Direct Foreign Investment in Peru:
New Rules for an Old Game

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Introduction

The Peruvian Revolution has altered drastically the place of direct foreign investment in the nation's economic life. The dimensions of this change can be appreciated only if we begin before the beginning, tracing the evolution of policies and attitudes toward foreign investment in the twenty years preceding October 1968, when civilian government came to an end. The paper begins with a summary of that history. Then it describes how the present government has developed its foreign investment policy, first by reviewing the development of general laws and policy statements, then by surveying several case histories of expropriation and contract renegotiation. Next, it draws on further case studies to describe Peru's new approach to doing business with foreigners, and assesses the foreigners' reaction to the new rules of the game. The paper then concludes with a summary of the extent to which foreign investment policy has changed under the Peruvian Revolution, and the directions of further change that seem indicated for the future.

Peru under the Old Rules of the Game

The United States emerged from World War II at the zenith of its power and moral authority. The bastion of democracy, it had saved the world from fascism. The dominant economy in a shattered world economic system, its resources seemed essential to any effort at economic reconstruction and development.

Peru emerged from World War II a weak, underdeveloped economy, and immediately entered a period of devisive political conflict over fundamental issues of economic policy: inflation, deficit spending, exchange controls, and devaluation. Throughout the presidency of Bustamente (1945-1948), the economy remained paralyzed as political strife continued between an intractable APRA and an equally intractable conservative elite.

The issues that divided Peru held enormous significance for United States business interests. Their export operations became increasingly unprofitable as the authorities held grimly to the pegged official exchange rate despite a near doubling of wholesale prices in three years. The traditional elite, deriving much of its economic power from cotton and sugar exporting, also grew increasingly restive under exchange control. Despite intense Aprista opposition, the political and economic pressures for devaluation became irresistible. The first major devaluation came in September 1948, but it could not arrest the process of political deterioration. The following month General Odria launched his successful coup, returning conservative interests to full power and driving APRA underground. When the official rate was abandoned in November 1949, exporters were able to exchange all their foreign exchange earnings at a new floating rate that represented a 141% devaluation.[1] Controls were dismantled and rates were unified. In a continent that was witnessing ever-increasing state intervention in economic life in country after country, Peru had turned around to begin a march in the other direction that continued for the next 18 years.

Foreign investors could not have been more pleased. For minerals exporters, terms of trade increased from 117 (1945 = 100) in 1948 to 169 in 1949.[2] Furthermore, the floating rate gave assurance of more rapid adjustment in future periods of domestic inflation or external recession. The new exchange rate system was followed by a new mining code, promulgated in May 1950, that replaced onerous export taxes with the more moderate income tax obligations then required of industrial and commercial firms. This change was further sweetened by a number of special ingredients: exemption from excess profits taxes, exoneration of import duties on mining equipment, provision

of percentage depletion, and guarantees against new taxes for 25 years.[3] Through these changes the total tax burden of the mining sector declined from 35% of gross profits in 1948 to about 20% in the early 1950s.[4] For U.S. companies, the total decline was greater still, since the switch from export to income taxation permitted taxes paid in Peru to be credited against tax liabilities in the United States.

Besides these features of the Código de Minería, the famous Article 56 provided that, in deposits declared to be of marginal quality, specially low tax rates could be negotiated and would remain in effect until the investor had amortized his original capital outlay.[5] This clause provided legal basis for the Toquepala contract, signed with the newly created Southern Peru Copper Corporation in 1954, that guaranteed a 30% tax rate until the investment had "earned net profits (after deduction of depreciation, mine preparation amortization, depletion, and all taxes) sufficient to amortize therewith all capital investment."[6] This special provision gave virtually no extra margin of benefit, since other U.S. mining firms were paying about 30.6% at the time.[7] However, it set the stage for acrimonious controversy twelve years later.

Thus Peru opened its doors wide to foreign investment, and for the first time in decades big investments poured in. Foreign business groups applauded Peru's new direction. "In its mining and oil codes," wrote Fortune, "Peru has viewed the modern wielder of power shovel and drilling rig not as an 'exploiter' but as the fulcrum for economic development. More important, it has maintained a scrupulous respect for private property and for the principle of free markets and convertibility."[8] The country's leading conservative proudly stated: "Peru has come to be looked upon as one of the most attractive countries for foreign investment in Latin America."[9]

The triumph of conservative economic policy was not brought about without controversy. Before Odria's coup, the political battle centering in the Congress found reflection in all parts of Peruvian intellectual life. After the coup the voice of APRA was silenced and public discussion became distorted by the threat of censorship, but sufficient freedom remained to permit a raging debate on Odria's exchange rate policy between Lima's leading newspapers, El Comercio and La Prensa.

The curious feature is that so bruising a fight could have ignored foreign interests so completely. Critics of the new system tore into La Prensa and the export interests it represented as if such interests were exclusively Peruvian.[10] The deposed President Bustamente, sitting down in exile to write a defense of his administration, produced a political testament that never once mentioned foreign companies.[11] The major changes in mining legislation passed nearly unnoticed and totally uncriticized.[12] With the United States standing at its zenith, only termacefalos would think of attacking North American investments in postwar Peru.

So remarkable a situation was destined to unravel with the passage of time. APRA, permitted to reemerge in 1956, soon began a steady drumbeat of criticism against the mining agreements signed during Odria's dictatorship. "The sell-out of our natural resources during the eight years under the regime of official terror," wrote an Aprista columnist in 1958, "has no precedent in the history of our republic."[13] The tempo picked up after 1959, when a sharp increase in gasoline prices rekindled old animosities toward the International Petroleum Company. Then in 1963 Fernando Belaunde captured the presidency and brought to power a new social group: middle-class, technocratic, and to a degree infused with Social Christian thought.[14] This new generation made Belaunde's

government more nationalistic than any of its predecessors. Yet despite occasional statements of impatience over economic relations with the United States and despite somewhat greater severity of terms for foreign investors in petroleum and mining, Peru's favorable view of foreign investment remained unaltered.

This favorable view is revealed by the absence of a general policy toward foreign investment. No policy existed because no problem was perceived. Thus when Belaunde's economic strategy spoke of developing "la industria nacional," this term merely referred to industry located physically within Peru, without reference to nationality of ownership.[15] In a similar vein, Belaunde captured the rising nationalist sentiment of the time in the title of his political testament: La conquista del Peru por los peruanos.[16] Despite the title, however, the book had nothing to do with throwing out the foreigners; rather its concern lay in an engineering conquest of terrain, in mountains and jungle. Belaunde's generation viewed development entirely as an engineering and technocratic problem.

The investment climate thus remained generally warm and sunny, but storm clouds began gathering over petroleum fields and copper mines. The case of IPC is so well known and so peculiar that it will not be discussed in this paper. Mining, however, cannot be set aside so quickly through claims of special distinctiveness. The changing treatment extended to the mining industry holds more general significance for what it says about changing attitudes toward foreign investment in general.

The first moves concerned tax rates. In 1950 mining companies had been required to pay the full industrial profits tax, but they were unaffected by the rate increase of 1958 that raised the top bracket from 20% to 35%. When Belaunde raised the top bracket for mining companies to 30% in February 1964

and then to 35% in November of the same year, the companies protested that such increases violated the guarantee against new taxes contained in the Código de Minería.[17] The government's reply held that the new laws lay fully with the code, since they were not new taxes but rather new rates on old taxes. Indeed, the government was quite correct, such was the terminological looseness with which the Código de Minería had been drafted. The foreign companies grumbled, but they could do nothing as the total tax bite on profits rose from about 30% to 48.65%.[18]

With this change the Toquepala contract, guaranteeing a tax rate frozen at 30%, took on an entirely new significance. By the mid-1960s, the war in Vietnam had driven copper prices sky high, and the owners of the "marginal" mine were making money hand over fist. Peru awaited the moment when Southern Peru would recover its capital, for the government's share of profits could then jump by 18.65 percentage points. One can therefore imagine the consternation of those Peruvians who first looked into the fine print of the Toquepala contract to discover that the 30% rate remained in force until <u>net</u> profits, net of taxes, <u>depreciation</u> and <u>depletion</u>, had accumulated to equal the original investment.

Very quickly, Southern Peru found itself under attack from several directions. In 1965 the Director of Tax Collections (Superintendente de Contribuciones) ruled that Southern Peru had already recovered its capital and would thenceforth be liable to the normal tax rate. This declaration, apparently based on a definition of capital recuperation that blithely ignored the fine print of the contract, found only faint support within the government itself. Southern Peru appealed to the courts, but violated Peruvian law by failing to pay up pending the judicial decision. The government permitted this illegality and thereby outraged vocal sectors of Peruvian opinion. The finance minister even attempted to quash the Superintendente's initiative.[19]

Also in 1965, the Congress formed a special commission to investigate the Toquepala contract. Its labors covered two years, and its articulate, detailed final report excoriated the Código de Minería, the contract, and the company itself.[20]

As Congressional hearings and fiscal quarrels dragged on through months and years, various critics, led particularly by the newsweekly Oiga, widened the attack to every aspect of the government's copper policy. Criticism on other issues accumulated rapidly: underpricing of exports, manipulation of account books, falsification of metallic content, particularly of gold and silver traces, unreasonably low tax rates.[21] Again and again, critics hammered home the message that the assertion of Peruvian sovereignty required much tougher bargains to be driven with the foreign miners. Characterizing Toquepala as "a fabulously rich mine," (una mina requísima) Oiga brushed aside any fears that foreign investors would be scared away from Peru's mineral wealth:

> "Throughout the world there exist capital funds interested in investing in copper mines. If the present holders of concessions decide that our conditions are not suitable, we can anticipate, with absolute certainty, that other investment sources from other countries will come forward."22/

As we shall see below, later events have not substantiated this view, such has been the international investment community's skittishness about risk taking in a revolutionary setting. Nevertheless, my own preliminary estimates suggest that Toquepala had indeed become "una mina riquísima," and that foreign investors generally secured very healthy profit rates in Peru under the Ancien Regime. These estimates, which will be discussed in a separate paper, show that Toquepala earned an after-tax return of about 19% for Southern Peru, while Marcona earned about 28% on its iron ore venture. The corresponding figures for U.S. manufacturing investment in Peru stands at about 16-17%. While these profit estimates are not nearly as high as the figures used by some

critics, they indicate that Peru had indeed become an attractive country for foreign investors. The aspirations articulated by conservatives in the 1950s had come true, even at the same time that the critics of the 1960s were starting to make Peru look less attractive. Reflecting the alarm of U.S. investors witness to the attacks on Southern Peru and other companies, the U.S. Embassy's survey of the situation spoke of "political ideologies in Peru (that) counterbalance somewhat the benefits offered by the geological and mineralogical situation."[23]

The Toquepala question remained unresolved until Finance Minister Ulloa reached a new agreement with the company as part of his emergency fiscal measures in mid-1968. That agreement required Southern Peru to give up its favored treatment and pay normal tax rates retroactively, but only from the beginning of 1968.[24] While it perhaps represented a reasonable compromise between the maintenance of legal fine points and acquiescence to absurd contract provisions inherited from the past, three years of acrimonious debate could not be so quickly washed away. The special disadvantages of direct foreign investment remained more obvious than ever before to important sectors of public opinion. The fundamentally favorable view of the Belaunde government toward foreign investment had not been altered, but this perhaps merely indicated the continuing failure of that government to recognize the power and importance of changing attitudes. The storm clouds were gathering over the Palacio de Gobierno as well.

The Peruvian Revolution and the New Rules of the Game

From the moment that the Armed Forces took power in October 1968 and declared Peru to be entered into a revolutionary process, official pronouncements on questions of economic development changed significantly in both language and substance. In part, this change merely reflected regional intellectual

currents, as Latin America moved (leftwards) from cepalismo to dependencia. But the change in Peru was particularly abrupt and drastic. Here one beheld a government whose access to power had been triggered by the historic abuses of a foreign company and whose first year of rule was marked by intense diplomatic and economic pressures exerted by the United States. It is hardly surprising that the Peruvian leadership was quick to incorporate concepts such as external dependence and imperialism into its official diagnoses of the Peruvian development problem. Thus in the words of President Velasco:

> "The structural root of the great problems that beset Peruvian society ... arise in final analysis from its double, interrelated condition of being a society that is underdeveloped and subject to imperialist domination .... For this reason it is not possible to resolve any of our major problems without confronting the crucial questions of dependence and underdevelopment."

Clearly the development problem was no longer considered essentially technocratic.

Throughout Latin America, the U.S.-based multinational corporation has commonly been marked as the principal mechanism for the exercise of imperialism and the perpetuation of dependence. In the Peruvian case, this link to foreign direct investment remained conspicuously absent in revolutionary ideology, except in the case of the International Petroleum Company. Time and again, however, Velasco and others emphasized that the IPC affair was an exception and, "... for that reason, a case which has no relation to the policy followed by the Revolutionary Government with other foreign companies that exploit the country's natural resources and whose legitimately acquired rights are respected and will always be guaranteed."[26]

The analytical link between foreign investment and imperialism was avoided by the Peruvian government because it decided not to throw the foreigners out. Rather, it has chosen to tame the multinational beast, to make it work better for national interests. This approach, being more

pragmatic than ideologically elemental, has given foreign investment policy low ranking among the points rattled off in any capsule summary of the Revolution's accomplishments.[27]

The pragmatic approach to foreign investment emerged in President Velasco's first Independence Day Speech of July 1969. The old way of doing business was rejected, since: "Private investment, even if it creates points of economic modernization, serves under present conditions as a mechanism for removing wealth from Latin American countries." But Velasco immediately went on to state flatly: "Latin American development requires foreign capital."[28] Clearly the foreign investment game needed new rules.

When Velasco next returned to the subject of foreign investment in a public speech, in April 1970, he began by arguing that Peru indeed held the power to write new rules and obtain better bargains:

> "We are not a weak group of nations at the mercy of foreign capital. They need our raw materials and our markets. And if we need capital goods and advanced technology, the evident bilaterality of these needs must lead to new arrangements that protect the present and future interests of Latin America."29/

This stated, Velasco proceeded to outline the two main rules of the new game. First, natural resources and basic industries would be reserved for state enterprise. Second, in other non-basic sectors, foreign investment "would be channeled through joint ventures or through private companies, subject to a fixed period of reversion to the State once the total investment and an acceptable return have been covered by profits."[30]

With these words Peru adopted the fade-out joint venture as its principal new instrument of tightened control over foreign investment. This new so-called Velasco Doctrine, emphasizing bargaining and joint ventures, carried a message vaguely familiar to anyone whose memory stretched back forty years to similar proposals put forward by such dissimilar advocates as Haya de la Torre and Victor Andrés Belaunde.[31] The difference lay in the fact

in 1970, for the first time, the government was prepared to do something about it.

When implementing legislation followed a few months later, it went well beyond new rules for foreigners and encompassed the total restructuring of industrial enterprise. The major provisions of the Ley General de Industrias affected all private enterprise, both national and foreign.[32] Only a few firms would be affected by the reservation of basic sectors to state enterprise. But every firm was shaken to its roots by the prospect of compulsory profit sharing that would lead to eventual joint ownership and joint decision-making with the firm's workers. While the law contained special provisions for reducing foreign ownership in any firm to minority participation, this involved little extra burden in a situation where all firms were required to surrender 50% of equity to the workers. The only difference, which could be a very important difference, concerned the period required for divestment. For national enterprises following the dictates of the Ley de Industrias, the time required for raising worker participation to 50% depended on the firm's profit rate and reinvestment policy.[33] The special provisions for foreign firms could result in a more rapid divestment for foreigners. Provision for such an eventuality was established in the Reglamento of the Ley de Industrias, but the actual pace divestment was left open for subsequent negotiation.[34]

The Ley de Industrias avoided all but the most basic outlines of a foreign investment policy because such a policy had first to be developed within the Andean Group. Decision 24, when it emerged from the Andean bargaining table in late 1970, contained many of the controls and restrictions implicit in the idea of tougher bargaining but missing in previous Peruvian legislation.[35] Thenceforth, it stated, foreign investors would be subject to regulations regarding permission to invest, terms of

overseas borrowing and access to local credit. Contracts for licensing patents or trademarks, or for obtaining technical assistance, would be subject to review. Annual profit repatriation would be limited to 14% of invested capital. The most publicized feature of Decision 24, however, lay in its endorsement of the Velasco Doctrine; it required forced divestment to a minority position, under an explicit deadline of 15 years. However, last-minute compromise between Peru and Colombia partially dissipated the impact of this provision by exempting already-established foreign firms that did not intend to take advantage of trade liberalization under the Andean Common Market.

In subsequent legislation of early 1972, the Peruvian government reasserted its application of forced divestment to all foreign manufacturing firms, not just those exporting to other parts of the Andean Group, but the time period remained open to case-by-case bargaining.[36]

The new rules of the game, thus set up in general form, called for a massive bureaucratic effort to fill in the details. Each control provision implied a new agency of control, a new series of procedures, and a new area of administrative jurisprudence. Once these details are established, the new system will be normalized.

This has not happened. The government, preoccupied throughout 1972 and 1973 with more immediate problems in the functioning of industrial communities and the industrial programming negotiations of the Andean Group, has left many of the most important details hanging unresolved.[37] While little progress has been made in the refinement of general rules, however, new developments in foreign investment policy have taken place on two other fronts. The first concerns expropriation and reorganization as the government has dealt with foreign companies in basic sectors earmarked for transfer to

state control. The second concerns negotiations with particular foreign investments required to achieve governmental targets for industrial and export development.

Expropriation and Reorganization in Basic Sectors -- Some Case Studies

For some foreign investors, the process of clearing private companies from the basic sectors meant expropriation with highly satisfactory settlements regarding compensation. Consider two cases from telecommunications and banking.

In the early years of the Belaunde administration, the Compañia Peruana de Telefónos, an affiliate of ITT, provided Lima with terrible telephone service. It did so because its regulating agency, the Junta Nacional de Telecomunicaciones, refused rate increases. Finding itself locked in to such low return on past investment, the company refused to expand that investment despite the acute need for expansion of facilities.[38] On the other hand, the Junta felt a rate increase to be inappropriate reward for such quality of service. This impasse was finally broken in 1967 by an agreement that called for the company to double the number of telephone lines within three years, in return for which rate increases would be granted sufficient to earn a 12% return. Both parties carried out their sides of the bargain. The company's expansion program improved service dramatically; the government authorized rate increases even at moments of political difficulty.[39]

This new harmonious relationship notwithstanding, in October 1969 the revolutionary government suddenly announced the expropriation of ITT's 69% share in the telephone company. Final agreement was reached quickly, and called for ITT to receive $14.8 million for shares that had been carried on the books at a value of $18.5 million. Four million dollars would be paid

in dollars, the rest in soles or value in kind. With these local accounts, ITT agreed to build and operate a major new hotel, valued at $12 million, and a telephone equipment factory that would be 40% government-owned. In addition, Bell Telephone of Belgium, an ITT subsidiary, would receive various contracts for telephone lines and equipment supply.[40]

ITT emerged quite satisfied from negotiations that had set total compensation at 80% of book value. While this result could have been lamented as a 20% loss, one must remember that the values were based largely on equipment purchases made from other subsidiaries of the same corporation, and thus could have been challenged and even rejected by government negotiators suspicious of inflated asset prices. The incentive for such inflation was clear, since the higher the value, the greater the allowable profit under controlled rate-setting. Suspicions notwithstanding, the government accepted all of ITT's equipment valuations. ITT got out of a tight corner with most of its capital not only intact, but also invested in more promising sectors.

If ITT was content, so was the Peruvian government and Peruvian public opinion. The same cannot be said with respect to the terms upon which Case Manhattan's share of the Banco Continental was bought out. Even before the price was announced, it was evident that the government would treat Chase well. Anticipating the announcement of favorable terms, the _Peruvian Times_ commented on the government's desire to avoid an acrimonious expropriation, "because this could well create an unfavorable reaction in banking circles outside the country, some of which, it appears, were stunned by the sudden way the (Banco) Popular was taken over."[41] But even with this forewarning, the sober _Peruvian Times_ gasped at the "sky-high prices" announced the following week: Chase was to get $6.3 million, as compared to the $1.7 million it had invested 6 years earlier. At a moment when the market value

per Banco Continental share stood at 102 soles and the book value at 188, the government had agreed to a share price of 586 soles.

While the Peruvian Times was merely incredulous, other reactions in Peru ran from glee to outrage. Among the gleeful were to be found various politicians from the Belaunde era, happy to grasp an opportunity for embarrassing the government on an issue of entreguismo. Among the outraged were the Loyal Left, Oiga and Expreso, who kept asking for more clarification to an event they found difficult to comprehend. The clarifications that were issued consisted largely of accounting exercises that were remarkable for three reasons.[42] First, all valuation estimates were based on future profitability; the possibility of a valuation instead based on past investment costs was not even considered. Since the Banco Continental had become a very profitable business, this meant that the government freely conceded Chase's right to capitalize its high profit rate into the expropriation price. Second, within the possible calculations based on future profitability, the numbers actually chosen were particularly generous; they included an initial profit total taken from a very prosperous year, and a low discount rate on future profits which undoubtedly lay below Chase's opportunity cost of capital. Third, the detailed calculations underlying the valuation estimates can only be described as travesties of proper accounting practice. Crucial numbers were plucked from thin air; valuations based on past cost and future profitability were added together.

In fact, the price was not arrived at by such tenuous calculations, which rather represented ex post rationalizations. The price had been set by Chase Manhattan. In the economical words of Caretas, "Chase decided to sell dear."[43] Chase having named its price, take it or leave it, the Peruvian government took it and spent the following two months explaining itself.

Public critics remained dissatisfied, while within the government even President Velasco felt obliged to express his unhappiness with proferred explanations.[44] In the end, however, the government stuck to the announced terms. It emerged from the experience with revolutionary credentials somewhat tarnished, but with the consolation that in the future Peru would have a friend at Chase Manhattan.

While ITT and Chase Manhattan emerged unscathed from the expropriation process, other companies fared much less well. At this other extreme, consider the cases of two companies driven to the wall, a railroad and a refinery.

In the 1960s, major railway systems remained in private hands in only three countries of the world: United States, Canada, and Peru, where the Peruvian Corporation, that ancient artifact of the British bondholders, continued operating the engineering marvels built a century ago by Henry Meiggs. As in so many countries, however, railways in Peru were a sick industry, in need of substantial infusions of capital for new equipment if trucking competition was to be fought off and economic survival assured. In 1962 the Peruvian Corporation obtained a loan of $19.5 million from the World Bank and Export-Import Bank, the Peruvian government serving as guarantor, in order to rejuvenate itself through the introduction of diesel engines and other new equipment. The effort failed. In 1967 the Corporation defaulted on these loans, which were assumed by the government's Banco Industrial. Acting as an unpaid creditor, the government took over administration of the Corporation in 1971 and in 1972 auctioned off and bought the assets for $21 million.

The passing brought little mourning, but some recrimination. The president of the Corporation charged that bankruptcy had been forced upon

the railroad by the government's refusal to permit required rate increases. Peruvian Times commentary suggested the same thing, while at the same time pointing out that road competition for Cerro de Pasco mineral output always represented a competitive threat that effectively controlled railroad rates. Government officials went even further, charging that road competition had obliged the Corporation to set rates lower than those permitted by government regulation.[45] The controversy carried over to auction price as well. A government-approved valuation of 1971 set the Corporation's assets at $62 million, but at the moment of auction in 1972 a new valuation of $31 million was produced. Since auction rules stipulated that the price paid had to be at least two-thirds of the valuation, the final price therefore came to $21 million. As chance would have it, this turned out to be just enough to cover outstanding indebtedness to the World Bank, Export-Import Bank, and workers' compensation fund.[46]

It appears that saving the Peruvian Corporation would have required vigorous government support, involving not only rate increases but also some control over trucking competition, perhaps in the name of avoiding wear and tear on the Central Highway. This the government had been unwilling to do under both Belaunde and the Armed Forces. Perhaps the Corporation would have been permitted to reorganize under a continuing civilian government. As it turned out, the military government took over with a surgical incisiveness. No complaints were raised about excessive payments to corporation shareholders, because the corporation shareholders didn't get anything.

Refinería Conchán Chevron S.A. was set up in the early 1960s as a joint venture between Standard Oil of California and Prado interests. Warmly welcomed to Peru as a means of giving competition to IPC in the domestic market, the company was exempted from payment of turnover taxes under special provisions of the Ley de Promocion Industrial, declared by the government of

President Prado. The exemptions were later challenged by government tax authorities, and litigation begun under the Belaunde administration came to an end in May 1972 with a disallowal of the exemption and a claim of back taxes amounting to 86 million soles ($2 million).[47]

In the meantime, things had not gone well for Conchán. Standard of California found itself saddled with a wholly owned subsidiary, since its Peruvian partners never put up their capital subscription; moreover, they were saddled with a chronic loser, thanks to the severity of gasoline price controls in recent years. Payment of the back taxes would have obliged Standard of California to put more money into an operation that had no future. This they refused politely to do, so in June 1972 the company was intervened by the government, and, the following March, put up for auction. Only one bidder appeared, Petroperu, which offered an amount exactly equal to the amount of unpaid taxes.[48]

Throughout the whole procedure, the government scrupulously avoided any charges of corruption or bad faith on the company's part. Thus no tax penalties were claimed. However, neither was the government prepared to consider a negotiated settlement, letting the company off the hook for having perhaps made an honest mistake. Nor did it show particular generosity regarding the sale price. The official valuation, which exactly equalled the amount of back taxes, represented only a third of the company's own valuation.[49] Quite evidently, the government really didn't want Conchán around any more. Under new legislation, Petroperu is granted a monopoly of petroleum refining in Peru, so Conchán's very presence was an anachronism. Furthermore, any enterprise associated with Prado interests had to be viewed with a certain distaste.

From the extremes of expropriation experience, we next turn to a case of reorganization in that most reorganized of all industries, automobiles.

In recent decades the conventional wisdom of economic development has made industrialization synonymous with economic progress. At the same time, particular industries have acquired fame as the key elements of industrial progress. The steel industry held this distinction for several decades until the close of the 1950s, when the mantle was transferred, first by Khrushchev to petrochemicals and then by Servan-Schreiber to computers.[50] For Latin America in the 1960s, this distinctive role was surely assigned to the automotive industry.

Like so many of its neighbors, Peru pushed ahead rapidly and decisively in the early 1960s to create its own automobile industry. Within the general provisions of the Ley de Promoción Industrial, a decree of late 1963 announced a number of special tax incentives for automobile assembly.[51] The decree held the line on the already high tariff rates for imported assembled vehicles, and provided special exonerations on the importation of unassembled CKD kits. The kits were relieved of all specific tariffs, and sustained only an ad valorem charge of between 10 and 15%. In additicn, companies were exempted from the 5% turnover tax on sales between manufacturer and dealer, as well as certain additional charges, provided that only 10% of the car's value consisted of Peruvian parts. The government announced that it was prepared to sign five-year contracts on these terms, at the end of which period it would expect the local content share to have reached 30%.

The terms proved attractive enough to automobile assemblers. The first contract was signed with General Motors only three months after the decree, and by April 1964 two contracts had been signed and nine other

applications received from various automobile and truck producers.[52] This is hardly surprising: the rate of effective protection being offered the assembly industry amounted to something around 200%.[53] The figures in Table 1 give an indication both of the industry's growth and of its financial condition. Value added is obtained by subtracting the value of inputs from the gross value of production. It is, in turn, divisible into wages and salaries and profits gross of taxes and depreciation. Gross profit therefore came to the following:

1965	S/. 66 million
1966	229
1967	276
1968	227
1971	643

Total investment in the early years of the automobile industry has been estimated at approximately 675 million soles.[54] Therefore, gross profits during 1966-68, the first full years of operation, averaged about 36%, i.e., the gross payback period was 2-1/2 - 3 years. Assuming a length of life for assembly plants as short as 10 years, this implies a net return on investment, after taxes and depreciation, of about 16%. Since total profitability is given by this 16% figure plus those profits generated elsewhere in the multinational system from sales of parts and kits, it becomes clear that the automotive stampede into Peru was the economically rational thing to do.[55]

Table 1

Automobile Industry

(Units and millions of soles)

	Units Produced	Gross Value of Production	Imported Inputs	National Inputs	Wages and Salaries	Value Added
1965	2,824	S/. 314	S/. 173	S/. 21	S/. 54	S/. 120
1966	13,170	1,437	911	155	142	371
1967	17,414	1,936	1,330	161	169	445
1968	10,119	1,513	997	112	177	404
1969	16,860					
1970	14,456					
1971	16,639	2,616	1,360	401	213	856
1972	23,796	3,899		785	284	

Sources: Asociacion Peruana de la Industria Automotriz, Boletin, No. 68, January 1973, and special tabulations. Banco Industrial del Peru, Situacion de la Industria Manufacturera, 1966 and 1967. Isidoro Korngold and Josef Maiman, "La industria de ensamblaje automotriz en el Peru," mimeo, 1969, p. 40. 1971 data from special tabulation, Ministerio de Industrias.

This congenial arrangement was interrupted after only a few years, when in 1967 the Belaunde government attempted to change the rules of the game. By a series of decrees, it shut major foreign firms out of local borrowing opportunities, raised the ad valorem duty on CKD kits from 12% to between 20 and 44% depending on the kit's c.i.f. value, and redefined CKD kits more stringently, charging that "some assemblers have done little more than loosen the bolts and pass the vehicles off as CKD's."[56] Moreover, the tariff increases were declared to be retroactive and thus imposed essentially as fines amounting to as much as $706,000 in the case of General Motors. The automobile companies responded by refusing to pay retroactive tariffs and threatening to sue the government for breach of contract. They refused to claim CKD kits on the docks and started cutting production. The Belaunde government backed down and reached a compromise under which CKD tariffs would rise to 20% without retroactive provisions.

Curiously enough, Peru passed through this 1967 controversy without anyone, government or otherwise, suggesting that the companies were making too much money under the terms of the original contracts. The stated reason for the government's move was the fiscal crisis. The only expression of dissatisfaction with previous contractual arrangements was technical -- the failure of some companies to do enough assembling -- rather than financial. To be sure, Carlos Malpica blasted the automobile companies for excess profits, but Malpica's work did not command respect in the days of Belaunde as it would later under the Revolutionary Government of the Armed Forces.[57] Furthermore, nobody stumbled onto the opportunities for additional profit-taking through pricing of CKD kits.[58]

Two years later, in the last days of 1969, the military government unleashed the first policy thunderbolt to fall on the automotive sector. It called for new concession bids under drastically changed conditions:

(1) Local content requirements were escalated dramatically. From 15-20% in early 1970, they were to be raised by steps to 70% by February 1, 1973. Choice of composition for local content was also to be restricted. Any Peruvian automotive parts certified by the government as equivalent to international standards of price and quality had to be used. Importation of motors was to be prohibited after January 1974.

(2) Foreign companies were given just one year for fading into minority ownership.

(3) CKD tariff rates were shifted to a scale, depending on engine size, ranging from 5% to 85%.

(4) The number of models produced was strictly limited.

(5) Importation of assembled cars was prohibited. Prices of assembled cars were to be set annually by the Ministry of Industries.

Ten producers hurriedly assembled formal proposals by the March deadline, and then waited. In August, the government announced the winning bidders. Four automotive producers remained and five were shut down. One truck producer remained and three were shut down.

The survivors of this shake-out found themselves in a new environment of tightened control and heightened uncertainty. The controls reduced price-cost margins (dealer markups included) from about 45% in Belaunde's time to about 20%. The return on investment did not increase so drastically,

however, because each remaining company increased production volume. Two-shift operations, formerly unheard-of, became the industry norm, and in some cases profit rates even increased. The uncertainty of the new environment derived from the widespread realization that the new rules of 1970 were not the last changes that would be visited upon the industry. Some of the subsequent changes, however, involved easing the severity of the new rules. For example, the local content targets announced in 1970 were lowered or postponed time and again. Similarly, CKD tariffs were lowered in 1972, and 1974 dawned with the fade-out rules on foreign ownership yet to be implemented.

But while pragmatic accommodation thus set to rights some of the disarray created by old thunderbolts, new storm clouds appeared. Only one month after the August 1970 announcement of who would stay and who would leave, new bids were called, this time for monopoly rights to produce gasoline engines and power trains. This tender produced great confusion, since it failed to allow sufficient engine variety to accommodate the eight automobile models authorized the month before.[59] The government dropped the tender, apparently for lack of takers. The line of industrial expansion that it had begun could be continued only after further contraction in the number of companies and models.

By early 1972, the government appeared to have surrendered completely on the local content issue, having lowered the end-of-year goal from 70% to 35%. Yet in fact it had not surrendered its vision of an integrated automotive industry. Quietly casting about for new ways in which to reorganize the industry, in mid-year the government approached General Motors and one or two other companies regarding the possibility of a monopoly concession -- cars, trucks, engines, everything to be handled by one producer.

When nothing came of this approach, it returned to an earlier formula -- new bids from the remaining producers. In January 1973, for the fourth time in the 10-year history of the industry, new terms of operation were announced. The most important rules of this new game were the following:

1) The number of automobile producers would be reduced from four to one or perhaps two.

2) The producer(s) would build an engine and transmission plant, and also contribute capital to a forge and foundry for casting basic automotive parts.

3) The producer(s) would export automotive parts equal in value to the kits imported. This so-called _intercambio compensado_ provision was offered as a more flexible substitute for local content regulations.[60]

Once again, proposals were hurriedly prepared and submitted, this time by the end of May 1973, and then the companies waited. In December 1973 the government delivered what may be the last thunderbolt in the revolutionary reorganization of the automotive industry: Toyota was named the chosen company. If a second company is needed, Volkswagen was second. Chrysler, the only one of America's Big Three to survive the first shake-out, finished dead last.[61]

Automotive reorganization has been characterized by frenetic competition, as each company attempted to salvage what it could of past investments and future market potential. While loss of a bid with consequent expulsion from the local market, has come as a crushing blow to local executives, their companies can view the loss of the Peruvian market as a matter of limited importance. By contrast, the major mining companies cannot afford

to treat Peru with such detachment. The stakes are far bigger, as are the risks. As a final case for examination, we return to the storm clouds that have hovered around the Southern Peru Copper Corporation.

More than with any other single project, Peru's economic and political prospects in the first years of the Revolution have turned on Cuajone, a mammoth open pit copper deposit recently estimated to require $550 million for full development. Cuajone has formed the key element in plans for an expanding mining sector, the sector that gives firmest prospects for future growth in export earnings.

Before its demise in October 1968, the Belaunde government had begun negotiations over Cuajone with the same New York-based Southern Peru Copper Corporation that had provoked such nationalistic resentment over the Toquepala contract. Once the dust had settled from the IPC expropriation and the Hickenlooper menace , the military government returned to the issue of Cuajone and found itself confronted with a delicate choice between political solidarity and economic necessity. Clearly the ideal solution lay in awarding the Cuajone concession to a European or Japanese group. Yet despite a certain amount of brave talk about others who might come forward, in fact the world-wide supply of potential investors was highly limited.[62] Few companies poscess familiarity with the technology of open pit copper mining. Fewer still have access to the enormous amounts of capital required. Moreover, the potential difficulties of sharing transport, refinery, and export facilities with Southern Peru in its adjacent Toquepala deposit essentially ruled out the entry of a new company. The choice available became clear: It was Southern Peru or nothing.

Matters came to a head in late 1969, at a time of great uncertainty about Peru's economic prospects. The foreign debt needed refinancing and the domestic economy needed more spending to pull it out of recession. Neither foreign creditors nor domestic investors were prepared to commit funds without a solid indication that Peru intended to maintain regular business connections with the centers of world capitalism. The indication that they wanted was the Cuajone contract.

Politically, it was no easy matter for the government to sign. In the weeks following the first announcement that the contract was nearly ready, the Peruvian Left mounted an all-out campaign of opposition. The terms hardly mattered; any contract would bind Peru more closely into the capitalist orbit. In the words of one critic: "Any foreign investment whatsoever is enslaving. The task of the Revolution must be to enable Peru to exploit its own resources."[63]

Journalistic opposition from outside reflected the far more important opposition that lay within the government. The Cabinet met in crisis sessions, and the government's position changed somewhat to accommodate the inner stresses. The signing was postponed, slightly tougher terms were demanded of Southern, and a new Mining Law was promised. The government denied all the time that it felt any pressure connecting Cuajone to the refinancing of Peru's foreign debt, yet President Velasco's perhaps unguarded response to a reporter's question tells a different story:

> "The government doesn't have any money. When we assumed power we found a disastrous situation. Huge debts, both external and internal. The Peruvian economy is in large part paralyzed. Lines of credit are closed. The country needs capital for its development."64/

Two weeks after these un-revolutionary remarks, the government signed on the dotted line. Perhaps never before or since has the meaning of external dependence seemed clearer in the context of the Peruvian revolution. 65/

Southern Peru Copper Corporation began the new decade with a contract, but without the required investment funds. No longer could it step up to the window at the Export-Import Bank as it had done before for Toquepala. That particular funding source had been shut down as part of the U.S. financial boycott against Peru, a boycott imposed in retaliation for the expropriation of IPC.[66] As for private lenders, they viewed Peru somewhat more favorably after signing the Cuajone contract, but no surge of funds into Peruvian mining materialized. After all, expropriation was in the air in Latin America, in Chile, in Bolivia, even in Venezuela, and the Peruvian revolution's ultimate political direction seemed to change with every month. Lenders persisted in waiting a bit longer before commiting funds to Peruvian mining, and so months dragged into years as Southern Peru doggedly kept up its search for finance.

That search had received an early setback with the Mining Law of April 1970, which converted the minerals exporting business into a government monopoly and reserved all future metal refining for state enterprise. These moves appeared to break all possibility of guaranteeing copper deliveries to favored buyers in exchange for finance from those buyers.[67] The government came forward with sufficient assurances to allay those fears, only to create new fears later in the year through regulations that threatened loss of mine concessions if companies failed to develop them rapidly.[68] Financing negotiations with a consortium of Japanese smelters were well under way at the time, and optimistic announcements in November suggested that the deal was nearly settled. In fact, the final settlement never came.[69] A sharp decline in world copper prices apparently turned Japanese investors away from Cuajone, but only because higher prices were required to make the political risk worth running. In the words of Metals Week,

"with the new left wing military government in power, financing is understandably a very tricky proposition.[70]

Through most of 1971 and 1972, Cuajone financing remained at a standstill. Southern Peru continued to invest depletion allowances and net profits from Toquepala into Cuajone, thereby maintaining the investment schedule called for in the contract. In the meantime, Peru's credit-worthiness in the eyes of the world's major lenders slowly but steadily improved. The government consistently demonstrated its intention of honoring debts to foreign lenders, no matter how embittered the fights with certain foreign companies. Moreover, fairly tight fiscal and monetary policies produced that aura of fiscal responsibility so cherished by potential lenders. The premium over London interbank rate required of Peru diminished steadily.

By late 1972 the price of copper was high again. Peru was a better credit risk. The Eurodollar market was loaded with funds looking for projects. These factors encouraged formation of a consortium that arranged a $200 million loan to Southern Peru for Cuajone. The consortium was organized and led by the Chase Manhattan Bank of New York.

Yet even with this major breakthrough, Southern Peru was not entirely out of the woods. Nearly a year was to elapse between acceptance of the Chase consortium proposal by Southern in December 1972, and actual signing in late November 1973. Furthermore, an additional $200 million was still required to complete the financing package. While announcement of the Chase consortium loan included a confident prediction that the remainder would be collected without difficulty from suppliers' credits and long-term sales contracts, in fact a fundamental obstacle remained.[71]

Both members of the Chase group and other potential lenders still required further guarantees. It was all very well that Peru's credit-worthiness had improved, but the loan for Cuajone were being made not to the Peruvian

government but to a U.S. company. Thus the lenders' perception of default risk by the company was inevitably influenced by Peru's treatment of expropriated companies. The risk surely appeared real and non-negligible. To the early casualties of IPC and the Grace properties expropriated by the Agrarian Reform had been added not only Conchan but also all the U.S. fishmeal companies plus a couple of road construction firms. Then during 1973,negotiations for the purchase of Cerro de Pasco became increasingly tense, threatening a new diplomatic crisis of IPC magnitude.[72] In this environment the potential lenders insisted on the additional protection of U.S. government participation in the financing package. Some loans, however small, had to be obtained from the Export-Import Bank. The U.S. government would not permit such a loan, however, without a general settlement of outstanding expropriation issues. The Cuajone project remained stuck on dead center.[73]

Although prospects for such a settlement appeared more remote than ever in mid-1973, in fact it suddenly materialized in the first days of 1974, capping many months of quiet diplomacy undertaken by James Greene, a New York banker designated as special emissary of the U.S. government.[74] The terms illustrate neatly the potential of imaginative diplomacy in finding compromise between apparently irreconcilable opposing positions.

Faced with positions which,on the one hand,demanded some compensation for IPC and,on the other hand,insisted that IPC was absolutely non-negotiable, the settlement formula called for a lump sum payment to the U.S. government, with subsequent distribution to the various companies undertaken by the U.S. government in accordance with U.S. law. In an appendix to the agreement, the Peruvian government listed the companies whose claims it considered included within the agreement. The IPC was, of course, not included in the Peruvian list. However, the appendix was also stated to be a unilateral declaration by the Peruvian government that did not modify the provisions of the basic

agreement. Thus the Peruvian government declared itself to be no party to any arrangement involving compensation to IPC. Nevertheless, IPC will undoubtedly claim compensation under U.S. law and get it.

As compensation agreements go, this one is not particularly generous to expropriated companies. The funds available for distribution amount to $76 million, as compared to the companies' claims in the order of $250 million. Peru's bargaining stance over previous years had been sufficiently tough to convince the companies that their alternative to half a loaf was none. Therefore they settled, and the U.S. government agreed to the following article in the final text:

> "The Government of the United States declares that the payment of the sum referred to in Article II cancels any liability or obligation of the Government of Peru to United States nationals, their subsidiaries, branches and affiliates."75/

The financial war was ended. The U.S. companies had been swept out of the basic sectors to Peru's satisfaction.

As for Cuajone, within a matter of weeks the Export-Import Bank announced a $55 million loan for equipment purchases, and a few days later the President of American Smelting and Refining Company, which owns majority interest in Southern Peru, was able to announce that the financing package was at last complete.[76] At the same time, however, he also announced further difficulty with the Peruvian government over the guarantee of copper deliveries to certain participants in the financing package. Although the difficulty will most likely be settled expeditiously, it serves to remind foreign investors that in the newly normalized investment climate of revolutionary Peru, risk is reduced, but not to zero.

These various cases show that as state enterprises have taken over in the basic sectors, foreign investors have been bought out or swept aside in arrangements ranging from sky-high prices to confiscatory expropriation.

Despite this range of results, the outcomes are by no means random. In large part they have depended upon the particular bargaining strength of each foreign company, where this strength has derived from the company's capacity to provide financial or technical services needed by Peru. Chase Manhattan was able to offer technical assistance and access to the New York financial market. It was well paid. The Peruvian Corporation had nothing to offer. It was driven to the wall. Other cases are intermediate to these extremes, but they all illustrate the remarkable pragmatism of Peru's approach to foreign investors, a pragmatism advocated by President Velasco and evidently adhered to by negotiators.

These considerations seem not to apply in the case of IPC itself, since Peru has undoubtedly lost far more in blocked loans and withdrawn aid than would have been involved in a moderate plan for compensation. The political capital accumulated by the IPC expropriation, however, must not be forgotten; after all, it provided political sanction for the Armed Forces to take power in the first place.

In addition to this basic element of pragmatic assessment of benefits, the popularity cycle described by Vernon and others undoubtedly has played some role.[77] By this view, a foreign firm is greeted most warmly on arrival, but as years stretch into decades the welcome wears thin and the host country becomes increasingly aware of the negative factors that derive from the company's presence.

This argument suggests that the big old-time companies would be first to get the axe. In the case of Peru, four companies fall into this category -- Cerro de Pasco, the Peruvian Corporation, IPC, and Grace -- and sure enough, all four are gone. It is not obvious, however, that they left specifically because of resentments that had built up over the decades. Cerro asked to be bought out, and the final price seems likely to make Cerro content. The Peruvian Corporation was a basket case. IPC was a special case, so everyone says, although it does fit Vernon's view exactly. As for Grace, most of its operations were either in agriculture or in basic industrial sectors. Other holdings have been sold off as part of a long-standing company objective to get out of South America.[78]

The Shape of the Future, in Mining, Petroleum, and Industry

While old foreign investments were being reorganized in some sectors and expropriated in others, elsewhere in the economy the government pushed ahead with plans for industrial and export development that included foreign participation under new terms. We must examine a few more case studies concerning these terms in order to gain a better sense of the role being reserved for foreign investors in a reorganized Peruvian economy.

In early 1972, the Peruvian Times forecast the future of Peruvian mining with these words: "The chief entrepreneur in the search for mining capital is clearly Mineroperu: The development of the Cuajone deposit by Southern Peru Copper Corporation is the last big new mine that will be financed solely by private enterprise."[79] Mineroperu, the new state mining company, holds rights to innumerable promising ore bodies that reverted to the state when private companies were slow to develop them. It has chosen to cut its teeth as a big-time mining enterprise by developing an open pit copper mine at Cerro Verde. This seemed an appropriate choice, since Cerro Verde's proximity to Arequipa reduced greatly the need for infrastructural investment, thus cutting down on both capital costs and planning problems.

The organizational changes at Cerro Verde mark stages in the entrepreneurial development of Mineroperu. First plans called for a joint venture with Anaconda, which had been holding on to the Cerro Verde concession for 50 years. In late 1970, however, negotiations collapsed with Mineroperu's insistence on majority ownership. Stating that required loans could not be raised in world markets on such a basis, Anaconda dropped

the concession, wrote off $4.3 million of development expenditures, and left Peru.[80]

Only two months after Anaconda's announcement, a Belgian delegation was in Lima offering a financing and technical assistance package. Similar offers soon came from a British-Canadian consortium, and the following October Mineroperu signed a memorandum of agreement with the British and Canadians. The agreement called for a turn-key job. British Smelter Constructions, Ltd., was charged with all aspects of opening the mine--finance, equipment purchase, construction. Engineering design work was to be subcontracted to Wright Engineers of Vancouver. Once put onstream, BSCL would stay on for an additional year and then hand the key over to Mineroperu.[81]

More tough bargaining was to follow this preliminary agreement, and when the final contract emerged nine months later, the terms had changed significantly. Now Mineroperu was to run the project instead of British Smelters, although BSCL still held responsibility for the three principal functions of finance, purchasing, and construction. Having passed through the stages of silent partner and turn-key recipient in Cerro Verde negotiations, Mineroperu as manager forms the shape of the future in Peruvian mining.

Yet that future is not yet assured. Mineroperu's plans for future mine development require enormous sums of foreign capital which will probably become available only if it's managerial record is a successful one. In Mineroperu's only venture thus far, finance has proven to be no problem. Most funds for Cerro Verde came from export credits of the British and Canadian governments. The remainder came from the first loan Peru ever floated on the Eurodollar market.[82] However, Cerro Verde

has been delayed by technical problems that are not yet resolved.

The difficulty arose with the decision to begin operations on a veneer of oxide deposits, using a refining process that has several unique and untried features.[83] Despite the best efforts of the Canadian consulting firm, the process has not been made to work on Cerro Verde ores. While the experiments continue, the development schedule has been set back. In the words of one authority on Peruvian mining:

> "What most mining people in Peru and New York are now saying is that Minero Peru made its first big mistake in even attempting to process the oxide ores--that it should have stripped the oxide zone away as overburden ....and gone straight to work on the lower levels. Its second mistake, they continue, is in not realizing it made the first mistake, and just abandoning the oxide-electrowinning process now."[84]

Financing sources in the U.S. and Europe read this experience as evidence of Mineroperu's inexperience. The shape of the future in Peruvian mining depends greatly on successfully overcoming that inexperience during the next few years.

Where Mineroperu had to start from scratch, Petroperu sprang full-grown from the ashes of IPC. Petroperu inherited a production and distribution system and also an efficient administrative organization. All it lacked was capital for exploration. Whereas Mineroperu chose to bypass foreign mining companies and obtain finance through suppliers' credits, Petroperu could not do this. The risks are such that suppliers could not consider similar terms for petroleum explorations. Yet the old-time concession contracts appeared particularly unappetizing in the petroleum sector. Accordingly Petroperu hit on the idea of a service contract that shared output instead of profits, an approach that had been tried previously only in Indonesia, and in somewhat different form.

Petroperu sought out Occidental Petroleum, a company widely reputed to be venturesome, and signed them to the first service contract in June 1971.

Perhaps the two outstanding features of the Occidental contract are its emphasis on assertion of sovereignty and its simplicity.[85] In the words of General Fernandez Baca, "The contract naturally puts special emphasis in affirming, at every instance, the sovereignty of the Peruvian nation. Experience has taught us much in this respect."[86] Thus the contract emphasizes that the concession is held by Petroperu and that the petroleum flowing from the wellhead belongs to Petroperu, which then pays half of it to Occidental as a service fee. In the calculation of tax liability, however, Occidental receives a tax credit for the 50% petroleum share kept by Petroperu. This more than covers tax liabilities and renders the tax calculation an exercise having only arcane legal significance. Its economic insignificance furnishes the basis for the contract's simplicity: Systems of tax audit control become unnecessary. Everything reduces to the 50/50 split at the wellhead.

The contract held two other features important to Peru. First, it pushed Occidental to rapid development of the assigned area. Geophysical exploration had to begin within 6 months, drilling within 30 months, 3 wells drilled within 4 years, and 10 within seven years. Petroperu had no difficulty with Occidental on these points. Within 26 months of signing, Occidental had drilled five wildcats and hit oil on every one. These combined with three successful Petroperu wildcats to set off a stampede for Petroperu service contracts. By late 1973, when the government called a halt to new contracts, 18 had been signed with various companies, all similar in terms to Occidental's except that the output division was 45/55,

in favor of Petroperu.[87]

The contract's second important feature lies in the absence of a capital commitment from Petroperu. All the risk is shifted to the foreign companies. This is of course an advantage, particularly if no pertoleum is found, but it also means that the profits tax implicit in output sharing will be lower either if truly spectacular discoveries are made, or if ordinary discoveries are made at a time of spectacular increases in world petroleum prices. In no case could the implicit profits tax fall below 50%, which is a respectable tax bite in most industries.[88] But petroleum exporting countries are accustomed to tax rates in the order of 75% these days. The recent dramatic escalation of world petroleum prices, an event very hard to have foreseen in 1971, may make the 50/50 output division too generous a contract, thus generating a political head of steam that will force renegotiation of the percentage division at the wellhead.

Petroleum service contracts became a political volcano in Argentina in the early 1960s. Careful management and attention to issues of sovereignty by Petroperu has thus far averted a similar development in Peru, even as the country passes through a nationalistic revolution. Output sharing contracts probably obtain foreign capital and technology in as antiseptic a manner as possible. Their only danger is that they shift the risk all too well.

The shape of things to come in industry is perhaps best judged not by the new terms offered the automobile industry, but by the course of negotiations with companies lacking pre-existing investments in Peru. Only by examining such cases can we say something about Peru's prospects for driving automotive-type bargains without first having lured the

foreigner into the country on substantially easier terms.

Other sections of Peru's motor vehicle industry provide instructive examples. In April and May 1971, six months after the first shake-out of the automobile producers, the government called for bids on the production of tractors and diesel engines. The terms offered were similar in the two tenders. The foreign company would be minority partner in a joint venture with Induperu, the government's industrial development corporation. The number of models to be produced would be carefully stipulated, local content requirements would be high, around 75-80% within five years, the plants would be located in Trujillo and would have prospect of near-monopoly positions in the Andean Common Market. A capital contribution to the forge and foundry would be required, by direct subscription from the diesel company, from reinvested profits in the case of the tractor company. Local content regulations would be less onerous for tractors, since locally produced diesel engines would count, but in addition the tractor tender included _intercambio compensado_ provision, i.e. that exports equal imports, two years before this feature cropped up in automobile negotiations.[89]

Both tenders received strong responses. Seven companies bid for the tractor contract--three from England, two from Italy, and one each from Rumania and the Soviet Union. The closest thing to an American bidder was Ford of England. Apparently the major U.S. tractor producers weren't interested.

The same was not true in the diesel bidding, where three of the seven bidders were American--Cummins, Caterpillar, and Continental Motors, engine maker for Checker cabs. Continental made the most spectacular proposal of all, offering a production volume seven times what the government had asked for, the bulk to be directed to export markets outside the

the Andean Group.

Eighteen months later, the tractor contract was awarded to Massey-Ferguson, an English-Canadian company, and the diesel contract jointly to Vovlo of Sweden and Perkins of theU.K., the latter a Massey-Ferguson subsidiary. Contracts were not actually signed until July and September of 1973. This extraordinary delay is testament to the complexity of the contracts, and to the difficult trade-offs that confronted the government. The fundamental trade-off lay between efficiency and backward linkages. Despite the apparent usual fixation with local content, government negotiators were in fact preoccupied with what they themselves referred to as the "inefficiency cost" of local supply".[90] Partly to avoid that cost, the tractor contract called for at least one third of local content to be produced by the company itself, where presumably the inefficiency cost would be lower.

Another important trade-off lay between cost and bargaining position within the Andean Group. The final choice on the tractor contract lay between Massey-Ferguson and the Rumanians, who offered a lower cost financing package. The government, however, feared that a Rumanian tractor contract would carry little weight in future Andean negotiations. And if Peru fails to get a tractor assignment in those negotiations, neither Rumanian nor any other tractor producers would have much future in Peru.

Peru's position in the crucial Andean negotiations is therefore strengthened by having a contract with a name brand. It may also be strengthened by the compensatory export provision, which serves as a partial guarantee that the quality of the Peruvian product will not be allowed to slip below Massey-Ferguson's worldwide standard. In addition to improving

Peru's bargaining position, this provision can encourage the technology flow that Peru wants from foreign investors.

In tractors, in diesels, and in every new major industrial enterprise, the technology possessed only by foreign companies is indispensable. Peru wants that technology and is prepared to offer in return protection from competititon, a minority share of the equity, and a constrained form of managerial control. This represents an uncertain bargain, since countless details will surely remain to be worked out long after investment is begun. Also, government policy makers are still feeling their way, and may well change the terms in the future. Nevertheless, the lesson of the tractor and diesel tenders is that many foreign companies are prepared to accept these terms and take their chances in joint ventures with Peruvian state enterprises.

The Response of the Foreigners

> "It's been some years since I lived in Peru, but I visited there recently, and was really impressed. You hear all this pessimism about business in Peru these days, but I think it's exaggerated. From what I saw, I think you can really do business, and make money. But I wouldn't want to invest there."

This comment by an American businessman neatly captures the prevailing outlook among the more progressive elements of the foreign business community in Peru today. Most feel in some sense captive, unable to get their money out, obliged to make the best of a situation not of their choosing. In the meantime, they make good profits. But they bring in no more

investment funds.

Even before the beginning of the Peruvian revolution, in the friendly days of Belaunde, one knowledgeable observer described typical business strategy as follows: "Make a minimum investment, plow back profits, borrow locally, and grow to maintain your market share with a minimum commitment." New investment funds were brought in so sparingly because of fears of devaluation, exchange control, and political instability. Today, this same observer characterized business strategy as more concerned with quick payoffs rather than growth and reinvestment. Defensive investment has given way to Take the Money and Run.

Foreign businessmen see risk of expropriation and loss of managerial control as the major deterrents to investment. The expropriation risk arises partly because the government has not yet established definitively which sectors are to be reserved for state enterprise, as the fishmeal expropriations demonstrate. It also comes from a lingering concern that the revolution may well shift dramatically to the left, perhaps socializing all industry. Without any shift in the revolution's direction, foreign businessmen find themselves staring straight at the specter of lost management control. The government views the Comunidad Industrial, through which 50% of the firm's equity will ultimately pass to the workers, as a means for bringing harmony of interests between management and labor. Most foreign businessmen view it as an invitation to chaos. To put off the day of reckoning when the workers' share rises to 50%, businesses have strong incentive to reinvest and expand, thus increasing their own share. Thus firms already in the country do invest, but the incentive that moves them contains rather more

of the stick than the carrot.

While risk of expropriation and loss of control constitute the major drawbacks to further investment, the drain on management time under the new rules of the game is often mentioned as an important secondary factor. One manager commented, "All our department heads are in the Ministry three or four days every week." The extra effort derives partly from the complexity of labor relations in the era of the Comunidad Industrial, partly from proliferating regulatory mechanisms, particularly those concerning profit repatriation. Some foreign subsidiaries have repatriated profits without difficulty but have hit snags on royalty payments to the parent corporation. Other companies have had repatriation requests delayed from one to three years.[91] The apparent arbitrariness of treatment increases risk for all foreign investors.

Profits available for repatriation are substantial. A profit squeeze is not often mentioned as an important deterrent to foreign investors in Peru today.

For these various reasons, nearly all new investors coming into the country do so through special contracts, as in the cases of petroleum, tractors and diesels. Being partly owned by the government, and judged important in government development plans, such firms can be more confident of entering a facilitating environment. The government wants them to succeed.

As we have seen in some of the case studies, not all foreign companies look with favor even on the opportunities of special contracts. Company reaction often depends on the idiosyncratic response of individual managers, but in general American companies seem particularly

skeptical about investment prospects in Peru. The reasons advanced for this are many. The Europeans and Japanese are said to have greater experience in joint ventures with governments.[92] It is also suggested that big American firms, already well established in the larger markets of Brazil, Argentina, and Mexico, feel that they already have enough investment in Latin America and are therefore less interested in the Andean Group. Then again, the rhetoric of the new nationalism is aimed more directly at Americans, building a stronger sense of rejection on top of what had probably been a stronger ideological antipathy in the first place. Perhaps some such combination is required to produce the viewpoint of one American businessman that "Decision 24 cannot be considered a satisfactory body of legislation. It is entirely negative," or of another who characterized the new rules of the game as built on "a legal structure so precarious that any company putting its faith in it is just putting its head into a trap."

Business decisions that spring from such viewpoints sometimes acquire surprising form. One company, for example, was described as making enormous profits, yet the board of directors of the parent corporation remained persistently unhappy about the situation. Their unhappiness arose not merely from a perception of the proper risk discount to be applied in calculating expected future returns, but also because of an abhorrence of the prospect of being expropriated per se. The board's agitation finally convinced the Latin American manager that he should sell out at a bargain price, but he could find no takers.

The American business community does not speak with a single voice on the proper response to Peru's new rules. The opinions just

described are likely to be challenged increasingly in board rooms across the United States.[93] Out of such challenges, American corporations will no doubt make their grudging accommodations with the new way of doing things in Peru. The accommodation will be easier to make if the rules are loosened, as has been predicted recently.[94]

The New Foreign Investment Game -- How Different Is It?

Looking over the Peruvian economic landscape in the first days of 1974, one sees dramatic changes in the foreigner's role compared to what it had been five years earlier at the end of Belaunde's administration. In that Peru of the ancien regime, the largest and most visible firms in nearly every sector had been foreign. Almost without exception, Peruvian firms were small-scale operations. Peruvian state enterprise consisted of little more than a moribund steel company, a modest shipping line, a shipyard, a few fertilizer plants, and some sectoral development banks.

After five years of the Peruvian Revolution, most of those large and visible foreign firms are gone, replaced or absorbed by state enterprises. In transport and communications, Lima's power company, the national telephone system, the railroads, and Peru's international airline have all been transferred to the state. In manufacturing, the cement, chemical, and paper industries were defined by the Ley de Industrias as basic, to be reserved for the state, and have been taken over. The government steel plant has been expanded considerably. Among export sectors, the entire fishmeal industry was nationalized in a stroke; so was the sugar industry, through the 1969 Agrarian Reform law. The petroleum

industry, where it all started, consists of one firm: Petroperu. Only in mining were major foreign firms still to be found. But in mining too the state has become dominant. Cerro de Pasco was expropriated on the first day of 1974, to be recreated as the state-owned Empresa Minera del Centro.[95] Elsewhere, the most promising ore bodies are reserved for Mineroperu, to be developed in coming years along the lines of Cerro Verde.

Outside of commodity-producing sectors, state enterprises have acquired marketing monopolies of all major commodity exports and a major share of domestic food distribution. In finance, most of the insurance industry has been nationalized, along with three of the major commercial banks.

Thus it turns out that state enterprises have become the chosen institution for achieving the objectives of the Velasco Doctrine. Transferring the commanding heights of the economy from foreign to national ownership has not meant a substitution of local capitalists for foreign capitalists. The government has little interest in developing powerful local capitalists, even if it could. A private sector, reformed by its sharing of power through the Comunidad Industrial, is still counted on to play an important role, but only in sectors of secondary importance. These are also the sectors where scale economies are thought to be less important, firms are smaller, and no one firm need grow to politically threatening size.

In this new Peru declared to be "ni capitalista ni comunista," what role remains for direct foreign investment? The question is surely answered by the recent Greene compensation agreement if it had not been answered earlier by the Cuajone contract: The Peruvian revolution has no

intention of severing economic relations with Western capitalism. On the contrary, it desires to normalize and thus strengthen those relations. Normal relations would imply renewed credits from international lending agencies, but Peru is after bigger game than that. Most important of all, Peru needs access to the Export-Import Bank and to New York and European capital markets for the enormous volume of funds required to expand the mining and petroleum sectors.

These relations involve more than finance. Peru also remains in the market for technology, both scientific and organizational, so the government will want to continue dealing with direct investors. The organizational forms will surely vary from one deal to the next -- joint ventures in some cases such as the tractor and diesel contracts, petroleum-type production agreements in others, management contracts in still others that will resemble Cerro Verde.

The government's plans for industrial investment concentrate on massive projects in a few basic sectors -- the automotive complex, petrochemicals, paper. Peru is forging ahead quickly in these sectors, partly to improve its bargaining position in Andean Group negotiations, partly to fulfill the government's vision of the most promising path to development. Along this path foreign participation will be required at every step of the way, in order to obtain and incorporate foreign technology. While the government will always prefer a joint venture or co-production agreement, it is not inconceivable that an occasional wholly-owned foreign subsidiary will be let in, if the foreigners bargain from great strength (as IBM is able to do) and are able to extract such a price. In every case, the foreign firm will justify its presence to the government by forming a key link in

the government's own chain of industrial projects.

Outside these major project areas, foreign investment is technically welcome under the conditions stated in the Ley General de Industrias and Decision 24 of the Andean Group. As mentioned above, however, these conditions are bureaucratically complicated, with many procedures and policies not yet fully worked out. Companies are liable to find themselves caught in a variety of possible crunches, on issues such as price policy, profits repatriation, royalty payments, import permits, and permission to expand through reinvestment of profits. In most cases, these issues are processed smoothly by the bureaucracy. But when obstacles arise they cannot be gotten around by the smooth accommodations generally available under earlier governments. And they arise often enough to lend substance to the impression that Peru's general welcome to foreign investors is highly qualified.

From what nations are foreign investors sought? From all nations, even the United States. Peru has deliberately diversified its economic and diplomatic relations, and has given special effort to expanding trade with new markets in China, Cuba, Eastern Europe, and other parts of the Third World. This diversification extends to foreign investment as well. New investment proposals have been welcomed not only from Japan and Western Europe, but also from such unexpected sources as Rumania, Bulgaria and Albania. Yet at the same time, the government does not want to lose contact with American industry. It was a source of disappointment to many officials that all the automotive contracts wound up without a single American entrant. Some were angered at what they saw as an American corporate boycott of their industrialization plans. On the other side,

some Americans have seen discrimination in the quick dismissal of the Continental diesel proposal and the fourth place finish of Chrysler in the final automotive crunch. Ministry officials explain both these results in technological terms. The automobile contract, which involved a small vehicle, saw Chrysler pitting its Hillman against Toyota and Volkswagen. It was not to be.

These continued associations with multinational corporations and major banking houses have caused some critics to conclude that Peru's new rules of the game involve cosmetic change without altering the fundamental realities of imperialist penetration and economic dependence.[96] The conclusion depends very much on one's definition of imperialism and dependence. One could, for example, see the essence of dependence in the formation of consumer preferences through the communications media of Western capitalism. Once the media have done their work, the public craves and the government must deliver the trappings of Western, middle class existence. By this view the Peruvian revolution is no revolution at all.

Another view of dependence is more concerned with lack of bargaining strength and vulnerability to manipulation by imperialist pressure.[97] By these criteria the present military government differs substantially from its civilian predecessors. Foreign businessmen and diplomats view it as sometimes unreasonable and sometimes erratic, but always a formidable adversary over the bargaining table. It is a government highly impervious to political penetration by outsiders, whether they be foreigners or Peruvian civilians. Furthermore, it is likely to remain that way, as the growth of large state enterprises in basic sectors limits the concentration of independent economic power.

It might be argued that multinational corporations and major foreign banks acting in unison could exert overwhelming power against so small a country as Peru. In fact this eventuality seems unlikely. Peru has already won a fight against the world's largest corporation. Moreover, while Exxon blustered, and General Motors turned up its nose, Massey-Ferguson made a deal. Peru bargains from strength so long as it can find enough companies like Massey-Ferguson.

One finds greater difficulty in deciding if Peru is really better off as a result of the new rules for foreign investment. I suspect, however, that Peru is indeed better off, for three reasons.

Perhaps the most frequently mentioned reason concerns the gains that closer supervision can provide through enabling a host government to obtain foreign capital and technology at lower cost. Effective supervision would make supranormal monopoly profits less likely, and would make it more difficult to hide any such profits in royalty payments, transfer prices, or other time-honored gimmicks.

Such gains are undoubtedly real, significant, and worth pursuing, yet I suggest that they represent the least important of the three forms of gain that the new rules can provide Peru. This is because the mythology of foreign company profit rates has probably outrun reality by a wide margin. My impression is that foreign companies in Peru have generally earned profits that could be described as healthy but not extravagant. The few cases verging on the extravagant have generally involved old mining and petroleum concessions. Virtually everywhere in the Third World, concessions as they were written 20 years ago were giveaways. In most countries the terms have been tightened greatly in recent years, however,

without recourse to revolution.[98]

The second source of gain lies in the general satisfaction a society obtains by doing things for itself. Economists have incorporated this idea into their frameworks by considering nationalism as a collective consumption good.[99] While this may seem a rather artificial construct, the phenomenon is real and important. The accomplishments of a nation reflect on every citizen of that nation. A nation obliged to employ foreign companies to accomplish its significant tasks of production can feel little pride in itself. Inevitably, its citizens will sense that the nation's lack of economic accomplishment reflects poorly upon them.

The creation of Peruvian enterprises and Peruvian leadership within the national economy undoubtedly provides satisfaction. It also provides the most severe challenge that Peru has faced in this century. Having constructed a network of state enterprises destined to control the commanding heights of the economy, Peruvians will become obliged to manage, to administer, and to perform entrepreneurial functions as never before. The benefits to be obtained from successfully meeting this challenge are the greatest of all. It involves nothing less than changing a nation's character in a way that can bring development out of under-development. I have suggested elsewhere that the greatest obstacle to economic progress in Peru's history lies in the fact that the traditional elite consisted of rent collectors rather than entrepreneurs.[100] The social cost of this economic fact is incalculable. The opportunity of escaping from that sorry heritage is the greatest potential benefit that can come from the present government's decision to assume a managerial role in its dealings with foreign enterprises.

To speak of this opportunity is also to speak of the danger that confronts Peru along the course it has chosen. In the next decade, the Peruvian economy will prosper or atrophy according to the effectiveness with which the new public enterprises are managed. This concern has already been emphasized above, particularly with respect to mining development at Cerro Verde, but the challenge lies in every sector with every state enterprise.

The new rules of the game present a challenge for the regular bureaucracy as much as for the state enterprises. The new rules are complex and involve all the various dimensions of control mentioned above as part of Decision 24. The bureaucratic challenge lies in achieving this control without inadvertently driving potential investors away from Peru. The danger of the system lies particularly in its bringing discouragement to small investors, both foreign and domestic, who lack special influence and who might never be rescued from bureaucratic snags through special intervention.

The investment plans of larger, more visible, more influential firms are not freed of similar problems. A review of the tractor and diesel contracts, for example, creates fears that from their very complexity industrial progress could founder in an ocean of red tape. The principal guarantee of this not happening lies in the importance the government attaches to the development of these enterprises. Such contracts may therefore be workable only in key industries that hold the government's continuing attention.

At the moment, these are the industries that Peru wants out of Andean bargaining. The haste to get started and thus improve negotiating

position tends to sweep all cost considerations aside. Unfortunately, a country can't develop efficiently according to an evolving comparative advantage if next century's industrial structure is to be decided tomorrow. One can only hope that the efficiency loss will not be too great the day after tomorrow. Many foreign companies hold this same sense of urgency. They aren't sure where the Andean Group is going, but they would rather not be left behind. Having lost the tractor contract in Peru, for example, Fiat secured a contract in Bolivia and has sought other footholds in Colombia.

In the next few years, therefore, the flow of new investment and new technology must be left to the Fiats and Massey-Fergusons of world capitalism, companies whose world-wide strategies call for aggressive expansion in new markets like the Andean Group. Such companies will probably be able to provide Peru with its basic technological needs in coming years. Nevertheless, it must be recognized that in moving to a new set of rules for direct foreign investment, Peru has inevitably traded quantity for quality. The quantity is reduced not because the terms available in a transformed Peru are undesirable terms, but rather because of risk. The future is still murky and uncertainty confronts the investor on all sides. The loss of some foreign investment is a price that must be paid for the rapid institutional change of the Peruvian Revolution.

To sum up, then, the benefits to Peru lie in the impetus to development of the nation's human resources, national pride of accomplishment, and lower payments to required foreign factors of production. The costs lie in the efficiency losses caused by reliance on inexperienced public enterprises, complicated bureaucratic control procedures, hasty commitment

to massive projects in the scramble for Andean Group bargaining positions, and loss of some foreign investors unwilling to incur risks in Peru's changing political environment. The present Peruvian government has developed these new rules confident that the benefits outweigh the costs. I believe that most foreign observers, perhaps after a moment's hesitation, would agree.

FOOTNOTES

1. The November 1949 certificate rule stood at S/. 15.68 to the dollar, compared to the official rate of S/. 6.50. (15.68 - 6.50) /6.50 = 141%. This exchange rate experience is documented in Rolf Hayn, "Peruvian Exchange Controls: 1945-1948," Inter-American Economic Affairs, Spring 1957, pp. 47-70.
2. Shane Hunt, "The Growth Performance of Peru," mimeo, 1967, p. 19.
3. José Rocha Fernandini, "La legislación minera en el Perú durante el siglo XX," in José Pareja Paz Soldan ed., Visión del Perú en el Siglo XX, Vol. 1, Lima, 1962, pp. 229-259. Also Romulo Ferrero, Comentarios acerca de los Impuesto en el Perú, Lima, 1955, p. 8.
4. Total taxes, including arbitrios, expressed as a percent of gross profits plus tax payments, declined over 1948-1954 as follows: 35%, 28%, 27%, 21%, 12%, 25%, 20%. Source: Banco Central de Reserva, Renta Nacional del Perú, 1942-1949, pp. 94-95, and similar tables in other issues.
5. Código de Minería, reprinted in Peruvian Times, Special Mining and Petroleum Number, August 1951, p. 25.
6. Toquepala contract, reprinted in Peruvian Times, Nov. 19, 1954, p. 7.
7. This consisted of a 20% industrial profits tax, 12% on dividend remissions, and 1% on foreign branches. Cf. Ferrero, op. cit., pp. 9-12. Also Charles W. Wright, "What Chance has Foreign Capital in Peru," Engineering and Mining Journal, December 1954, pp. 82-83.
8. John Davenport, "Why Peru Pulls Dollars," Fortune, Nov. 1956, p. 131.
9. Pedro Beltran, "Foreign Loans and Politics in Latin America," Foreign Affairs, January 1956, p. 302.

10. The exchange rate debate is discussed in Wilson Brown, "Governmental Measures Affecting Exports in Peru, 1945-1962: A Study of Policy and its Making," Unpublished Ph.D. dissertation, Fletcher School of Law and Diplomacy, 1965, pp. 143-152.

11. José Luis Bustamente y Rivero, _Tras años de lucha por la democracia en el Perú_, Buenos Aires, 1949.

12. See, for example, _La Prensa_, May 13 and 24, 1950. _El Comercio_, August 9, 1949, May 13, 1950.

13. _La Tribuna_, Nov. 19, 1958.

14. Arnold Payne, "Peru: Latin America's Silent Revolution" _Inter-American Economic Affairs_, Winter, 1966, pp. 69-78.

15. "_El Perú Construye_." _Mensaje presentado al Congreso Nacional por el Presidente Constitucional de la República Arquitecto Fernando Belaunde Terry el 28 de Julio de 1965_, pp. 264-266.

16. Fernando Belaunde Terry, _Peru's Own Conquest_, Lima, American Studies Press, 1965.

17. _Peruvian Times_, March 6, 1964, p. 6; November 6, 1964, p. 1; November 20, 1964, p.1. U.S. Embassy, "Some Factors Bearing on New Mining Ventures in Peru," March 23, 1967 (mimeo), p. 6.

18. On top of this, a partial exchange control was introduced in February 1964 with the ruling that depletion allowances could no longer be repatriated, but had to be reinvested. See Hernando de Lavalle, _A Statement of the Laws of Peru in Matters Affecting Business_. Supplement No. 1, Washington, Pan American Union 1965, p. 21. U.S. Embassy, _op. cit._, p. 7.

19. _Oiga_, May 19, 1967, p. 8. The case is reviewed in _Oiga_, November 28, 1969.

20. Dictamen de la Comision Bicameral Multipartidaria encargada de revisar el convenio celebrado entre el Gobierno del Peru y La Southern Peru Copper Corporation, para la explotación de las minas de Toquepala y Quellaveco, y su amplicación para las de Cuajone. Lima, Febrero de 1967, 2 vols. The findings are summarized in Carlos Malpica, Los dueños del Perú, 3rd Edition, Lima, 1968, pp. 176-181.

21. Oiga, November 19, 1965, pp. 15-16; May 27, 1966, pp. 10-11; May 12, 1967, p. 11; June 21, 1968, pp. 8-9; November 28, 1969. Dictamen..., pp. 90-93. Malpica, op. cit., pp. 173-187.

22. Oiga, May 12, 1967, p. 11; June 21, 1968, p. 8.

23. U.S. Embassy, op. cit., p. 8.

24. La Prensa, June 19, 1968. Oiga, June 21, 1968, pp. 8-9.

25. Speech of October 28, 1971, reprinted in Comité de Asesoramiento de la Presidencia de la República (COAP), La Revolución Nacional Peruana, 1968-1972. Lima, 1972, p. 95.

26. Speech of January 31, 1969, reprinted in Velasco La Voz de la Revolución. Discursos del Presidente de la República Juan Velasco Alvarado, 1968-1970, p. 15.

27. For example, a study of the Centro de Altos Estudios Militares (CAEM) lists 5 objectives and 34 accomplishments of the Revolutionary government without ever mentioning foreign investment. "Today's Peru," Lima, 1972). The 223 pages of the national economic plan for 1971-1975 contain precisely one paragraph on foreign direct investment that restricts itself to generalities. (Presidencia de la República, Plan Nacional de Desarrollo, 1971-1975. Plan Global. Lima, 1971, p. 46).

28. Speech of July 28, 1969, reprinted in Velasco La Voz de la Revolución, p. 62.

29. Speech of April 6, 1970, reprinted in Velasco La Voz de la Revolución, p. 203.

30. ibid, p. 204.

31. V. R. Haya de la Torre, El antimperialismo y el APRA, 2nd edition Santiago, 1936, pp. 33-36. Victor Andrés Belaunde, La realidad nacional, 3rd edition, Lima, 1963, p. 197.

32. Decreto Ley 18350, July 27, 1970. This and other relevant legislation is reprinted in Confederación Nacional de Comerciantes (CONACO), Régimen Industrial del Perú, Lima, 1972. Important provisions are summarized in Price Waterhouse Peat and Co., Information Guide for Doing Business in Peru, February 1973.

33. In fact, a high rate of reinvestment from profits could keep the workers' share below 50% permanently. See Pedro de las Casas, Angel de las Casas and Augusto Llosa, Analisis de la Participación de la Comunidad Industrial en el Capital Social de la Empresa. Lima, 1970.

34. See Articles 16 and 17 of the Law and Articles 215, 216 and 229 of the Reglamento. CONACO, op. cit., pp. 83, 216-220.

35. Decision 24 was ratified by Peru as Decreto Ley 18900, dated June 30, 1971. The text is reprinted in CONACO, op. cit., pp. 282-303. The history of Decision 24 is reviewed in John Lindquist, "The Merits of Forced Divestment: The Experience of the Andean Group," Research Program in Economic Development Discussion Paper No. 31, Princeton University, mimeo, October 1972.

36. CONACO, op. cit., pp. 328-329; Price Waterhouse, op. cit., p. 63.

37. Such as, for example, the definition of foreign investment upon which the 14% profits repatriation is based. Note the bewilderment of Price Waterhouse, _op. cit._, p. 70.

38. The company's annual return on investment averaged 6.8% over 1958-1966. _Peruvian Times_, April 11, 1969, p. 6.

39. _Peruvian Times_, March 15 and May 10, 1968.

40. _Peruvian Times_, March 27, 1970.

41. _Peruvian Times_, August 28, 1970.

42. Official valuation reports were reprinted in a special supplement of _La Prensa_, Nov. 13, 1970.

43. _Caretas_, Nov. 15-19, 1970, p. 10.

44. _Oiga_, Nov. 6, 1970, p. 8.

45. _Peruvian Times_, April 28 and October 13, 1972.

46. _Peruvian Times_, August 25 and November 17, 1972.

47. _Peruvian Times_, June 9, 1972.

48. _Peruvian Times_, March 23, 1973.

49. _Peruvian Times_, March 2, 1973.

50. Jean Jacques Servan-Schreiber, _The American Challenge_, New York,1968.

51. Decreto Supremo 80, November 22, 1963.

52. _Peruvian Times_, April 10, 1964.

53. In the early 1960s new cars sold for about double their c.i.f. value. Assuming a 33% distributor's markup, this implies a 50% nominal tariff rate. The c.i.f. value of CKD kits was about 80% that of an assembled vehicle. The rate of effective protection on value added is given by (.50-.8(.15))/.2 = 190%. Local content requirements lower this effective rate, however. Assume that the 30% local content is also priced 50% above c.i.f. value. The CKD component would then decline to 50%, and the rate of effective protection to 137%.

54. The dollar figure is \$25 million. Peruvian Times, August 21, 1970, p. 3.

55. The reader must be cautioned, however, that this profit estimate is tenuous. It assumes that tariffs on CKD kits are included in the cost of imported inputs reported in the various sources of Table 5, but that social security contributions are not included in wage costs. Korngold and Maiman, op. cit., p. 45, show that in 1968 the automobile industry paid S/. 76 million for social security contributions and all taxes except customs duties. Expressed as a share of the gross value added in Table 1, this comes to 28%, which figure is used for all three years. In separate interviews, two representatives of the industry claimed substantially longer payback periods for their respective companies.

56. Peruvian Times, June 30, 1967.

57. Carlos Malpic, El mito de la ayuda exterior, Lima, Moncloa, 1967, pp. 120-124.

58. Automobile companies customarily price the complete CKD kit at full average cost. As parts are removed from the kit during the process of import substitution, the kit price is reduced by only the marginal cost of the deleted components. Thus as local content rises, imported kits become increasingly overpriced. Companies allegedly follow this practice as a means of discouraging import substitution and thereby preserving economies of scale obtained in the centralized production of parts for a worldwide network of assembly plants. See Sebastiaan J. Kleu, "Import Substitution in the South African Automobile Industry," unpublished doctoral dissertation, Harvard Business School, 1967, pp. 67-73. Also Jack Baranson, Automotive Industries in Developing Countries. Baltimore, Johns Hopkins Press for IBRD, 1969, p. 37.

59. Peruvian Times, October 2, 1970.

60. Peruvian Times, June 1 and September 7, 1973.

61. Andean Times, December 7, 1973.

62. Persistent rumors of Russian financing came to nothing. Apparently the Russians weren't interested. See Anibal Quijano, Nationalism and Capitalism in Peru. A Study in Neo-Imperialism, New York, 1971, p. 46. Also, Janet Ballantyne, "The Political Economy of Peruvian Gran Mineria," Unpublished doctoral dissertation, Cornell Business School, January 1974, p. III-15.

63. Caretas, Nov. 11-21, 1969, p. 10. See also Oiga issues of Nov. 7, 14, 21, and 28; also "Vox y Voto" Column in Expreso, Dec. 30, 1969.

64. Oiga, Dec. 5, 1969, p. 9.

65. In leftist circles throughout Latin America, the Cuajone contract produced substantial disillusionment regarding the Peruvian revolution. This is reflected in Pumaruna Letts, Perú: Mito de la Revolución Militar, Caracas, 1971, pp. 70-75, and Anibal Quijano op. cit., pp. 22-26.

66. U.S. government decision-making that led to the policy of "non-overt hostility" toward Peru is analyzed in Jessica Einhorn, "The Effect of Bureaucratic Politics on the Expropriation Policy of Nixon Administration: Two Case Studies," Unpublished doctoral dissertation Department of Politics, Princeton University, January 1974.

67. Peruvian Times, March 13, April 24, 1970.

68. Latin America, Sept. 25, 1970, p. 309; Business Week, Aug. 29, 1970, p. 26. Peruvian Times, October 2, October 9, November 6, 1970.

69. La Prensa, Nov. 4, 1970; Correo, Nov. 5, 1970; Metals Week, May 10, 1971; La Prensa, May 21, 1971; Peruvian Times, Dec. 3, 1971.

70. Metals Week, May 10, 1971.

71. Peruvian Times, March 9 and June 1, 1973; Andean Times, December 7, 1973, p. 7.

72. Peruvian Times, July 13, September 28, 1973. New York Times, Sept. 25. Sept. 30, 1973.

73. Ballantyne, op. cit., pp. IV-16,17. Andean Times, Feb. 22, 1974.

74. Andean Times, Jan. 4, Jan. 18, Feb. 22, 1974. New York Times, Feb. 20, 1974, p. 11. The full text of the agreement is reprinted in the Andean Times issue of February 22.

75. Andean Times, February 22, 1974, p. 5.

76. The Ex-Im loan was announced on April 11, 1974. The ASARCO president's remarks were made at the company's annual meeting of April 23, 1974.

77. Raymond Vernon, Sovereignty at Bay, New York, 1971.

78. Peruvian Times, April 30, 1971, Nov. 17, 1972. New York Times, Feb. 16, 1974.

79. Peruvian Times, April 14, 1972, p. 17.

80. Peruvian Times, October 16, and December 4, 1970, and February 12, 1971.

81. Peruvian Times, February 5, June 11, and October 8, 1971. Ballentyne, op. cit., pp. IV-17-26.

82. Peruvian Times, July 7, 1972.

83. Peruvian Times, Special supplement on Cerro Verde, March 23, 1973, pp. 18-27.

84. Ballantyne, op. cit., p. IV-21.

85. The contract is described in Peruvian Times, June 25, 1971, and Marco Fernández Baca, El Contrato de Operaciones Modelo Perú, Departmento de Relaciones Públicas de Petroleos del Perú, 1973.

86. Fernández Baca, _op. cit._, p. 11.

87. _Peruvian Times_, June 8, August 10, and September 7, 1973.

88. The relation between output share and equivalent profits tax is as follows. For the foreign company, let Q be output, P the price of output, C the production cost per unit of output, s the output share paid to government, t the equivalent profits tax rate, pb profits before taxes and pa profits after taxes. Then:

$$QP - QC = pb \qquad (1)$$

and

$$QP\ (1-s) - QC = pa = pb\ (1-t) \qquad (2)$$

Substitution (1) in (2) and rearranging terms gives an expression for the equivalent profits tax rate:

$$t = \frac{Ps}{P-C} \qquad (3)$$

Let k be the margin by which price exceeds cost, i.e., C (1 + k) = P. Then:

$$t = \frac{s\ (1+k)}{k} \qquad (4)$$

The greater is k, the more profitable the operation, and the _lower_ is t, the equivalent profits tax rate. If k is 0, cost and price are the same, and the company makes no profit but must pay its output share. The equivalent profits tax rate is infinite. Alternatively, let price be the double of cost, i.e., k is 1.0. Assuming an output share of 50/50, then the equivalent profits tax rate t is 100%. Finally, if costs are trivially small, then k is infinite and t is 50%, its lowest possible value.

89. _Peruvian Times_, March 12, and October 8, 1971. Also Council of the Americas, _Andean Pact: Definition, Design, and Analysis_, New York, n.d. (1973), Part IV. pp. 12-18.

90. *Peruvian Times*, November 24, 1972, and July 13, 1973.

91. Ballantyne, *op. cit.*, p. III-32.

92. It should be noted, however, that much of Japan's new flurry of investment activity in Peru consists of loans rather than equity. See special survey of Japanese investment in the *Peruvian Times*, Sept. 29, 1972. Japanese caution about major mining investment is described in Ballentyne, *op. cit.*, p. III-25.

93. For one such challenge, see Jon Basil Utley, "Doing Business with Latin Nationalists," *Harvard Business Review*, January-February 1973, pp. 77-86.

94. *Andean Times*, December 21-28, 1973, p. 4.

95. *Andean Times*, January 4, 1974, *Latin America*, January 4, 1974.

96. E.g., Quijano, *op. cit*. Also César Germaná, "Si es Bayer...¿Es Bueno?" *Sociedad y Politica*, No. 2, Oct. 1972, pp. 31-33.

97. This view is important in the well-known article of Osvaldo Sunkel, "National Development Policy and External Dependence," *Journal of Development Studies*, October 1969, pp. 23-48.

98. See Louis Wells, "Foreign Investment in Joint Ventures," Center for International Studies, Harvard, Economic Development Report #167.

99. Harry Johnson, "A Theoretical Model of Economic Nationalism in New and Developing States," in Harry Johnson, editor, *Economic Nationalism in Old and New States*, pp. 1-16. Also Albert Breton, "The Economics of Nationalism," *Journal of Political Economy*, August 1964, pp.376-386.

100. Shane Hunt, "Growth and Guano in Nineteenth Century Peru," RPED Discussion Paper No. 34, Princeton University, February 1973.