

CEPAL

Review

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UNITED NATIONS
ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN

SANTIAGO, CHILE, AUGUST 1987

C E P A L

Review

Santiago, Chile

Number 32

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Internal debt and financial adjustment in Peru

*Richard Webb**

The crisis of the 1980s was preceded in Peru by five years of economic stagnation which accentuated its effects. Gross investment fell sharply, as did industrial and farm production and construction. However, this fall was due mainly to activities connected with domestic demand, for activities responding to the international market did not have the same results.

Against this background the author analyses the financial evolution of enterprises in the period 1980-1985. He shows that although the financial situation of productive enterprises deteriorated rapidly, they managed to transmit to other sectors a large part of this deterioration. This did not produce widespread bankruptcies, despite the sharp drop in sales at the beginning of the crisis. On the one hand, there was a decline in real wages and in the relative prices of industrial sector inputs. On the other hand, enterprises deferred and reduced their tax payments and the service of their debts, with the result that the doubtful debts in the banks' portfolios reached unprecedented levels. The authorities abandoned the policy of positive real interest rates introduced in 1981 and made it easier for enterprises to obtain refinancing loans. According to the author, businesses managed to withstand the crisis with surprising success, but their survival mechanisms had a high social cost and probably helped to aggravate the overall crisis.

*The author was Chairman of the Central Reserve Bank of Peru. This study was prepared under the auspices of the Joint Project UNDP/ICLAC RI.A/77/021 "Implications for Latin America of the International Monetary and Financial System".

Introduction

During the period 1980-1985 Peru, like the majority of the countries of the region, underwent an economic crisis without precedent in this century. This crisis saw a drop of 16% in the gross domestic product and a doubling of the inflation rate from 60 to 120% a year in the first months of 1983. Real wages and salaries in modern activities fell by 40% between 1982 and 1985, while the external public debt increased by 44%.

As in the rest of the region, in Peru the crisis was closely connected with the well-known external events of those years: world recession and sharp decline in raw materials prices, increase in world interest rates, protectionism, and closure of external financial markets.

But there were two additional factors in the Peruvian crisis. The first was the El Niño ocean current, a dramatic phenomenon which caused a direct loss of 5% of the gross domestic product in 1983 and the effects of which exacerbated the effects of the crisis in the external sector during this period.

The second factor was a consequence of events in the decade before the crisis. In Peru the recession of the 1980s was a continuation of a state of almost continuous financial and productive crisis since 1975. Unlike the rest of the region, Peru did not grow between 1975 and 1979, and in this period the economy suffered a collapse of its traditional financial stability and was further weakened by institutional changes and State intervention throughout the 1970s and especially in the period 1970-1975. The state of the economy at the end of the 1970s—beset as it was by distortions in the labour, land and capital markets and by an inflated and exceptionally inefficient public sector—probably reduced its adjustment capacity during the 1980s.

What was the effect of this crisis on business debt? Was there a financial crisis in the private sector? How did the financial problems of enterprises affect the overall performance of the economy?

An attempt will be made to answer these questions. Section I summarizes the aggregate economic performance to show the global context in which businesses operated in that period.

Section II considers the financial performance of enterprises on the basis of their audited balances submitted annually to the National Supervisory Commission for Companies and Securities (CONASEV). Lastly, section III offers some interpretation of all this.

It must be pointed out that generally speaking the available statistics are limited and many of them unreliable. Furthermore, this topic has received little attention in the country. The material presented here is therefore extremely tentative in nature.

I

Economic performance in 1970-1985

1. Background (1970-1978)

It is difficult to understand the performance of business in the 1980s without a knowledge of what happened in the previous decade.

The 1970s produced two negative factors for business. The first was the sharp increase in intervention and direct participation by the State in the economy (1970-1975). This *dirigisme* was accompanied by redistributive measures which smashed the rules of the game with respect to the domestic and foreign guarantees enjoyed by business.

In this period the government imposed a drastic agrarian reform, the effects of which on business attitudes were due not only to the expropriation itself but also to the bureaucratic arbitrariness and political hostility with which the transfer was carried out. The ownership of industries and mines was affected by the Joint-Ownership Law which transferred part of the profits to the workers and gave them a share in the management of the enterprise. There were at the time draft laws with the same objective for other sectors of activity, and although they were not promulgated the feeling of threat persisted. Business was also affected by the Labour Stability Law which made manpower cuts almost impossible. Lastly, the government expropriated various activities and enterprises, mostly in foreign ownership, but including some Peruvian ones, as in the fishing industry for example.

State intervention increased with the establishment of exchange rate and imports controls, as well as with the increased regulation of investment and other aspects of productive activity.

The second negative factor occurred in the second half of the 1970s. From 1975 to 1978 there was a period of acute macroeconomic instability in which inflation far exceeded its earlier levels of 10 to 20%. From 1975 to 1979 inflation averaged 44% and relative prices, especially of items controlled by the government such as foreign exchange and fuel, underwent large and sudden changes. The Central Bank lost all its reserves and both access to foreign exchange and its price became extremely uncertain for business, a situation which the country had not known since the 1940s. Production stagnated and at the end of the decade the per capita income was 5% lower than in 1974. Throughout the 1970s investment, especially private sector investment, declined.

The adverse effect of all this was offset in part by a recovery in the balance of payments in the last years of the decade. The volume of exports increased by 65% between 1975 and 1979 when the oil pipeline from the northern forests and a large copper mine came into operation, and non-traditional exports increased from US\$96 million in 1975 to US\$845 million in 1979. In addition, and by way of exception, export prices rose in 1979. The improvement in the balance of payments was also due to a sharp reduction in imports following the measures of fiscal austerity and monetary control of 1978-1979. In those two years the gross domestic product began to recover at an annual rate of 3%, despite the reduction in aggregate demand imposed by the stabilization programme.

The balance of the 1970s was not favourable for the productive capacity. This capacity

Table 1
 PERU: GROSS PRIVATE INVESTMENT,"
 1950-1985
 (Percentage of gross domestic product)

	Percentage
1950-1959	17.7
1960-1969	12.3
1970-1979	8.0
1980-1982	10.8
1983	7.9
1984	6.8
1985	6.8

Source: Prepared on the basis of national accounts figures from the National Institute of Statistics (INE) and the Central Reserve Bank of Peru (BCRP).

"Includes variations in stocks. Excludes public enterprises.

declined under the cumulative effect of a decade of lower investment and as a result of the loss of business flexibility due to the various distortions in the factor and goods markets and to the subjection of a large part of the economy to greater regulation and direct management by the bureaucracy. The experience of those years also affected the business outlook, reducing the willingness to invest in the country and increasing speculative operations. This trend was streng-

thened by chronic uncertainty about the availability of foreign exchange, by the possibility of using loans in the national currency at negative real interest rates, by the feeling of greater insecurity with respect to the rights of ownership and profits, and by the greater risks resulting from an unstable macroeconomic situation. All this increased the reluctance to risk investing own capital and therefore enhanced the relative advantage of borrowing,

The effects of all this on business performance can be summed up in the following statistics on private investment and the probable flight of foreign exchange: the average annual rate of private investment for the decades 1950, 1960 and 1970 was 17.7, 12.3 and 8% (table 1). The apparent decline in investment was accompanied by an apparent increase in the flight of foreign exchange: in the same decades the errors and omissions in the balance of payments were on average 0.6, 0.8 and -1.1 % of the annual gross domestic product.

2. Three and a half years of recovery:
 January 1979 to June 1982

The 1970s closed with a number of swallows which seemed to be heralding summer. Between January 1979 and June 1982 the economy slowly recovered and it grew by 13% throughout the

Table 2
 PERU: GROSS DOMESTIC PRODUCT BY EXPENDITURE", 1980-1985
 (Index: 1980= 100)

Year	Consumption		Public expenditure		Private investment		Exports		Imports		Gross domestic product	
	In- dex	Percent- age varia- tion	In- dex	Percent- age varia- tion	In- dex	Percent- age varia- tion	In- dex	Percent- age varia- tion	In- dex	Percent- age varia- tion	In- dex	Percent- age varia- tion
1981	102	2.0	106	6.0	127	27.0	95	-5.0	110	10.0	103	3.0
1982	102		115	8.5	115	-9.4	107	12.6	116	5.5	105	1.9
1983	93	-8.8	103	-10.4	55	-52.2	95	-11.2	87	-25.0	92	-12.4
1984	96	3.2	94	-8.7	58	5.5	100	5.3	70	-19.5	97	5.4
1985	98	2.1	87	-7.4	58		101	1.0	61	-12.9	98	1.0

Source: Prepared on the basis of information from the Central Reserve Bank of Peru (BCRP).

period, while inflation remained at a high but stable rate of 60% a year. The shortage of foreign exchange for business disappeared with the exports boom of 1979-1980, and several measures were introduced to open up imports. The total demand increased with the higher wages of 1980 and with the growth of public investment. The legal framework for owners seemed more reliable with the return of a democratic government, which moreover tended towards the centre or centre-right. The government also aligned itself directly with the attitude of the second phase of the previous régime, moderating some of the reformist measures, in particular the one concerning labour stability. Furthermore, the increased supply of foreign exchange and the good relations with the IMF and the rest of the world financial system created expectations of less macroeconomic instability.

But the promised summer did not come. Export prices began to fall in the first months of 1980 and by June 1982 the index of the purchasing power of traditional exports had lost half its January 1980 value. Confidence in the availability of foreign exchange disappeared rapidly in the face of the external recession, the sharp increase in imports (41% in three years) and the drop in reserves which began in the first months of 1981.

The industrial sector suffered the joint impact of lower tariffs, higher exchange rates, openness measures, rapid expansion of overseas purchases by enterprises and State bodies which traditionally pay no customs duties, and smuggling stimulated by the laundering of the foreign currency generated by the drugs traffic, and by the dumping caused by the world recession. In 1980-1981 the relative prices of industrial goods fell: the reduction was 28% for the textiles and footwear sectors and 21% for household appliances. The external sector acted as a strong depressive force through its effects both on direct demand and on expectations.

The growing fiscal deficit added to the worries about the future. On the other hand, the heavy inflow of external loans helped to maintain the level of international reserves, and the recovery of the world economy created hopes. In these circumstances business invested little, but there was a solid flow of return on capital from abroad which was invested mainly in foreign

currency bank certificates. The growing uncertainty about the future did not seem to affect this instrument of dollar savings. Private investment increased slightly from 1980 to 1982 (to 10.8% of GDP), but without reaching the levels of 1950-1969 (table 1).

3. Crisis; July 1982 to July 1985

The last half of 1982 was a period of deepening recession, a result of the continuing decline in the value of exports and of the external competi-

Table 3

PERU: GROSS DOMESTIC PRODUCT BY ORIGIN"

(Index: 1980 = 100)

	Farm- ing sector	Mining	Manu- fac- tures	Con- struc- tion	Others'	Total gross domes- tic product
1978	101	96	91	81	93	93
1979	105	105	95	84	96	97
1981	110	96	100	111	104	103
1982						
I	112	103	100	122	104	105
II	118	99	100	114	108	107
III	112	102	98	114	104	104
IV	111	104	90	104	100	100
1983						
I	110	86	86	88	98	95
II	100	99	82	93	95	93
III	95	99	79	84	89	88
IV	101	98	75	92	94	90
1984						
I	110	101	80	87	94	93
II	110	100	84	91	97	95
III	120	102	85	97	99	98
IV	120	103	83	88	98	97
1985						
I	120	106	93	88	101	101
II	117	108	85	79	98	97
III	115	108	82	72	96	95
IV	117	108	83	75	98	97

Source: National Institute of Statistics (INE).

"Deseasonalized.

Includes the fisheries sector.

^Includes the government: sector.

Table 4
 PERU: GROSS DOMESTIC PRODUCT, 1978-1986*
 (Millions of WOintis)

	Endogenous	Exogenous	Total	Exogenous adjusted by terms of trade	Adjusted total
1978					
I	55.2	23.0	78.2	23.0	78.2
II	55.6	22.8	78.4	22.8	78.4
III	55.2	22.7	77.9	22.7	77.9
IV	55.4	25.1	80.5	25.1	80.5
1979					
I	56.9	24.6	81.5	28.7	85.7
II	55.1	25.4	80.5	30.8	85.9
III	57.3	26.5	83.8	32.6	89.9
IV	56.8	25.9	82.7	32.0	88.8
1980					
I	60.5	25.2	85.7	32.7	93.2
II	58.9	24.3	83.2	32.5	91.4
III	59.4	24.2	83.6	32.2	91.6
IV	62.2	23.4	85.6	30.4	92.6
1981					
I	63.7	23.6	87.3	27.1	90.8
II	60.7	25.1	85.8	29.0	89.7
III	62.6	24.2	86.8	27.8	90.4
IV	63.3	25.1	88.4	28.0	91.3
1982					
I	63.1	25.7	88.8	26.5	89.6
II	63.7	26.4	90.1	27.1	90.8
III	62.9	25.3	88.2	25.7	88.6
IV	59.2	25.1	84.3	25.0	84.1
1983					
I	56.9	22.5	79.4	24.1	81.0
II	56.3	22.6	78.9	24.4	80.7
III	53.1	22.4	75.5	24.0	77.1
IV	52.8	22.7	75.5	23.6	76.4
1984					
I	53.7	24.6	78.3	25.2	78.8
II	55.7	24.8	80.5	25.2	80.9
III	57.1	26.1	83.2	26.2	83.3
IV	55.3	26.6	81.9	26.2	81.5
1985					
I	58.3	27.0	85.3	26.2	84.5
II	56.1	26.0	82.1	25.0	81.0
III	46.1	33.9	80.0	31.6	77.7
IV	54.9	26.7	81.6	23.4	78.3
1986					
I	59.3	25.0	84.3	21.2	80.5
II	62.8	26.3	89.1	21.5	84.3
III	64.0	26.7	90.7	21.1	85.1

Source: National Institute of Statistics (INE).

*Deseasonalized.

Includes: agriculture, fisheries, mining, primary manufactures and non-traditional exports, where the output depends to a large extent on factors independent of domestic policy (mainly the position in world markets and the weather).

tion confronting the industrial sector. Despite a restrictive monetary programme —the Central Bank did not lend to the government— the expenditure capacity was maintained by means of heavy external borrowing, both public and private, increasingly in the form of short-term loans. However, much of this spending capacity was directed abroad, and almost all the productive sectors recorded declines in the second half of 1982.

From the first months of 1983 the crisis took on a new dimension with the climatic disaster caused by the El Niño current. The loss of harvests, mineral and oil shipments, fisheries, and certain manufactures and other light activities connected with the affected raw materials amounted to 5% of the national product. Moreover, the fiscal and monetary losses depressed industrial and commercial sales even further: public expenditure declined 7% in real terms (table 2).

The business disaster was not limited to the collapse of sales; from the first months of 1983 inflation rose to an annual three-digit rate, and relative prices began to undergo major changes especially with the faster devaluation, the reduction of subsidies for fuel and other controlled items, and the shortage of many farm goods.

In the space of a year and a half (June 1982 to December 1983) industrial production fell 25%, farm production 17% and construction 19% (table 3).

When these production losses are broken down it can be seen that the decline caused by the reduction of aggregate demand was greater than the production losses due to outside causes (the weather and the international recession). During those 18 months the real product of primary and export activities fell 14% (table 4). When the loss of real income connected with the terms of trade is included, the decline is 13%. However, in the rest of the economy (i.e., in industrial, commercial and service activities where production responds better to demand in the short term) the reduction in the product was 17%.

This pattern was repeated in the manufacturing sector. The production of primary goods, mainly for export, fell 29% in the space of nine months owing to the weather (table 5). But the recovery was rapid; between January 1983 and

Table 5
PERU: VALUE ADDED IN MANUFACTURING:
MANUFACTURE OF PRIMARY GOODS
AND OTHER MANUFACTURES,
1978-1985

(Index: 1980 = 100)

	Manufacture of primary goods"	Other manufactures	Total
1978			
I	990	85.0	88.0
II	91.0	89.0	90.0
III	81.0	92.0	89.0
IV	122.0	91.0	98.0
1979			
I	105.0	84.0	89.0
II	107.0	89.0	94.0
III	105.0	93.0	96.0
IV	117.0	97.0	102.0
1980			
I	108.0	89.0	93.0
II	100.0	99.0	100.0
III	95.0	101.0	100.0
IV	96.0	111.0	108.0
1981			
I	86.0	97.0	95.0
II	104.0	98.0	99.0
III	84.0	102.0	98.0
IV	110.0	107.0	108.0
1982			
I	99.0	95.0	96.0
II	102.0	98.0	99.0
III	91.0	100.0	97.0
IV	99.0	96.0	96.0
1983			
I	72.0	85.0	82.0
II	73.0	84.0	81.0
III	83.0	78.0	79.0
IV	81.0	79.0	80.0
1984			
I	94.0	71.0	76.0
II	98.0	79.0	83.0
III	97.0	81.0	84.0
IV	104.0	83.0	88.0
1985			
I	112.0	82.0	88.0
II	91.0	82.0	84.0
III	102.0	75.0	81.0
IV	107.0	83.0	88.0

Source: Central Reserve Bank of Peru (BCRP).

"Includes the manufacture of non-ferrous basic metals, sugar, petroleum, fish meal and other fisheries products.

June 1985 production increased 31.3%. The rest of industry, which had much idle capacity from 1983 or even 1982, grew by only 0.6% between December 1983 and June 1985.

Another of the effects of the international recession and the weather problems was the decline in investment; private investment fell by 35% in real terms in 1982-1983 and total investment by 29%. It can be seen that the internal component was larger than the external one in the recession in this period.

The global situation underwent no substantial change in the following 18 months, i.e., until the introduction of the radically different economic programme imposed by the government in July 1985. Production in the primary sectors and in other sectors where supply does not depend on domestic demand made a full recovery

during 1984, but the rest of the domestic economy remained in deep recession. The financial framework also remained unstable, with three-digit inflation which continued to rise, owing largely to faster devaluation and the increase in the prices of energy and public services. The monetary programme restricted lending and increased interest rates in a desperate attempt to check the flight of capital and the transfer of liquid assets into dollars. These processes were already stimulated not only by the general instability and the high relative profitability of the dollar but also by a degree of uncertainty about the measures which the new government might take.

In these circumstances it was natural that private investment should remain depressed and that speculation and recession should continue.

II

Financial performance of enterprises in 1980-1985

1. Purpose and method

The purpose of this section is to examine the effect of the crisis on the financial performance of enterprises, using information obtained directly from their balances. A particular purpose is to discover in what way the crisis affected the liquidity, borrowing, profitability and solvency of the most important enterprises.

The data on the financial performance of enterprises presented below are based on the audited balances submitted annually to the National Supervisory Commission for Companies and Securities (CONASEV) by major enterprises in various areas of activity. As these data had been published only in partial form and intermittently, it was necessary to obtain additional information directly from the CONASEV work sheets.

The statistical value of this sample has some limitations owing to certain features of the data: the sample is biased towards the large enterprise; the structure by activity (table 6) differs from that of the country, and the size of the sample of enterprises has increased over time.

(The number of enterprises submitting returns increased from 785 in 1980 to 2 010 in 1984.) However, the degree of cover of total sales has varied less: as a percentage of GDP, reported sales were 43% in 1980, 57% in 1982 and 48% in 1984; in the case of manufacturing enter-

Table 6

PERU: PERCENTAGE BREAKDOWN
OF NET SALES, BY SECTOR,
1980 AND 1985

	1980		1985	
	Millions of intis	Percentage	Millions of intis	Percentage
Mining	591	27.3	7 924	10.7
Manufacturing	990	45.8	33 569	45.4
Commerce	480	22.2	20 702	28.0
Others	101	4.7	11 771	15.9
Total	2 162	100.0	73 966	100.0

Source: Based on data of the National Supervisory Commission for Companies and Securities (CONASEV).

prises, the sample increased from 19% of total GDP in 1980 to 23% in 1982 and 21% in 1984.

In addition to these limitations, the data have another defect, the importance of which is impossible to establish; the non-truthfulness of the balances. Replying to a question about the real impact of the crisis on his lending bodies, a banker told me: "It is really very difficult to say, and I would never try to find out from the balances because they have nothing to do with the truth. The only thing I can do to verify the position of a businessman is to check the borrowing ratio (debts to other banks reported by the Office of the Superintendent of Banks) and look him in the eyes".

2. Liquidity

During the period under study the liquid assets of the enterprises declined, but they managed to maintain a positive level of liquidity (table 7).

The most important changes in the structure and composition of the liquidity of the enterprises were the following:

a) In manufacturing enterprises current assets declined as a proportion of total assets. In 1980 liquid assets made up 0.61% of total assets, whereas in 1985 the figure was 0.50%, with a drop of 16.7%. Nevertheless, these enterprises managed to maintain a balanced liquidity position by adjusting their short-term liabilities to changes in their liquid assets. Thus, the liquidity index (the ratio of current assets to current liabilities: index 7.1 in table 7) remained positive and declined by only 5.9%, with its lowest level in 1983 (1.18). By 1985 the index had recovered to 1.28, similar to its pre-crisis level in 1982. The commercial enterprises were able to maintain greater stability in the management of their liquidity owing to the nature of their activities, and the mining enterprises had positive levels in each year, despite the especially acute crisis, and

Table 7

PERU: EVOLUTION OF THE LIQUIDITY OF ENTERPRISES, 1980-1985

	1980	1981	1982	1983	1984	1985
a) Manufacturing enterprises						
7.1 Liquidity index	1.4	1.4	1.3	1.2	1.3	1.3
7.2 Cash liquidity	.54	.76	.80	.82	1.0	1.0
7.3 Cash-bank turnround (number of days)	11	12	27	29	34	27
7.4 Accounts receivable turnround (number of days)	74	64	71	91	74	64
7.5 Current assets/total assets	.61	.52	.53	.48	.49	.50
7.6 Assets in hand and at bank/total assets	.03	.03	.06	.06	.08	.14
b) Commercial enterprises						
7.1 Liquidity index	1.3	1.3	1.2	1.2	1.2	1.2
7.2 Cash liquidity	.81	.82	.83	.90	1.0	1.0
7.3 Cash-bank turnround (number of days)	12	11	17	20	24	21
7.4 Accounts receivable turnround (number of days)	79	80	69	86	62	55
7.5 Current assets/total assets	.75	.77	.76	.77	.77	.77
7.6 Assets in hand and at bank/total assets	.05	.05	.07	.08	.12	.15
c) Mining enterprises						
7.1 Liquidity index	1.6	1.3	1.1	1.4	1.2	1.4
7.2 Cash liquidity	1.3	.52	1.0	1.4	1.6	1.5
7.3 Cash-bank turnround (number of days)	36	10	15	28	30	28
7.4 Accounts receivable turnround (number of days)	69	42	64	80	86	82
7.5 Current assets/total assets	.36	.39	.18	.21	.22	.32
7.6 Assets in hand and at bank/total assets	.07	.02	.02	.04	.04	.14

Source: National Supervisory Commission for Companies and Securities (CONASEV).

even achieved a surprising increase in their liquidity index in 1985.

b) The slower rate of turn-round of accounts receivable (accounts receivable as a proportion of sales: index 7.4) was a major problem for the enterprises, but they offset it with a slower turn-round of accounts payable. Thus, the average collection period increased in manufacturing from 71 to 91 days between 1982 and 1983 and then declined to 74 days in 1984 and to only 64 days in 1985.

c) On the other hand, the increasing profitability of very liquid financial instruments, in particular bank certificates in foreign currency (table 8), meant that the enterprises tried to maintain their liquidity in a more profitable form, i.e., cash in hand and at bank, in particular by delaying settlement of their accounts payable. Thus, in the manufacturing sector the ratio of resources in hand and at bank to sales (multiplied by 360: index 7.3) increased from 11 days in 1980 to 27 days in 1982 and continued to rise to 34 days in 1984. The same thing happened in commerce and mining. Paradoxically, therefore, the enterprises maintained a higher balance in hand and at bank during the years of crisis than before (table 7, indices 7.3 and 7.6). The CONASEV statistics do not distinguish between types of bank deposit, but the information obtained in interviews and the sharp increase in the total deposits in foreign currency at the national level confirm that the increased amount of cash at bank was mostly invested in foreign currency.

d) The performance of the mining enterprises was similar to that of manufacturing, but with greater variation of their liquidity indices and with smaller immediately available balances in hand and at bank (index 7.6).

3. *Assets turnover*

The assets turnover (ratio of total sales to total assets) can be used as an indicator of changes in output and installed capacity, although it does not indicate the absolute level of use of installed capacity.

In the commercial sector the assets turnover remained stable, but this was not the case in manufacturing (table 9)- In manufacturing (index 9.2) the ratio tended to decline up to 1983

Table 8

PERU: REAL FINANCIAL PROFITS AND REAL COST OF CREDIT,¹¹ 1980-1985

(Annual rates)

	Deposits		Opportunity cost of deposits (%)	Cost of credit in intis (%) ^b
	In intis (%)	In dollars (%)		
1980	-14	-5	-9	-4
I	-18	-14	-5	-9
II		6	-6	11
III	-27	-16	-13	-19
IV	-10	11	-19	1
1981	-5		-5	-1
I	-31	-10	-23	-28
II	5	-8	14	9
III	9	8	1	13
IV	5	13	-7	8
1982	-1	24	-20	-2
I	-6	7	-12	-5
II	5	37	-23	6
III	3	27	-19	
IV	-7	42	-35	-9
1983	-21	14	-31	-20
I	-34	1	-35	-36
II	-23	30	-41	-24
III	-28	20	-40	-25
IV	5	-3	8	13
1984	-14	21	-29	
I	-24	-10	-16	-8
II	-8	33	-31	-1
III	-6	27	-26	15
IV	-15	94	-56	3
1985	-31	12	-38	-10
I	-39	44	-58	-24
II	-45	1	-44	-12
III	-29		-29	-8
IV	-5	-23	23	4

Source: Based on data of the Central Reserve Bank of Peru (BCRP).

¹¹Deflated by the cost of living.

Does not include tax on interest.

and to recover in 1984-1985. The fall in 1983 occurred despite the maintenance of inventory levels during that year owing to the rapidity of the decline in sales (index 9.1)- The reaction seemed to set in from 1984 when the average level of inventories began to fall. This decline also meant that the increased assets turnover from 1984 was achieved without greater use of installed capacity.

It is interesting to see that in the manufacturing and commercial enterprises gross profit margins on sales were maintained despite the smaller turnover (table 10, index 10.1, and table 9, index 9-2). The gross profit on sales managed to absorb the increase in fixed costs within the average operating costs (table 10).

It is concluded that the increase in fixed costs was absorbed by the reduction in variable costs, such as labour, and by the fall in the relative prices of certain components. In the case of labour, this is confirmed by the sharp decline in the index of real wages and salaries in enter-

prises employing 16 or more workers in Lima: real average earnings fell by 26% between the mid-points of 1980-1982 and 1983 and by a further 19% between 1983 and 1985 (table 11). It is also possible that the lower prices of certain agricultural products, such as timber, sugar and meat, also contributed to the reduction of variable costs.

The commercial sector also maintained a very stable gross profit margin on sales throughout the period.

4. Solvency

An enterprise's solvency is its capacity to meet its obligations, which also implies a degree of financial independence and borrowing capacity.

The main conclusion to be drawn from the summary of the management and solvency indices (table 9) is that, with the exception of mining, the crisis did not increase the enterprises' debt levels. Moreover, the ratio of net worth to

Table 9

PERU: MANAGEMENT AND SOLVENCY INDICES OF ENTERPRISES, 1980-1985

	1980	1981	1982	1983	1984	1985
a) Manufacturing enterprises						
9.1 Holding of stocks (number of days)	156	142	157	152	133	129
9.2 Total assets turnover	1.0	.95	.82	.75	.81	.91
9.3 Long-term net worth borrowing	.30	.28	.32	.18	.18	.14
9.4 Borrowing/assets	.57	.53	.55	.54	.52	.51
9.5 Leverage	1.4	1.1	1.2	1.2	1.1	1.0
9.6 Net worth guarantee	.85	.87	.99	1.1	-.98	.95
b) Commercial enterprises						
9.1 Holding of stocks (number of days)	95	85	91	92	79	70
9.2 Total assets turnover	1.6	1.7	1.6	1.5	1.7	2.0
9.3 Long-term net worth borrowing	.26	.41	.32	.14	.16	.15
9.4 Borrowing/assets	.66	.75	.73	.73	.73	.72
9.5 Leverage	1.9	3.0	2.7	2.7	2.7	2.6
9.6 Net worth guarantee	.50	.51	.67	.77	.69	.62
c) Mining enterprises						
9.1 Holding of stocks (number of days)	142	186	86	120	91	115
9.2 Total assets turnover	.70	.66	.47	.49	.58	.57
9.3 Long-term net worth borrowing	26	.35	.91	-.69	.18	.06
9.4 Borrowing/assets	.38	.48	.56	.53	.47	.31
9.5 Leverage	.61	.92	1.3	1.1	.90	.44
9.6 Net worth guarantee	.95	.90	1.8	1.6	1.5	.93

Source: National Supervisory Commission for Companies and Securities (CONASEV).

Table 10

PERU: PROFIT INDICES, 1980-1985

	1980	1981	1982	1983	1984	1985
a) Manufacturing enterprises						
10.1 Gross margin/sales	0.29	0.30	0.33	0.33	0.32	0.32
10.2 Gross profits/net worth	0.24	0.21	0.12	0.09	0.15	0.19
10.3 Gross profits/assets	0.10	0.10	0.05	0.04	0.07	0.09
10.4 Net profits/sales	0.05	0.02	0.02	0.01	0.05	0.04
10.5 Administrative costs/total earnings	0.07	0.07	0.09	0.08	0.08	0.09
10.6 Financial costs/total earnings	0.07	0.07	0.10	0.15	0.13	0.12
10.7 Operating costs/total earnings	0.26	0.27	0.35	0.37	0.34	0.33
b) Commercial enterprises						
10.1 Gross margin/sales	0.26	0.24	0.26	0.26	0.25	0.25
10.2 Gross profits/net worth	0.42	0.40	0.27	0.13	0.30	0.44
10.3 Gross profits/assets	0.14	0.10	0.07	0.04	0.08	0.12
10.4 Net profits/sales	0.06	0.03	0.02	0.01	0.03	0.04
10.5 Administrative costs/total earnings	0.04	0.06	0.10	0.10	0.10	0.10
10.6 Financial costs/total earnings	0.10	0.08	0.06	0.10	0.07	0.07
10.7 Operating costs/total earnings	0.24	0.24	0.29	0.30	0.28	0.28
c) Mining enterprises						
10.1 Gross margin/sales	0.62	0.39	0.53	0.62	0.53	0.39
10.2 Gross profits/net worth	0.45	0.16	0.28	0.26	0.07	0.12
10.3 Gross profits/assets	0.28	0.08	0.12	0.12	0.03	0.08
10.4 Net profits/sales	0.13	0.02	0.12	0.13	0.02	0.07
10.5 Administrative costs/total earnings	0.03	0.08	0.11	0.10	0.24	0.11
10.6 Financial costs/total earnings	0.05	0.06	0.04	0.14	0.16	0.12
10.7 Operating costs/total earnings	0.50	0.41	0.42	0.50	0.55	0.48

Source: National Supervisory Commission for Companies and Securities (CONASEV).

debt tended to improve in the manufacturing sector. Thus, the operating leverage (total liabilities to net worth: index 9-5) in this sector declined from 1.55 in 1980 to 1.03 in 1985, and the ratio of long-term debt to net worth (index 9.3) fell even further. On the other hand, the ratio of total assets to total liabilities (index 9-4) remained stable throughout the period 1980-1985. The difference between the behaviour of total debt and leverage is due to the fact that the leverage was favoured by the positive performance of the net worth. The high level of fixed assets and their upward revaluation protected the net worth against inflation. The resulting increase in net worth helped to prevent any increase in the leverage index.

The financing of the enterprises was basically short-term throughout the period (indices 9.3 and 9.5), reflecting both the unavailability of

long-term credit and the reduced investment in plant and equipment.

In 1984, after the sharp decline in sales (16.8%) in 1983, the enterprises were not disposed to increase their output, preferring to run down their stocks. The uncertainty was so great that they even preferred not to make investments in labour and repairs and other minor operating investments.

5. Profitability

The gross profit margin (table 10, index 10.1) indicates sales profits, after the cost of sales has been deducted, as a measure of the capacity to meet necessary operating costs, such as financial and labour costs, taxes, etc.

The gross profit margin remained almost constant throughout the period under study, des-

pite the fact that the increase in sales operating costs (index 10.7) was higher than the increase in operating income. Financial costs accounted for an increasing proportion of operating costs as a result of the increase in nominal interest rates. Between 1982 and 1984 operating profits—the difference between the gross margin and operating costs (indices 10.1 and 10.7)—were negative.

Despite this negative level of operating profits, the enterprises made profits from the management of their liquid assets.

6. Evolution of the performance of the enterprises by period

If the performance of the manufacturing and commercial enterprises is considered in terms of their response to the macroeconomic context, the following subperiods can be distinguished:

Table 11

PERU: REAL SALARIES AND WAGES

	Metropolitan Lima (in 1978* intis)		Salaries of central Government employees (in 1979 intis)	Minimum legal income (in 1979 intis)	Income index: informal sector
	(1)	(1)			
	Salaries	Wages	(2)	(3)	(4)
1979	39.93	26.91	33.88	11.06	100.00
1980	42.88	28.46	40.08	13.69	114.85
1981	43-60	27.87	40.24	11.55	144.21
1982	47.05	28.25	39.34	10.73	174.16
1983	40.34	23.38	31.36	11.02	148.69
1984	37.19	19.94	31.56	8.53	131.99
1985	-	-	26.42	7.49	130.24

Source: National Supervisory Commission for Companies and Securities (CONASEV).

(1) Ministry of Labour and Social Advancement, Survey of Establishments with 16 or more workers.

(2) Central Reserve Bank of Peru (BCRP): fiscal sector, based on data of the Ministry of the Economy and Finance (excludes bonuses).

(4) Central Reserve Bank of Peru (BCRP): income and product. Based on Consumer Price index data (1979 = 100) of the National Institute of Statistics. Average of domestic service wages, prices of shoe repair services, tailoring and other informal sector services.

a) *January 1980 to June 1982*: Although there was some dynamism in the sales of the manufacturing enterprises, the availability of idle capacity reduced the need for investment in plant and equipment.

The sales of the commercial enterprises were more dynamic, partly owing to the sharp increase in exports which was reflected in greater use of installed capacity and higher borrowing. The mining enterprises, despite the fall in mineral prices, continued with their medium-term investment plans.

b) *July 1982 to end of 1983*: There was a general decline in sales in both commercial and manufacturing enterprises and major changes in the management of their liquid assets. The enterprises tried to maintain a greater proportion of their assets in financial investments by delaying settlement of their obligations to the State, their suppliers and the banking system. The reduction in sales meant less use of installed capacity and declining profits.

c) *1984-1985*: The profit indices of the enterprises recovered and there was some improvement in sales, which was absorbed more by a reduction of inventories than by higher output. They continued to use financial investment instruments in the management of their liquidity.

7. Evolution of profits: the manufacturing sector

The evolution of the income and expenditure of the manufacturing sector will now be considered for the critical period 1981-1985 on the basis of the balances submitted to CONASEV (table 12). The situation is analysed at three points: the second half of 1981, a moderately prosperous stage preceding the crisis; the second half of 1983, the time of deepest recession; and the first half of 1985, following two years of adjustment.

The most striking point is that, despite a fall of 23% in the real value of sales, net profits remained positive, although declining to only a quarter of their earlier level. Furthermore, profit levels recovered rapidly and for the first half of 1985 almost equalled the absolute amount of profits in 1981, although sales remained 11% lower than in 1981. Accordingly, the net profit per unit of sales in 1985 (5.3%) exceeded the 1981 level (4.8%).

Table 12

PERU: PROFITS OF MANUFACTURING ENTERPRISES, 1981-1985

(Percentage of sales)

Half year	Net sales revenue	Costs				Operating margin	Financial income	Net profits	Index of overall profitability
		Sales costs	Financial costs	Taxes	Other costs				
1981: II	100.0	70.4	7.2	5.2	16.4	2.0	2.8	4.8	100.0
1983: II	77.0	66.6	14.2	4.3	19.6	-4.7	5.6	1.6	25.0
1985: I	89.0	65.1	12.7	4.0	18.1	0.1	5.2	5.3	98.0

Source: Prepared on the basis of data from the reports of the National Supervisory Commission for Companies and Securities (CONASEV).

The crisis impaired the profit margin by increasing the fixed costs per unit of sales and the financial costs through a higher nominal interest rate. The effect of fixed costs was reflected mainly under the heading "Other costs", which increased from 16.4 to 19.6% of sales between 1981(II) and 1983(II). Financial costs rose even more: from 7.2 to 14.2% of sales. In all, these factors increased the cost per unit of sales by 10.2 percentage points.

The compensatory factors were reflected primarily in the decline in variable costs or "Sales costs" from 70.4 to 66.6% between 1981(II) and 1983(H). As was stated above, the enterprises benefitted from a sharp reduction in real wages and some reduction in the relative prices of certain current inputs. In the case of wages, the reduction was sufficient to influence the average cost, despite their small impact on total costs. The decline in real wages offset in part the obstacles to manpower cuts created by the Labour Stability Law (although this law had given the enterprises a degree of flexibility during the three-year trial period before workers acquired tenure). As to the other inputs, between 1981 and 1983 the terms of trade improved by 11.5% in favour of industry (table 13).

The tax burden per unit of sales also declined. Part of this movement was reflected under the heading "Taxes", which fell from 5.2 to 4.3% in the first period and then 4.0% in 1985(I). With respect to the other taxes counted as sales costs, it must be assumed that they also showed a reduction, at least in payments made, for the government's total revenue declined by

28% in real terms between 1981 and 1983. Much of this reduction took the form of arrears and delays on the part of taxpayers, who in Peru are almost all enterprises.

The increase in the financial income of the enterprises also contributed to the maintenance of profit levels. This was due to the payment of higher nominal interest rates on their deposits and even more to the gains made by them as holders of liquid assets in foreign currency. As

Table 13

PERU: RELATIVE PRICES, 1980-1985

	Manufacturing		Agriculture	
	Index" (1979 = 100)	Vari- ation (percent- age)	Index (1979 = 100)	Vari- ation (percent- age)
1980	85.3	-14.7	105.6	5.6
1981	80.3	-5.9	96.2	-8.9
1982	81.6	1.6	81.7	-15.1
1983	89.6	9.8	86.7	6.1
1984	92.9	3.7	95.2	9.8
1985	93.9	1.1	77.4	-18.7
1981-1985		16.9		-19.6

Source: Agriculture: Sectoral Statistical Office of the Ministry of Agriculture.

"Implicit deflator of the value added in manufacturing divided by the GDP deflator. Based on data of the National Institute of Statistics (INE), *Cuentas Nacionales del Perú, 1950-1985*, September 1985, tables 4 and 5.

Price index based on a basket of 15 products and deflated by the cost of living index.

was seen in the previous section, the enterprises maintained their liquidity throughout the crisis—a fact incompatible with a sharp decline in sales—owing to the high return on the liquid assets maintained in foreign currency. Between the end of 1981 and June 1985 the average real return on foreign currency deposits was 23% (table 8). And it is probable that the decline in sales costs also reflected, in the form of capital gains on the movement of inventories, a financial profit resulting from the difference between the nominal interest rate and the inflation rate, which thus offset the greater burden of financial costs.

The net effect on profits can be seen in table 12. The margin of operating profits moved into the red under the first impact of the crisis, then fell from 2% in 1981(1) to -4.7% in 1983(H); however, this was offset by the increased financial income. The net profit per unit of sales remained positive, although falling from 4.8 to 1.6%. The continual reduction in operating and tax costs, and even a certain reduction in fixed costs per unit of sales shown under "Other costs", produced a full recovery in net profits for 1985(1). The net profit margin of 5.3% in 1985(1) also exceeded the level of 4.8% recorded in 1981(11). This recovery was com-

binated with a partial normalization of sales, which increased total 1985 profits to their pre-crisis level.

The results were similar in the commercial enterprises (table 14).

Table 14

**PERU: COMMERCIAL SECTOR:
FINANCIAL EARNINGS AND
PROFITABILITY OF THE
COMMERCIAL ENTERPRISES,
1980-1985**

(Percentage of sales)

	Oper- ating profit margin	Finan- cial income	Other income	Net profits
1980	2	2	2	6
1981	0	2	2	4
1982	-3	3	2	2
1983	-4	4	1	1
1984	-3	4	2	3
1985	-2	4	2	4

Source: National Supervisory Commission for Companies and Securities (CONASEV).

III

An interpretation

1. *The hypothesis*

The starting point for this consideration of the financial experience of the enterprises in 1980-1985 is the crisis of production and foreign debt which the country underwent. The analysis is expected to show whether there was a comparable and parallel crisis in the financial situation of the enterprises.

Several elements combined in the crisis affecting the enterprises during this period. The most important was the sudden collapse of sales between June 1982 and December 1983. The drop was 22% in real terms in the private non-farm sector; it was probably even greater in

modern-sector enterprises owing to the increase in informal and illegal activities in the economy.

Business finances were struck another blow by the faster rate of devaluation; after three years of decline (33% between December 1978 and June 1982) the real exchange rate began to climb, increasing by 19% during the next 18 months. This made the considerable foreign-currency debt incurred by the enterprises since 1980 more expensive: in two and a half years the foreign-currency debt (direct and endorsed) increased by 144% and at the end of 1982 it represented 51% of the total short-term debt of the enterprises (table 15). However, most of this foreign-currency borrowing did not form part of the

Table 15
 PERU: SHORT-TERM PRIVATE SECTOR DEBT, 1974-1985
 (Millions of 1980 intis)

		Direct			Indirect (guaranteed)			Total		
		N/C ^{fl}	F/C ^A	Total	N/C	F/C	Total	N/C	F/C	Total
1974	December			1 185	...		544			1 729
1975	December		...	1 236			508			1 744
1976	December	1 022	51	1 073	91	461	551	1 112	512	1 624
1977	December	939	94	1 033	80	666	745	1 018	760	1 778
1978	December	682	124	805	90	566	656	771	690	1 461
1979	December	615	148	763	107	346	453	723	494	1 216
1980	March	607	194	801	112	399	511	718	593	1 312
	June	695	187	881	131	432	563	826	619	1 444
	September	679	197	876	128	466	594	807	663	1 470
	December	710	228	938	137	471	608	847	699	1 546
1981	March	592	212	804	115	434	549	707	646	1 353
	June	742	209	951	116	387	503	858	596	1 454
	September	798	214	1 013	133	446	579	932	660	1 592
	December	895	222	1 117	127	450	578	1 022	672	1 694
1982	March	842	269	1 111	122	532	654	964	800	1 764
	June	892	319	1 210	138	564	702	1 030	882	1 912
	September	851	364	1 215	124	632	756	976	995	1 971
	December	854	391	1 245	131	631	762	985	1 022	2 007
1983	March	776	386	1 161	114	538	652	890	924	1 813
	June	706	400	1 106	116	455	571	822	855	1 677
	September	668	395	1 063	265	484	749	932	879	1 811
	December	693	378	1 071	122	405	526	815	783	1 598
1984	March	667	343	1 009	94	452	546	761	794	1 555
	June	696	364	1 060	99	375	474	795	739	1 534
	September	700	368	1 068	105	386	490	805	754	1 558
	December	694	425	1 120	103	400	503	797	825	1 622
1985	March	582	463	1 045	98	425	524	680	889	1 569

Source: Central Reserve Bank of Peru (BCRP), Monetary Sector Division.

^aN/C = National currency,

^bF/C — Foreign currency, valued at the exchange rate at the end of the period.

country's external debt but was financed by means of dollars kept in the country in the form of bank certificates in foreign currency.

The initial effect of the faster devaluation in 1983 included a psychological factor: the devaluation rate doubled in nominal terms in the first months of 1983 from an annual rate of 72% in 1982 to 140% in the first half of 1983. The real increase was actually much less because inflation also doubled, but for much of the year the out-

look seemed alarming to businessmen burdened by an increasing dollar debt.

At the same time businessmen began to feel the effects of the restrictive monetary policy: real lending to the private sector in local currency declined by 21% between June 1982 and the end of 1983. Moreover, the credit restrictions were aggravated by the external financial crisis: the level of external short-term borrowing, including endorsed loans, declined by 26% from

a maximum of US\$3 028 million at the end of 1982 to US\$2 238 million in the first quarter of 1984. Part of this reduction was probably voluntary, as a response to the faster devaluation, but the cutback in lending to Peru by the international banking system must also have made a contribution.

As was to be expected, the combined effect of these factors produced a serious financial crisis in the enterprises. Their cash flow suffered the simultaneous effects of the decline in sales, tighter credit and larger financial payments on the dollar debt. Profits were affected by the reduced capital turnover and the high level of fixed costs, which included part of the labour costs owing to the rigidity of Peru's Labour Stability Law. And the decline in profits and the increase in the burden of foreign-currency debt undermined the solvency of the enterprises.

2. *The results*

The information presented in the previous section indicates that the enterprises were less affected by the crisis than might reasonably have been expected. There were few bankruptcies (some timber companies, some companies linked to a bank which failed) and a few temporary shut-downs. The survival rate was high, at least in the modern sector of the economy.

The performance of the financial indices presented in section II confirms this picture of

survival. The liquidity index declined but without becoming negative, and one of its components (cash and bank liquidity) even increased. In the majority of activities current liabilities increased as a percentage of sales between 1981 and 1983, but then declined in 1984-1985. In 1985 the level of short-term debt was lower than in 1981 in manufacturing, commerce, transport and services (table 16). Leverage declined in manufacturing and mining and remained relatively stable in commerce. Under the combined impact of smaller capital turnover and larger financial costs, including the foreign exchange losses due to devaluation, operating profits were negative throughout the period 1982-1985 (table 14). However, total profits were protected by increasing financial earnings which, between 1982 and 1985, more than exceeded the operating losses and enabled the manufacturing and commercial sectors, for example, to record positive net profits even in 1983, the worst year of the crisis.

3. *The defence mechanisms*

The survival of the enterprises was due to their own defence mechanisms, help from the government and the eventual recovery of the economy. The most important defence mechanisms as such seem to have been the successful transfer of the necessary adjustment to other parts of the

Table 16

PERU: CURRENT LIABILITIES BY SECTOR OF ACTIVITY, 1980-1985

(Percentage of sales)

Sector	1980	1981	1982	1983	1984	1985
Agriculture	49.8	76.4	44.4	40.7	36.0	30.0
Mining	23.0	32.6	33.8	30.8	39.7	38.7
Manufacturing	45.2	41.7	49.8	54.2	47.6	41.6
Construction	84.5	73.7	63.8	58.8	84.0	71.8
Commerce	36.5	35.9	39.0	41.6	36.4	31.6
Transport	34.8	51.8	51.4	48.3	42.6	37.4
Finance	60.9	83.0	48.2	144.8	55.0	51.1
Services	31.7	68.0	68.7	50.1	43.9	47.7
Total	37.5	38.9	43.5	48.9	44.3	45.5

Source: National Supervisory Commission for Companies and Securities (CONASEV).

economy and the financial gains made by the enterprises.

These gains offset the operating losses of 1982 to 1985 with large financial earnings which, in the case of industry, amounted to 6% of the value of sales in 1984 and, in the case of commerce, 4% of this value in 1983-1985 (table 14).

The opportunity to make these gains was created by the strong and persistent distortion of the financial market from 1982 and, in particular, by the high absolute profits derived from foreign-currency holdings. During the three years from March 1982 to March 1985 foreign-currency profits averaged 20% in real terms. In contrast, holdings of local currency invested at the highest market interest rate had a negative profit rate of 26%. Foreign exchange holdings, therefore, were the safest and on average most profitable investment for several years.

The importance of financial investments during this period can be measured by the value of the foreign currency deposits in the banking system. These deposits increased from US\$592 million at the end of 1979 to a maximum of US\$1 680 million in March 1985. As a proportion of total quasi-money this value increased from 38 to 72%. Some of these deposits were made by natural persons and some by the State, but it is estimated that private enterprises held between 60 and 70% of the total. Enterprises also held deposits abroad, as well as other securities in foreign currency. Thus, the financial losses suffered by foreign currency borrowers were offset by speculative gains, at least in the business sector as a whole.

Businessmen tried hard to obtain the liquidity to enable them to transfer their debt from dollars or to invest in foreign currencies. This quest for liquidity often had a recessive effect, especially when it meant reduced inventories, deferred investments and even the postponement of purchases and contracts necessary to the production cycle.

The enterprises also protected themselves by transferring the necessary adjustment to others. In 1983, for example, tax revenue declined by 31% in real terms over the previous year. An IMF mission thought that the government had permitted a "collapse" of the tax administration. In fact, many of the enterprises had no other

choice; the involuntary reduction of the tax burden from 17.6% of GDP in 1982 to 14.2% in 1983 meant a transfer of 3.4% of the gross domestic product from the State to the enterprises.

The workers also absorbed part of the adjustment: average wages and salaries in urban areas fell by between 20 and 30% from 1982 (table 11). The reduction mechanism was mainly the market, but the wages policy, which was designed to check big raises in order to reduce inflation and the fiscal deficit, probably helped to weaken the labour sector's defences. It is more difficult to assess the role played by manpower cuts. There was certainly more flexibility than is implied by the Labour Stability Law, which permitted the dismissal of workers who had not completed three years of service. Furthermore, businessmen used the purchase of retirement pensions, persuasion and other methods to reduce their workforce.

The transfer of the adjustment to the workers was also an automatic result of mechanisms such as piecework, commission work and other forms of payment which tied the worker's income to his output or to sales.

Table 17

PERU: DOUBTFUL DEBT PORTFOLIO OF
THE COMMERCIAL BANKING SYSTEM
AND SAVINGS BANKS 1979-1985

(Mil/tons of intis)

	Total loans	Doubtful debts			Per- cent- age loans
		Due	In legal collec- tion	Total	
1979	197.3	1.0	4.4	5.4	2.8
1980	391.1	2.6	4.8	7.4	1.9
1981	843.0	9.8	13.8	23.6	2.8
1982	1 514.4	44.7	36.2	80.9	5.3
1983	3 570.4	130.8	222.7	353.5	9.9
1984	6 953.1	231.6	708.4	940.0	13.5
1985"	15 512.0	389.9	2 393.0	2 782.9	17.9

Source; Office of the Superintendent of Banks and Insurance Companies.

"Preliminary data to September.

Table 18

**PERU: DOUBTFUL DEBT PORTFOLIO WITH THE COUNTRY'S
CREDIT SYSTEM, DECEMBER 1985**

(Millions of intis)

	Private enterprises	Public enterprises	Total system
Number	56	4	623
Unsecured loans	414 375	77 170	
Loans in arrears	338 199	523 891	
Legal collection	1 561 499	3 487	
Total doubtful portfolio	2 314 073	604 548	5 654 001
Total portfolio	3 464 072	1 441 790	22 880 227
Percentage of doubtful portfolio	66.8	41.9	24.7

Source: Office of the Superintendent of Banks and Insurance Companies.

Part of the adjustment was also transferred to the banks, a fact which contributed to the failure of three of them in 1983- 1984 (table 17 and 18). The banks' total bad debts increased each year from 1980, rising from only 1.9% of the total investments of the banking system in 1980 to 17.9% in 1985. In the end the Central Bank absorbed part of these bad debts, for it made support loans to several banks and had to guarantee the deposits of the banks which closed.

Lastly, it is possible that a part of the adjustment was transferred to the primary sector through a decline in the relative prices of raw materials. This is suggested by the index of real prices in the farming sector, which was 9% lower in 1983-1985 than in 1980-1982 (table 13).

Another source of aid for business was the government, mainly through the heavy subsidy implicit in the negative interest rates (table 19). In 1983 20.9% of the national currency debt was "liquidated" by the rates in force, and in 1985 the subsidy amounted to 18.6%. In all over the three years half of the 1982 debt was liquidated.

The monetary authorities deliberately sought to liquidate the debt. This meant abandoning, the policy of real interest rates introduced with great political difficulty in 1981 and caused a disagreement with the IMF which contributed to the collapse of the standby loan agreement signed in 1983.

A second instrument used by the government to support business in this period was

refinancing loans, which between 1983 and 1985 represented roughly 0.7% of the gross domestic product (table 20). It is probable that most of these loans were intended for the transfer of debt from dollars or the purchase of foreign currency.

However, notwithstanding these special refinancing loans the fairly tight monetary policy pursued during 1983-1985 led to a contraction of real lending. At the same time, the

Table 19

**PERU: EFFECT OF NEGATIVE REAL
INTEREST RATES ON OPERATIONS
IN NATIONAL CURRENCY**

(Millions of 1985 intis)

	Depositors' losses		Subsidy to private borrowers	
	Millions of intis	Percent- age ^a	Millions of intis	Percent- age ^b
1980	-2 303	15.6	413	3.8
1981	-918	5.7	73	0.5
1982	-595	4.0	234	1.7
1983	-3 738	30.9	2 447	20.9
1984	-1 743	14.6	705	6.1
1985	-3 125	54.8	1 253	18.6

Source: Based on data of the Central Reserve Bank of Peru (BCRP).

^aRefers to total deposits in the national currency.

^bRefers to total investments in the national currency.

Table 20

PERU: SUPPORT LOANS TO BANKS AND
ENTERPRISES GRANTED BY THE
CENTRAL RESERVE BANK,
1982-1984

(Flows in millions of intis)

	To enter- prises	To banks	Total	Percent- age of CTDP
1982				
I	.08	.38	.46	.56
II	.24	.42	.66	.69
III	.01	-.39	-.38	-.42
IV	.15	.10	.25	.30
1983				
I	.18	.50	.68	.93
II	.07	1.27	1.34	1.58
III	.66	.02	.68	.87
IV	.28	.22	.50	.68
1984				
I	.42	.13	.55	.76
II	1.03	.54	1.57	1.81
III	.32	.53	.85	.99
IV	.29	.15	.44	.56

Source: Based on data of the Central Reserve Bank of Peru (BCRP).

increase in the inflation rate speeded up the circulation of money and also contributed to the contraction of lending in real terms. Lastly, the large loans made to the government in 1985 to cover the deficit caused by the fall in revenue reduced the availability of credit for the private sector. The combined effect of these factors caused a sharp decline in the supply of credit in soles to the private sector: between June 1982 and March 1985 this sector's debt in local currency fell by 34% in real terms (table 15). Accordingly, Central Bank loans acquired much greater importance in the total flow of credit to the private sector (from 6% in 1980-1982 to 14.9% in 1983-1984), but they could not check the adverse effects of the factors mentioned above (table 21). Moreover, this cutback in lending had the opposite effect to that produced by other government measures, for it obliged the enterprises to make a larger adjustment.

4. Final comments

The social cost of the crisis for the enterprises took the form of losses of investment and even of productive capacity, and the lack of maintenance rendered equipment useless. For three years the net investment of the private sector was no more than 3 or 4% of GDP. Businessmen protected themselves by means of the flight of capital, which contributed to the balance-of-payments crisis. The errors and omissions in this balance increased from an annual positive amount of 2.4% of GDP in 1980-1982 to a crisis level of -3-4% of GDP in 1983-1985. Furthermore, a disproportionate part of the adjustment was transferred to the workers. Some non-tenured workers lost their jobs and those with tenure suffered a heavy loss of purchasing power. Incomes also declined sharply in the informal sector (table 11). Part of the adjustment was absorbed by the population as a whole by means of the inflationary financing of the fiscal deficit created by the non-payment of taxes and the protection of bank deposits. Inflation had a particularly damaging effect on savers who were not protected by assets in foreign currency.

The greatest damage, however, resulted from the recessionary multiplier effect of the

Table 21

PERU; REAL INVESTMENTS,
BY ECONOMIC SECTOR,
OF COMMERCIAL AND
INVESTMENT BANKS
(1979 = 100)

Public sector	1983	1984	1985
Agriculture	70	66	62
Livestock	2	2	1
Fisheries	4	5	4
Industry	193	185	147
Mining	42	52	51
Commerce	69	54	45
Construction	50	42	28
Public sector	11	2	3
Miscellaneous	75	76	61
Total	516	484	402

Source: Office of the Superintendent of Banks and Insurance Companies.

defensive reactions of businessmen exacerbated by the great distortion in the financial market. This tendency to react by cutting back had been strengthened by the business experience of the 1970s and it aggravated the recession: the enterprises achieved a degree of financial balance but at lower levels of production, investment, wages and total demand. Not only did demand-led production not recover after the collapse in 1983, it even fell by 2% between 1983 and the first half

of 1985, while production determined by the climate and the external demand increased by 17.3% in the same period.

In conclusion, it can be said that the financial experience of the enterprises during the crisis period under consideration contained a paradox: although they withstood the crisis with surprising success, their survival mechanisms had a high social cost and probably helped to aggravate the global crisis.