast. In the Sierra, 181 landowners controlled 60 percent of the cropland. In the first stage of agrarian reform, the land of 13,504 haciendas -- a total of 27 million acres -- is to be transferred to peasant families. During the first year the law was in effect, the government expropriated 314 large estates, settling 43,000 families on three million acres of land. The Agrarian Reform Law is thus, with the exception of Cuba's, the most radical legislation of its kind in the hemisphere.

The large sugar plantations on the coast, including the eight owned by the W. R. Grace Company, were the first to be expropriated. Since it is not economically feasible to subdivide land planted in sugar cane, this land is transferred directly to a workers cooperative on each plantation. In all other cases, the government is transferring the land to individual families. Unlike Cuba, the Peruvian regime is promoting the development

1/ Mensaje a la Nación del Presidente del Perú, en el Primer Aniversario del Dia de la Dignidad Nacional (Talara, 9 October 1969).

2/ Mensaje a la Nación del Presidente del Perú (Lima, 24 June 1969). The information which follows concerning the agrarian reform is based upon the pamphlet, Un Año de Reforma Agraria issued by the Ministry of Agriculture on June 24, 1970, and upon Reforma Agraria, Decreto Ley No. 17716 (24 June 1969) and Reglamento de Tierras para la Reforma Agraria, Decreto Supremo No. 163-69-AP (19 August 1969).

of medium-sized farms. On the coast, farmers are allowed a maximum of 350 acres of cropland. In the Sierra, the maximum is 35 to 130 acres, depending on the fertility of the soil and the location of the land. With regard to livestock, the law permits ownership of 3,500 acres on the coast, and in the Sierra enough land to "maintain 5,000 head of sheep in the dry season." In no case, however, is tenant farming or share-cropping permitted.

Through agrarian reform, Peru hopes to both rationalize the system of land tenure and stimulate industrialization. The increased earnings of the peasant-proprietors are expected to stimulate demand for the products of the manufacturing sector. Furthermore, with the exception of cash payments for buildings and livestock, the government is compensating expropriated owners with non-transferable agrarian debt bonds which mature in twenty to thirty years and pay 4 to 6 percent interest. The holders of the bonds are, however, encouraged to exchange them for shares of stock in an approved national industry where the rate of return is much higher. The bonds are accepted at face value, provided the owner contributes an equal amount of cash toward the purchase of stock.

The General Law of Industries,^{1/} which was promulgated one year after the Agrarian Reform Law, provides additional incentives for investment in the manufacturing sector and allows a larger role for state entrepreneurship. The industrial law (article 7) reserves for the public sector certain "basic industries," namely, petrochemicals, iron and steel, the refining of copper and other non-ferrous metals, fertilizer, cement, and paper.

^{1/} Ley General de Industrias, Decreto Ley No. 18350 (27 July 1970).

But privately-owned firms, or private firms with state participation, are allowed to operate in basic industries, provided a contract is negotiated stipulating the date which the ownership of such enterprises will be transferred to the state. Publicly-owned enterprises are not limited to basic industries, but may compete with private firms in any industrial activity.

To stimulate investment, the industrial law allows generous fiscal incentives to all manufacturing firms except those producing "superfluous luxury goods." The amount of the incentive depends upon the priority of the industry in the development plan. The basic industries and producers of capital and intermediate goods are of first priority. Essential consumer goods are of second priority, while non-essential consumer goods are of third priority. Luxury goods have no priority and are subject to the normal rate of taxation. Industries of the first, second, or third priority pay only a fraction of the normal tariff on imports of machinery and equipment and are allowed to re-invest a portion of their net profits free of tax. The portion of net profits which can be re-invested tax-free varies from 65 percent for industries of third priority to 85 percent for those of first priority. Enterprises which operate outside the urbanized area of Lima-Callao receive -- in addition to the above incentives -- a substantial reduction in the normal tax on profits.

The current regime is well aware of the fact that, if industry is to absorb the increasing number of Peruvians entering the labour force, there must be not only an increase in industrial growth, but also a

reduction in the rate of substitution of capital for labour in production. The government is encouraging manufacturing firms to employ intermediate rather than advanced technology whenever possible.^{1/} In the short run, this is a difficult policy to implement, for the technology currently in use has been imported from the advanced countries. To promote the adaptation of technology to Peruvian conditions, article 15 of the industrial law requires that enterprises spend 2 percent of their net profits on research and development. If this amount is not utilized within the firm itself, it must be donated to another research program or to the newly-created Institute of Technological Research. By encouraging local research, the government hopes to enable the manufacturing sector to make better use of Peru's relatively abundant supply of labour.

The most radical feature of the industrial law, and that which has been most publicized in the press of North America and Europe, is the phased "Peruvianization" of foreign-owned firms. All manufacturing enterprises were required to sign a contract with the state detailing the stages by which each company will become at least two-thirds Peruvian-owned. The time allowed for completion of ownership requirements varies "according to the nature of the firm and the technology employed," so that the owners can recover their original investment and a "reasonable profit" (Article 16). Companies in which Peruvians now own a majority of the outstanding shares are required to maintain national ownership and can only issue a maximum of 33 percent of new stock to non-Peruvians.

1/ Política Fiscal y Plan Económico 1970, Esposición del Ministro de Economía y Finances, General E. P. Francisco Morales Bermúdez (Lima, 27 February 1970).

Foreign participation in "joint ventures" cannot exceed 49 percent.

Within Peru, the most controversial aspect of the industrial reform has been the requirement that workers participate in the ownership and profits of the firm. 10 percent of the annual profits before tax must be paid to the employees as a cash bonus, and an additional 15 percent must be re-invested (free of tax) on behalf of all employees until such time as the workers and managers hold 50 percent of the outstanding shares of the firm.

The institution which is to change the organization of the Peruvian firm is the "Industrial Community." A decree of September, 1970, requires that an Industrial Community be set up in each manufacturing enterprise which has six or more full-time employees on the payroll.^{1/} The community will represent the employees and acquire shares of stock on their behalf, financed from 15 percent of the annual profits. Half of the dividends payable on these shares are to be divided equally among all full-time employees, and the other half proportional to the number of years of employment as a member of the Community. When the community has obtained 50 percent ownership of a company, individual shares will be distributed to the employees in proportion to their years of membership in the community: but these shares are not transferable, and are only redeemable by the Industrial Community at the time an employee leaves the firm.

The Industrial Community is the vehicle by which employees

^{1/} Ley de Comunidad Industrial, Decreto Ley No. 18384 (1 September 1970), Article 2. Firms with less than six employees are exempt from this law unless their gross annual receipts exceed 1 million soles (U.S. \$26,000).

can participate in the directorate of their enterprise. Each employee has one vote in the election of the Council of the Industrial Community. The Council, in turn, will appoint one or more representatives to the firm's board of directors, and the vote of these representatives will be weighted according to the number of shares held by the community. In other words, the representatives of the community can eventually reach, but never exceed, 50 percent of the membership and votes of a board of directors.

Public enterprises operating in basic industries are also required to set up industrial communities. But in this case the community will hold bonds rather than stock, and the Council can appoint only two members of the community to the directorate of the enterprise.

Although the idea of an industrial community was no doubt influenced by communitarian ethics and by the Yugoslav system of worker management, the Law of Industrial Communities cannot be regarded as a very radical measure in the Peruvian context. First, the plan is a very gradual one, for it will take many years for 15 percent of a firm's net profits to equal the investment of the original owner. Second, the original owner can take advantage of tax incentives to re-invest profits on his own behalf, prolonging the day when the industrial community will own 50 percent of the outstanding shares. Third, the benefits of improved morale and fewer labour disputes may well exceed the cost of the profit-sharing scheme. Fourth, and most importantly, since all firms with less than six employees are exempted from the law, this reform affects very few firms and even fewer Peruvian firms.

A perusal of the statistics which are available leads one to conclude that it is unlikely that the industrial community has affected more than 300,000 workers out of an economically active population of approximately four million. The 1961 census showed that 411,000 persons, or 13.2 percent of the labour force, were employed in the manufacturing sector of the economy. Of these, only 220,000 were classified as salaried employees and wage earners (see Tables 3 and 4). Data for 1962 suggest that there were approximately 3,000 industrial firms which employed five or more workers in that year. The total number employed by these firms was less than 150,000 workers.^{1/} Although there are no statistics available for later years, it is assumed that factory type employment is now a more significant portion of the industrial labour force than it was in the early sixties.^{2/}

TABLE 3

Distribution of the Economically Active Population, 1961

	Numbers	Percent
Agriculture and Fishing	1,555,560	49.7
Mining	66,413	2.1
Manufacturing	410,980	13.2
Construction	104,696	3.4
Services	<u>986,930</u>	<u>31.6</u>
Total	<u>3,124,579</u>	<u>100.0</u>

Source: International Labour Office, 1969 Yearbook of Labour Statistics, Table 2a.

^{1/} Carlos A. Astiz, Pressure Groups and Power Elites in Peruvian Politics (Ithaca, N.Y., Cornell UP, 1969), p. 62, Table 12.

^{2/} Plan Economico Anual 1970, op. cit., Vol. II, p. 30.

TABLE 4

Distribution of the Population Employed in Manufacturing, 1961

	Numbers	Percent
Employers and Self-employed	180,529	43.9
Salaried Workers and Wage Earners	219,926	53.5
Family Workers	9,826	2.4
Status Unknown	<u>699</u>	<u>0.2</u>
Total	<u>410,980</u>	<u>100.0</u>

Source: Ibid.

Although the absence of current statistics, especially on the extent of foreign ownership, makes an elegant quantitative proof impossible, the point to be made is simply that the main effect of the Peruvian industrial reforms will not be to change the structure of existing nationally-owned enterprises, but rather to encourage the development of national entrepreneurship. At present, it is doubtful that a significant number of native entrepreneurs exists in Peru. A sociologist who made an extensive investigation of the Peruvian textile industry a few years ago observed that

All too often we find owners and managers more mercantilistic than industrial in their actions and beliefs. One of the major obstacles to industrial progress in Peru is that there does not yet exist a powerful, cohesive group of 'industrialists,' that is, men whose primary economic concern is a manufacturing operation. In many cases Peruvian textile mills are peripheral activities of men whose major interest is more apt to be commerce and real estate speculation.^{1/}

^{1/} David Chaplin, "A Discussion of Major Issues Arising in the Recruitment of Industrial Labor in Peru" (mimeo, U. of Wisconsin Land Tenure Center, 1966). Quoted in Astiz, op. cit., p. 64.

President Velasco has also publicly lamented the lack of entrepreneurial activity in Peruvian industry. In an address to the Annual Conference of Executives (CADE), he reminded his audience of industrialists that

an industry is not only equipment, capital and markets. It is also -- and primarily -- a mentality, an attitude, a psychological perspective. And in today's Peru we have not only to increase investment, expand markets and rebuild plants;^{1/} but fundamentally we have to create a new industrial mentality.^{1/}

In the final analysis, the development of industrialists may prove to be a more difficult task than the development of industries.

Conclusion

In the Peruvian strategy of economic development, the state is to have a dynamic role; but the government has not abandoned the market mechanism. The structural reforms are, in fact, designed to rationalize the economic system so that the market mechanism can function as an essential part of the development process. If the agrarian reform is completed as planned, the agricultural sector should become important both as a supplier of raw materials to industry and as a purchaser of manufactured goods. The industrial reform complements the agrarian reform by stimulating industrial entrepreneurship and the expansion of the manufacturing sector. It remains to be seen whether these structural reforms are sufficient to maintain sustained industrial growth.

The goal of a doubled per capita income in 1990 -- which implies an annual growth rate of 7 percent -- is important not only as an end in itself, but also as a means to achieve a more equitable distribution of

^{1/} Discurso del Presidente del Perú en la Clausura de la 8^a Conferencia Anual de Ejecutivos (Paracas, 26 October 1969).

income and integrate the marginados into the economic and social life of the country. The industrial and agrarian reforms encourage a more equitable distribution of wealth and income within the agricultural and manufacturing sectors. The expansion of the national product is the only mechanism by which national income will become more equally distributed between the two sectors and throughout Peruvian society.

The structural changes being introduced in the Peruvian economy suggest that the industrial worker is to be in a more favourable position than his rural counterpart. At this time there are no incentives for investment in agriculture, while substantial incentives do exist in industry. Industry is thus encouraged to import labour-saving equipment to increase productivity per person, while agriculture is encouraged to employ labour-intensive methods with a low productivity per person.

The Peruvian regime appears to have adopted a rather schizophrenic policy with regard to industrial technology. On the one hand, it encourages research in the development of intermediate technology which is appropriate to Peruvian conditions. On the other hand, fiscal incentives reduce the cost of capital relative to labour in the production of manufactured goods. On balance, the regime is probably repeating the mistakes of its predecessor in encouraging the substitution of capital for labour, and thus the under-utilization of Peru's human resources.^{1/}

^{1/} In Bases para un Programa (op. cit., pp. 8-14) there is a criticism of the excessive imports of capital caused by the overvaluation of the sol during the administration of Belaunde Terry.