

Debate

The Price (and Costs) of Macroeconomic Stability in Peru: Some Lessons on the Implications of FDI-driven Growth

Samuele Bibi  and Sebastian Valdecantos

ABSTRACT

In the period 2000–2019, Peru enjoyed sustained GDP growth and a long period of macroeconomic stability; as a result, poverty was reduced markedly in comparison to the 1980s and early 1990s, when the country faced severe recessions and hyperinflation. This positive economic performance coincided with the implementation of a mainstream macroeconomic framework which, alongside favourable external conditions, allowed for continuous external financing of current account deficits, mainly through foreign direct investment (FDI). Against the background of current debates regarding the resurgence of debt crises and the advocacy of FDI as a way to avoid such crises, this article uses balance of payments and international investment position statistics to assess whether Peru's acquired macroeconomic stability can be deemed sustainable. Drawing on the contributions of the Latin American structuralist school and more recent analyses that have raised concerns, the article shows that Peru's external position has taken on a Ponzi profile, casting doubt on the idea that FDI is a superior way of external financing compared to external debt. It concludes with a discussion of the social and environmental implications of Peru's widely praised macroeconomic framework, highlighting the limits that peripheral economies face when their growth relies excessively on external financing.

INTRODUCTION

For a number of years, Peru has been in a period of political and social turmoil. In the six years leading up to 2023, six presidents have been in office:

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two were dismissed after impeachment, while two others resigned before the end of their terms. The social unrest that spread through the whole country in December 2022 following the removal of President Castillo and the installation of Dina Boluarte, had already been presaged in the election of April 2021, which was marked by polarization and high levels of vote dispersion. In the first round of the multi-candidate presidential election of that year, Castillo, of the left-wing *Perú Libre* (Free Peru) party, topped the poll in spite of winning only 18.92 per cent of the total; Keiko Fujimori of the right-wing *Fuerza Popular* (People's Force) party came second, with 13.41 per cent of the vote. By the beginning of 2023, more than 60 people had died in the demonstrations against the government and the political elites, and there is uncertainty over President Boluarte's chances of remaining in power until 2024, the self-imposed date of the next general election.

This social and political turbulence is in stark contrast with the apparently solid macro-financial stability that Peru has enjoyed since the beginning of the new millennium, following a period of volatile macroeconomic dynamics that characterized the country from the late 1970s until the early 1990s.¹ The high and sustained GDP growth rates that Peru has registered in the past two decades,² especially in 2003–13, alongside low and stable inflation and overall good macroeconomic indicators, have won praise from both academia and international organizations. While some toyed with assigning Peru the title of the new 'Latin American miracle' (IMF, 2008, 2012, 2017; Mendoza, 2013; Vietor et al., 2015), the International Monetary Fund (IMF) praised it for its economic expansion, paying tribute especially to credible stabilization policies and the implementation of structural reforms that allowed Peru to improve its economic efficiency and productivity (Ross and Peschiera, 2015). In 2020 the IMF underlined the fact that, with an average annual real GDP growth rate of 5.4 per cent during the previous 15 years, Peru represented one of the best-performing Latin American economies, mainly thanks to its sound macroeconomic policy framework (IMF, 2020). This framework consists of an inflation-targeting monetary regime combined with a managed floating exchange rate policy and a relatively open financial account, complemented with a series of macro-prudential policies. This orthodox macroeconomic framework, combined with a mining-based

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1. In the late 1970s inflation started to accelerate, alternating between periods with two-digit inflation rates (e.g. 1986 and 1987) and episodes of hyperinflation (e.g. 1989 and 1990). Between 1980 and 1991, the last year to see three-digit inflation, the annual average inflation rate was 10.58 per cent.
 2. Taking the average growth rates of the decades since the 1930s, Peru's four decades of highest growth have been the 1950s, 1960s, 2000s and 2010s (5.4 per cent, 6.0 per cent, 5.0 per cent and 4.5 per cent, respectively). However, growth was less volatile in the 2000s and the 2010s than in the 1950s and 1960s, as measured by the standard deviation. Moreover, the average growth rate during the commodity supercycle of 2003–13, which reached 6.2 per cent, surpassed any previous 10-year growth rate registered by the Peruvian economy.

enclave economy³ and the presumption that the proceeds of growth in this sector will trickle down to the rest of the economy, constitutes, in our view, the pillars of Peru's growth model.⁴

However, the contrast between Peru's apparent macroeconomic success story and the increasing social and political unrest leads us to question the foundations on which this growth model is built. Is there a price that Peru has had to pay, or a trade-off it has to face, for its achievements in terms of macroeconomic stability? Is Peru's sound macro-financial position just a smokescreen behind which potentially disruptive macroeconomic vulnerabilities have been accumulating over the years? And, most importantly, is Peru's macro-financial position really as solid as has been claimed?

Our contention is that beneath the surface of Peru's growth model, some vulnerabilities are mounting, some of which could put the development strategy in jeopardy, as the recent turmoil has shown. First, like most Latin American economies, Peru's growth process is characterized by persistent current account deficits, implying that it is reliant on a constant flow of external financing, in terms of both external debt and foreign direct investment (FDI), that increases its foreign liabilities. Second, the continuous growth of external liabilities does not seem to be correlated with a transformation of its productive structure that would, eventually, allow the economy to reduce its dependence on external financing. Third, this dependence on external financing generates subordination of macroeconomic policy to the mandates of creditors, thereby limiting the scope for expansionary policies aimed at reducing social gaps. If the perception that the proceeds of growth are not equally distributed becomes generalized, this could fuel social unrest. Fourth, as FDI has become the dominant form of external financing, concerns have been raised about environmental degradation related to the activities undertaken by foreign companies, which has also led to specific social tensions.

This article hopes to shed light on these issues with the aim of better understanding the (economic and social) sustainability of the growth model Peru initiated in the 1990s, and providing some tools for the analysis of other peripheral economies which share at least some of the four vulnerabilities of the Peruvian economy. FDI has often been perceived as a superior way of external financing because it supposedly generates more stable capital inflows compared to external debt. In particular, it has been argued that external debt is more susceptible to reversals and fluctuations, compared to FDI, since

3. Although the share of mining in value added has remained around 8 per cent since the 1980s, its share in exports has grown from 46 per cent in the 1980s to 58 per cent in the 2010s, and surpassed the 60 per cent threshold in the years of high mineral prices.

4. This article is based in part on research undertaken in Peru, which included interviews with technical staff of the Peruvian government and central bank, Banco Central de Reserva del Perú (BCRP), as well as with academics of universities in the Lima metropolitan area. These interviews helped us to identify the main pillar of Peru's growth model.

the former is strongly affected by changes in interest rates (Edwards, 2007; Moran, 2011) while the latter reflects longer-term commitments by foreign investors. Furthermore, external debt has traditionally been denominated in foreign currencies, which increases vulnerability in the event of sudden capital outflows and depreciation of the currencies of developing countries.

In the context of the significant surges in debt levels during the COVID-19 pandemic, and the aggressive interest rate increases following the inflation shock produced by the pandemic and the consequences of Russia's invasion of Ukraine, it is worth reflecting on the effectiveness of FDI as an alternative source of financing. Some authors have pointed to the risks and downsides of FDI, including: the denationalization of key strategic industries, in contrast to external debt, which preserves the sovereignty of key resources (Fischer, 2018; Lewis, 1978); the deepening of a specialization pattern based on static comparative advantages instead of promoting productive diversification (Botta et al., 2016); and 'horizontal expansions' which eventually lead to a gap between the inflow of foreign exchange (via new FDI) and the outflows related to profit remittances (Sunkel, 1972).

Drawing on the contributions of the Latin American structuralist school and more recent analyses that have raised concerns about the risks that development financing carries for macroeconomic stability and the development process itself (Fischer, 2015, 2018; Kregel, 2004), we use balance of payments and international investment position statistics to assess whether Peru's present macroeconomic stability in a context of persistent current account deficits can be deemed sustainable. Inspired by Minsky's extension of his financial instability hypothesis to the open economy (Minsky, 1993; see also Kregel, 2004), we then build some indicators to provide an overall measure of Peru's external solidity. Finally, we combine the results of our analysis with the evolution of social and structural variables, as well as with the specific social and environmental implications associated with FDI flows, to reflect on the limitations that Peru's growth model could impose on its development aspirations.

The article is organized as follows. In the next section we review the most relevant literature that helps us to understand the implications of Peru's situation as a peripheral economy and the challenges deriving from it. We also provide a brief review of the development finance alternatives and their associated risks, with a special focus on external debt and FDI. In the subsequent section we build a series of indicators — in the spirit of Minsky (1993) and Kregel (2004) — to measure Peru's external fragility and its sources. Our finding is that while the external fragility indicators based on external debt reflect a sound position, the inclusion of FDI-related outflows (dividends) suggests that Peru's external position has taken a Ponzi profile.⁵ We then discuss the implications of Peru's FDI-based external financing strategy in

5. A Ponzi profile is a situation in which the cash flows of a debtor (in this case, a country) are insufficient to pay for the future stream of interests resulting from its liabilities. In such

the macroeconomic, social and environmental dimensions. A short final section concludes the article.

LITERATURE REVIEW: THE PERIPHERAL ECONOMY CONDITION AND THE DOUBLE-EDGED SWORD OF EXTERNAL FINANCING

To ascertain whether Peru's acquired macroeconomic stability contains the seeds of potentially destabilizing side effects in the form of external vulnerability (with a currency or debt crisis as the worst-case scenario), it is necessary to consider its condition as a peripheral economy. Based on the contributions of Latin American structuralism since the 1950s (CEPAL, 1955; Prebisch, 1949; Rodríguez, 1977)⁶ and the broad literature that followed, we can define a peripheral economy as one with a subordinated form of integration in world markets, real and financial, which produces a high level of dependency on — and exposure to — the cycles and shocks that originate in the centre of the economic system.

On the real (productive) side, the peripheral condition manifests itself in a low-complexity productive structure, mostly biased toward the production of natural resource-based goods and heavily reliant on the imports of intermediate, capital and consumption goods. The imbalance between the production and exports of commodities on one side, and a strong dependence on high value-added manufactured goods on the other, led Prebisch and Singer to foresee a dismal prospect for the development aspirations of these economies. At the core of their thesis was the declining terms of trade (Prebisch, 1950; Singer, 1950), which would leave countries specializing in natural resource-based goods in a disadvantageous position. The concerns of the structuralist school contrasted starkly with traditional international trade theory which recommended that countries should specialize in the production of the goods in which they were most productive and efficient.

Within the framework of a peripheral economy, Diamand (1972) described an economy characterized by two or more sectors with divergent productivities as an 'unbalanced productive structure'. According to Diamand, the productivity divergences across sectors and the presence of 'black holes' in the productive structure (for example, the absence of domestic production of essential inputs), condemned peripheral countries to develop in an unbalanced manner, leading to chronic shortages of foreign exchange as the low-productivity sectors grew at a rate that could not be sustained with the proceeds coming from the exports of the high-productivity sectors. In the context of low financial integration before the end of Bretton

situations, the debtor needs to take more debt to roll over the payment of the principal but also the related interests.

6. CEPAL stands for Comisión Económica para América Latina y el Caribe, known in English as the Economic Commission for Latin America and the Caribbean (ECLAC).

Woods, two scenarios were possible: the ‘stop and go’ cycles described by Braun and Joy (1968), or demand management policies that kept growth within limits of the balance of payments equilibrium, as defined by Thirlwall (1979/2004). Given that most of the factors leading to balance of payments constrained growth are real in nature (that is, related to the real economy), Tavares (2000) calls this structural constraint ‘technological dependency’, further highlighting the persistent negative implications of the peripheral economies’ subordinated integration into world markets.⁷

The difficulties entailed by technological dependency were exacerbated after the abandonment of the Bretton Woods system and the subsequent heyday of cross-border capital flows seeking higher returns. International financial markets became a double-edged sword for peripheral economies. On the one hand, they could temporarily relieve the balance of payments constraint emanating from the unbalanced productive structure (or even enclave-economy structures in some cases) but, on the other hand, external indebtedness (be that public or private debt, or FDI) produced an outflow of payments in the form of interest and dividends that put more pressure on the balance of payments (Barbosa-Filho, 2004; McCombie and Thirlwall, 2004; Moreno Brid, 1998; Thirlwall and Hussain, 1982/2004). This high exposure to the upheavals of the external sector was reinforced by the post-Bretton Woods deregulation of cross-border financial flows, making peripheral economies importers of the financial crises and instabilities of advanced economies (Kregel, 2009). Several authors following Minsky’s legacy have found that financial openness tends to aggravate financial instability due to the procyclicality of cross-border financial flows (Arestis and Glickman, 2002; Kregel, 2009).

Although the real and financial sides of the peripheral economy condition are often intertwined, from a structuralist perspective it is claimed that the end game consists of transforming the productive structure (CEPAL, 2012). A more diversified and complex economy would lead not only to better employment and social conditions, but also to a more resilient external position. However, changing the productive structure of a country heavily reliant on extractivist activities is a long-term process that requires deliberate public policies and adequate financing. How to sustainably finance development is still an open question, but the dilemmas that this poses at the macro level are clearly laid out by Kregel (2004):

External capital flows as a basis for development policy are thus a two edged-sword that must be managed in order to generate positive benefits in the form of higher rates of growth of per capita incomes. Policy should be directed to providing supplements to private capital flows

7. Tavares’s (2000) notion of ‘technological dependency’ is, in turn, a synthesis of the long tradition of Latin American structuralism and dependency theories, among which we identify Prebisch (1949), Furtado (1961) and Cardoso and Falleto (1970) as the main references.

with a view to allow developing countries to maintain Domar's conditions for sustainability.⁸ (Kregel, 2004: vii)

Extending Minsky's financial fragility analysis to the open economy, Kregel shows how a development policy based on using positive financial flows to finance a constant trade deficit might put a country into a dangerous situation of external indebtedness, leading it, under certain conditions, to a Ponzi position. Such a financial position is unsustainable in the long term, implying that the whole development strategy will backfire as soon as the funding dries up. When this happens, the country will most likely suffer a currency crisis or a debt crisis, or a combination of both. And even when not directly leading to crises, external liabilities generate a reversal of flows from developing to developed countries (Abeles and Pérez Caldentey, 2022; UNCTAD, 2020), thereby threatening exchange rate stability.

What, then, are the financing alternatives for a country like Peru, and what can be done to avoid this creation of external vulnerabilities? One alternative, as already noted, is FDI, which has been presented as 'good cholesterol' compared to short-term capital inflows, which would be 'bad cholesterol' (Fernandez-Arias and Hausmann, 2001), and also as a more stable source of funding (Igan and Tan, 2015). However, recent work on another peripheral economy, Colombia, has shown that rather than diversifying the productive structure, FDI could lead to a deepening of the existing pattern of specialization and even to a 'financial Dutch disease' (Botta et al., 2016). Moreover, Fischer (2015, 2018) underlines that, particularly in Latin America, FDI has been the main channel of foreign finance and it has often translated into the denationalization of key strategic industries and foreign dominance. Fischer (2015) further stresses that while US-centred corporations and their affiliates expanded throughout the 1970s, once subsidiaries are well established in host countries, they can easily expand their operations, making use of domestic resources, both private and public, without necessarily needing further external FDI resources (as previously noted by Sunkel, 1972: 527). As a result of these 'horizontal expansions', FDI stops generating financial inflows but still entails financial outflows through profit remittances or interest payments.

As an alternative to FDI, it would be possible for development finance in peripheral economies to take the form of external debt, but accompanied by a series of precautions that would reduce its implied risks. IMF staff members have recently claimed that small open economies can achieve macroeconomic stability and economic growth through a combination of an

8. Domar's conditions for sustainability for a development policy based on external indebtedness refer to the ability of a country to obtain a consistent growth rate of financial account inflows that is higher than the rate of interest it pays on its outstanding debts to the rest of the world. If this condition is not met, the country's interest payments to the rest of the world will lead to a growing financing need that will eventually dry up the external financing, causing the whole development strategy to founder.

inflation-targeting monetary policy, interventions in the foreign exchange market, some restrictions on capital inflows and the use of macro-prudential policy (Basu et al., 2020). This strategy can also benefit from a change in the currency denomination of external debt, increasing the share of domestic currency denominated external debt to avoid the risks associated with undertaking excessive external debt commitments denominated in foreign exchange — the main risk being the difficulty of obtaining sufficient amounts of foreign exchange to pay both the capital repayments and interest in the context of a weakly performing domestic currency. However, in the same way that FDI inflows can lead to macro-financial instabilities, domestic-denominated debt can also be problematic and lead to ‘new forms of external vulnerability’ (Kaltenbrunner and Paineira, 2015).

In the next section we draw on the elements outlined above to assess whether Peru’s much-vaunted macroeconomic stability of the past 20 years, which is highly reliant on external capital inflows, has entailed any external fragilities that might be worrying. More specifically, we build upon Kregel’s (2004) conceptual framework extending Minsky’s analysis to the open economy to construct a series of indicators characterizing Peru’s external financial profile. We then analyse the results in light of the dynamics of the different components of the balance of payments over the recent decades.

LIGHTS AND SHADOWS OF PERU’S EXTERNAL POSITION, 2000–19

In the previous section we highlighted Kregel’s (2004) concerns with development strategies that rely on external financing, due to their potentially destabilizing effects on the macro economy. Given all the praise heaped upon Peru for its seemingly solid macro framework, two inevitable questions arise from a Minskyian and a Latin American structuralist perspective: first, has Peru’s external financing scheme been hedged,⁹ or are there any fragilities hiding underneath? And second, regardless of the sustainability of Peru’s external liabilities and their corresponding income outflows, are there any signs that Peru is actually going through a development process? A comprehensive answer to the latter question would require a definition of what development is; for the purpose of this article we take a structuralist approach to prioritize the transformation of the productive structure such that the economy becomes less reliant on imports and diversifies its export basket away from natural resource-based products. This would not only reduce the country’s need for foreign exchange (implying a fall in the need for external financing), but it would also create more jobs, ultimately allowing for better living conditions for a larger share of its population.

9. A hedge profile is a situation in which the cash flows of a debtor (in this case, a country) are sufficient to pay for both the principal and its related interests.

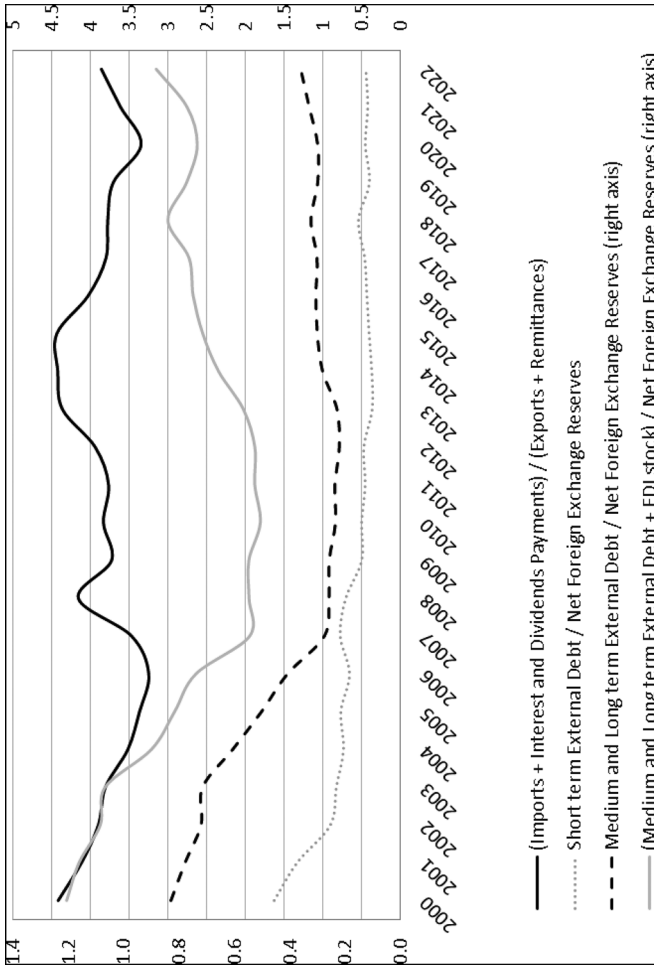
To address the first question, we draw on Minsky (1993) and on Kregel's (2004) extensions of Minsky's original work to the open economy to measure the external position of a country. Figure 1 presents one flow-based and three stock-based indicators related to sources and uses of foreign exchange. The flow-based indicator measures what proportion of current external outlays (imports plus interest and dividend payments, which by definition include FDI-related outlays) can be covered by exports and remittances. In line with the persistent current account deficit which Peru exhibited over the sample period (which is indeed a structural feature throughout its history), the indicator is persistently above unity (except for the years before the global financial crisis and 2020), implying a continuous need for financing. In Minsky's terminology, this would amount to a Ponzi situation, a clear indicator of external financial fragility. In other words, Peru's current foreign exchange inflows are insufficient to fulfil the payments on its external liabilities. As a result, more external financing is taken, mostly in the form of FDI (of which only 55 per cent consisted of profit reinvestment in the 2010s) and more recently including the issuance of external debt (see below for further details). One reason for the persistence of this deficit position over time is that Peru managed to keep external funding coming into the economy, which added to the favourable effect that the commodity supercycle had on the terms of trade.¹⁰ The other reason behind the stability of this Ponzi-like profile was the massive reserve accumulation of the Banco Central de Reserva del Perú (BCRP) (more on this below). However, should private external lenders decide to stop investing in the country, Peru would need to start using up its stock of reserves or might eventually, in case of major difficulty, have to resort to the IMF.

The stock-based indicators in Figure 1, on the other hand, reflect a sounder — although not entirely safe — position. In all cases external liabilities are compared to the net stock of foreign exchange reserves, the only difference being the term structure of the debt included in the numerator of the indicator. The good performance of these stock-based measures has been attributed to two factors: a series of macro-prudential regulations that were implemented to reduce the economy's exposure to the upswings of the global financial cycle and their implications for the domestic financial system;¹¹ and the reserve accumulation policy put in place by the BCRP. A first sign of sound macro management is the low

10. The commodity supercycle is commonly used to refer to the period 2003–13, in which commodity prices reached record levels, to a large extent due to China's high demand for these products, which benefited commodity exporters like Peru.

11. Based on Alam et al. (2019), Bortz (2023) summarizes the macro-prudential policies implemented by Peru as: measures to discourage the increase in capital inflows; measures to reduce the dollarization of the domestic financial system; measures to increase the resilience of the financial system and reduce the transmission of risks; measures to constrain the excessive increase in credit; and measures to reduce currency mismatches and their associated risks.

Figure 1. External Fragility Indicators, Peru, 2000–22



Source: authors' elaboration based on BCRP data (<https://estadisticas.bcrp.gob.pe/estadisticas/series/>)

share of short-term external debt in total debt, which is reflected in the low value taken by the corresponding indicator. A second sign is a significant reduction in long-term external debt as a source of financing, although a persistent increase is observed after 2013, reaching a level of 1.28 in 2022. Hence, even if these stock-based indicators look more positive than they did at the beginning of the 2000s, and even if the lower share of short-term external debt is good news for Peru, the upward trajectory of the indicator including medium- and long-term debt should not be overlooked.

The picture looks even less secure when FDI is included in the stock-based indicator, which not only lies well above unity but also increases by 50 per cent in the 2010s. Although this should not be seen as a warning of an imminent debt or currency crisis (the sudden withdrawal of the stock of FDI is unlikely), both the poorer performance of the stock-based indicators when FDI is accounted for and the Ponzi profile suggested by the flow-based indicator signal where the stress point of the development financing strategy chosen by Peru could be. Although it is argued that Peru's large stock of foreign reserves, and the potential use of IMF credit lines if necessary, could be enough to weather potential balance of payments tensions,¹² it must be kept in mind that stocks are finite and that relying on external lenders, whether they be transnational corporations, global investment banks and funds or even multilateral institutions like the IMF, imposes conditionalities (sometimes written, sometimes tacit), which affect the country's sovereignty in defining its own economic, social and environmental policies.

Peru's net debtor position is not, however, a new phenomenon, and neither is the external fragility shown by the indicators presented in Figure 1. Still, unlike its experiences in earlier decades,¹³ since the 1990s Peru seems to have managed to live with this persistent reliance on external financing. What did Peru do differently in the 1990s that allowed it to attain this macroeconomic stability? In line with other Latin American countries, Peru adopted the so-called New Consensus approach to macroeconomic policy. This framework consists of an inflation-targeting¹⁴ monetary policy framework whereby deviations from the long-run equilibrium are corrected through changes in the short-run interest rate, while fiscal policy is kept as passive as possible. The framework is usually combined with an open

12. This is the opinion that we heard in our conversations with the technical staff of the official institutions working with macroeconomic policy in Peru.

13. After a more nationally oriented and developmentalist model with high GDP growth rates of around 7 per cent during 1960–67, Peru experienced double-digit inflation in the 1970s due to the broader international context, and suffered severe recessions during the 1980s with a drop of GDP of up to 20 per cent as a result of the stabilization and adjustment responses to the 1982 debt crisis.

14. The inflation target established in 2002 was a 2.5 per cent rate, with a plus or minus 1 per cent fluctuation band. The target was reduced to 2.0 per cent in 2007, and there it has remained.

financial account and a flexible exchange rate.¹⁵ However, as noted by Pérez Caldentey and Vernengo (2022), pure exchange rate flexibility leads to a number of instabilities that can impact negatively on the goal of price stability. Thus, peripheral economies pursuing an inflation-targeting regime tend to implement a ‘managed floating’ exchange rate regime (implying interventions in the foreign exchange market) combined with a policy of foreign exchange reserve accumulation.

This was in fact the case in Peru, where the high financial account openness in a context of easy liquidity conditions worldwide enabled persistent capital inflows that resulted in exchange rate stability, as well as a remarkable increase in the net stock of foreign exchange reserves which increased 735 per cent between 2000 and 2019 (authors’ calculations based on BCRP data). In line with the inflation target, inflation was kept permanently at one-digit levels and stayed close to the target throughout the period. Considering Peru’s history of high inflation rates between the late 1970s and the early 1990s, strongly associated with exchange rate volatility, it seems that the taming of inflation was achieved to a large extent by the nominal exchange rate stability that was facilitated by both the commodity boom and the capital inflows.

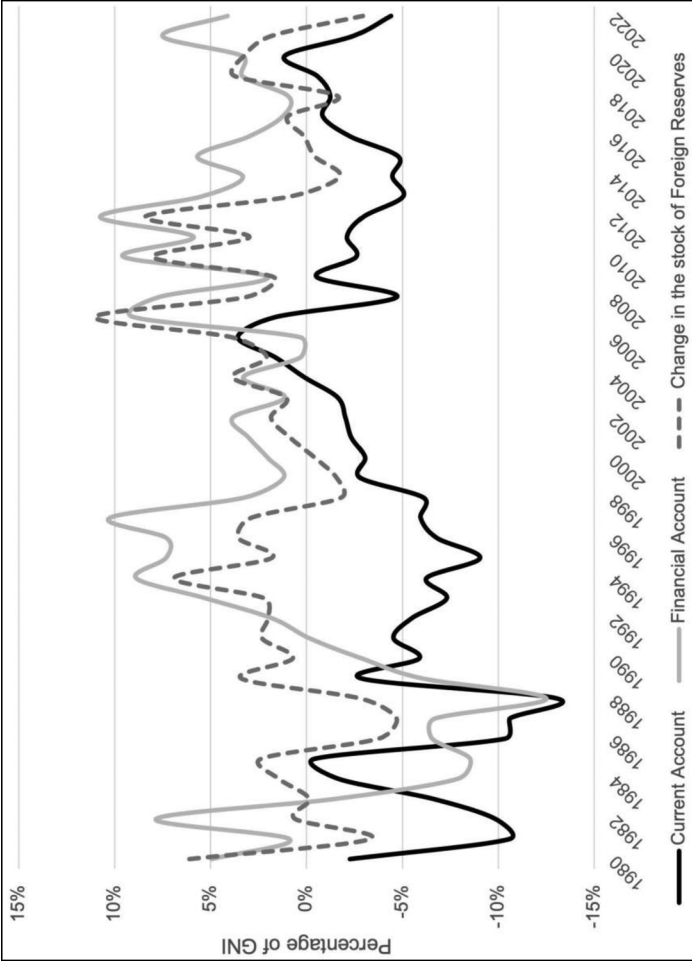
Peru’s External Sector Dynamics

Given its peripheral nature, and drawing on Ocampo’s (2013) notion of ‘balance of payments dominance’, it is useful to read Peru’s acquired macroeconomic stability through its relationship with the rest of the world. As Figure 2 shows, and in line with its economic history, Peru ran an (almost) uninterrupted current account deficit between 1980 and 2022, which was matched by a positive net capital inflow. The only period in which Peru managed to avoid current account deficits was 2004–07, a time of high commodity prices. The continuous financial account surpluses implied that, until the end of the commodity supercycle, the Peruvian central bank was able to increase its stock of foreign reserves, both for self-insurance and to avoid excessive real exchange rate appreciation. Thereafter, it managed to maintain the stock of foreign reserves at historically high levels.

A closer look at the current account shows that Peru registered a continuous positive current transfers balance (including remittances) of about 2 per cent of GNI and a positive trade balance in goods during the commodity

15. As Pérez Caldentey and Vernengo (2013) point out, ‘inflation targeting proponents argue that a flexible exchange rate regime is a “requirement for a well-functioning inflation targeting regime”. This view responds to the fact that in a world of full capital mobility, the monetary authorities cannot maintain an independent monetary policy and a stable exchange rate at the same time, the so-called Impossible Trinity or Trilemma’ (Pérez Caldentey and Vernengo, 2013: 358). For a detailed description and critique of the New Consensus model in an open economy, see Arestis (2009).

Figure 2. Balance of Payments, Peru, 1980–2022



Source: authors' elaboration based on BCRP data (<https://estadisticas.bcrp.gob.pe/estadisticas/series/>)

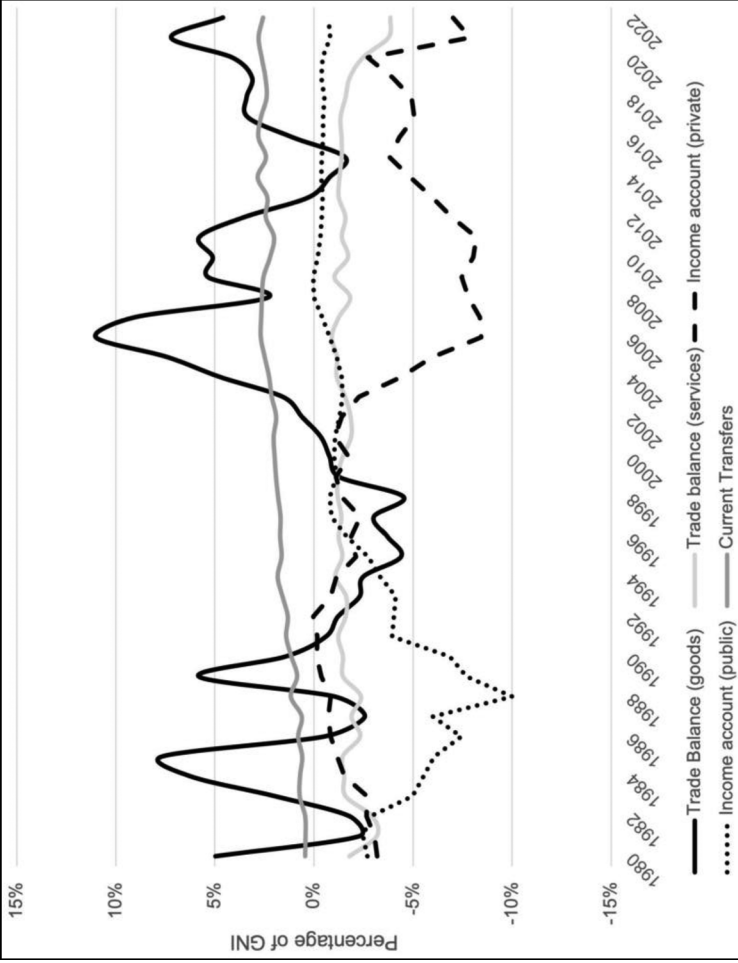
supercycle (Figure 3). However, at the same time, it also registered a persistent trade deficit in services and a negative income account balance in both the public and, particularly, the private sector. In line with the increasingly important role played by FDI as a source of financing observed in both the flow- and stock-based indicators presented above, a long-term perspective shows that the private income account overtakes the public one as the main driver of current account deficits. It is also worth noting that net exports, even considering the deficit in services, seem to have stabilized at a positive level on average. Failure to do this might have led to an even worse performance of the flow-based indicator (and the current account) that would have increased the country's external fragility. However, it must be pointed out that exports remain highly concentrated on mining products (60 per cent of total exports in 2018–20, with copper alone accounting for 30 per cent of total exports), thereby intensifying Peru's extractivist profile. This is also stressed by Jiménez (2019) who argues that the liberalization policies implemented since the 1990s, including financial markets, favoured the perpetuation of Peru's pattern of specialization based on extractivist activities.

On the financial side, Peru was already registering continuous capital inflows in the early 1990s (Figure 4), FDI being the most important driver of inflows followed by long-term loans.¹⁶ More recently, the public sector was also a recipient of external funding, although with a marked drop in the share of foreign currency denominated debt. This persistent inflow of foreign exchange more than compensated the current account deficits, which explains how the high GDP growth rates (even above population growth) could be sustained for so long without leading to a balance of payments crisis along the lines described in the literature (Barbosa-Filho, 2004; McCombie and Thirlwall, 2004; Moreno Brid, 1998; Thirlwall, 1979/2004; Thirlwall and Hussain, 1982/2004).

Despite the apparently consistent scenario combining current account deficits with financial account surpluses over the last 30 years, some relevant changes can be observed when these accounts — and the financial account in particular — are broken down. In line with the growing importance of FDI as a source of financing and with the associated increase in the average deficit in the private sector income account, shown in Figure 5, a structural change in the composition of external liabilities is observed when these are disaggregated by types and institutional agents. Figure 5 shows the share of the different types of external liabilities (for example, stocks) in total external liabilities as reported by the BCRP.

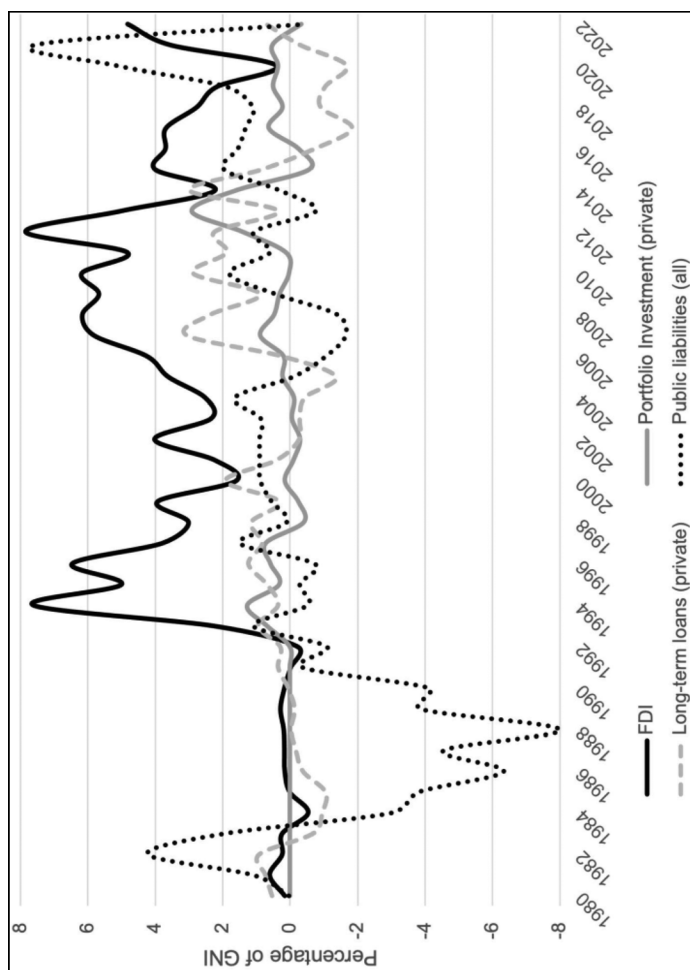
16. BPM6 is the latest Balance of Payments and International Investment Position Manual, which serves as the standard framework for statistics on the transactions and positions between an economy and the rest of the world. We depart from the current BPM6 reporting framework and represent inflows (for example, increases in external liabilities) with a positive sign to make the interpretation of the Figure more intuitive (meaning that an increase in the line representing FDI implies an inflow of FDI-related funds).

Figure 3. Sources of Foreign Exchange Inflows and Outflows: Current Account, Peru, 1980–2022



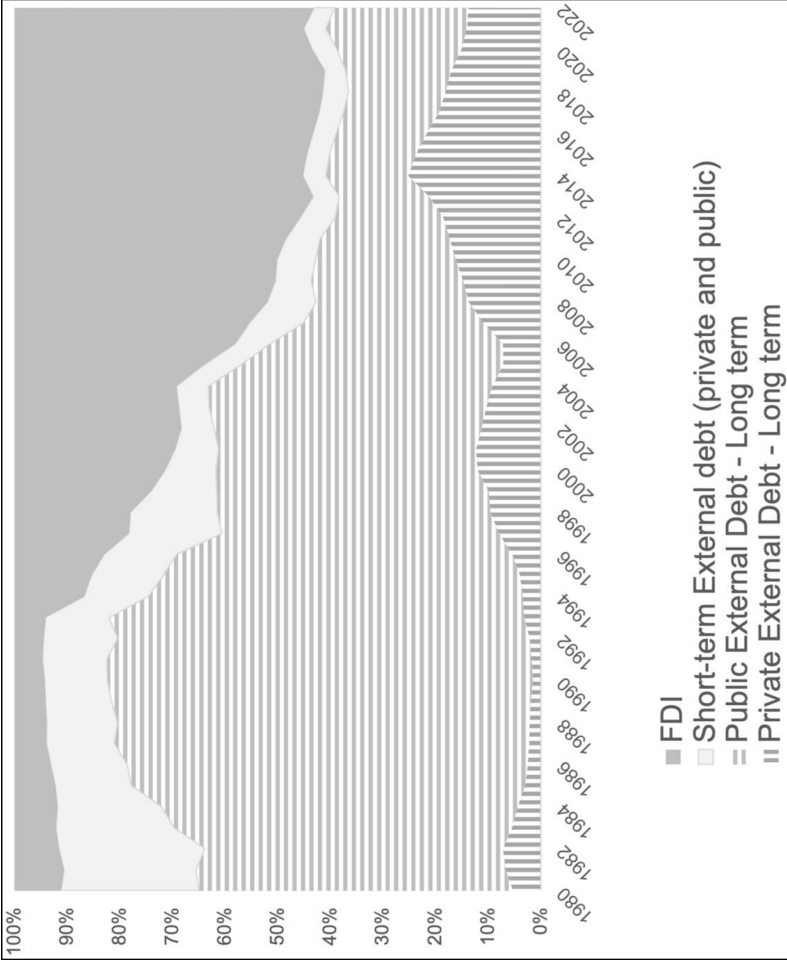
Source: authors' elaboration based on BCRP data (<https://estadisticas.bcrp.gob.pe/estadisticas/series/>)

Figure 4. Sources of Foreign Exchange Inflows and Outflows: Financial Account, Peru, 1980–2022



Source: authors' elaboration based on BCRP data (<https://estadisticas.bcrp.gob.pe/estadisticas/series/>)

Figure 5. The Changing Structure of External Liabilities, Peru, 1980–2022



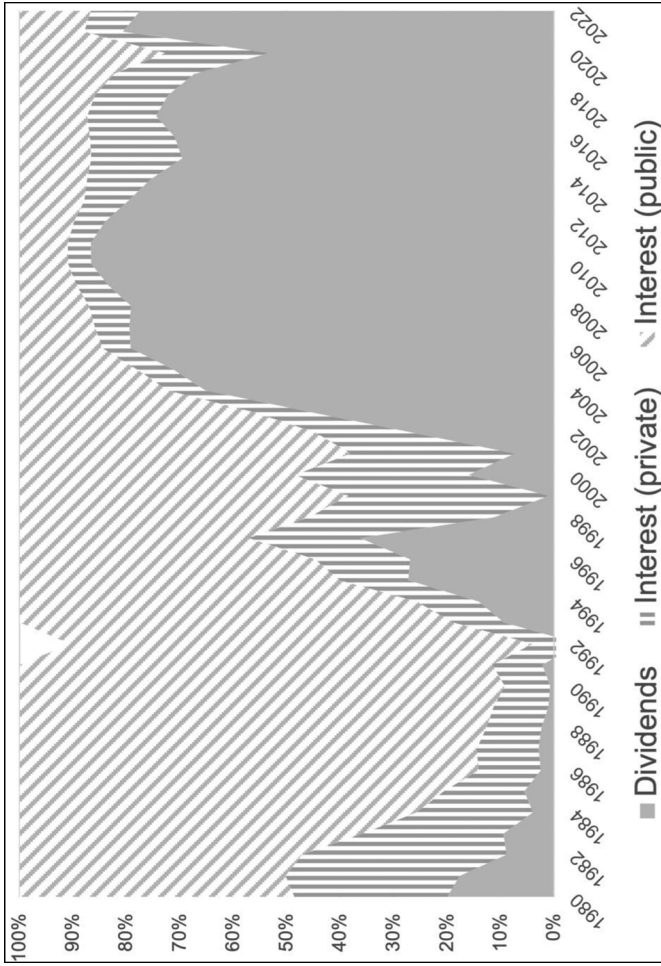
Source: authors' elaboration based on BCRP data (<https://estadisticas.bcrp.gob.pe/estadisticas/series/>)

The first point that stands out is that the systematic inflows of FDI registered since the early 1990s led to the share of FDI increasing from 6 per cent in 1990 to 57 per cent of total external liabilities in 2022, implying a significant increase in non-financial private sector participation in the external liabilities of the country. This explains why dividends paid by non-financial corporations (NFCs) have become the most important factor behind the private income account deficit, as shown in Figure 6. This is an aspect also noted by Fischer (2018: 3369) in the case of Brazil, signalling the existence of a pattern consisting of ‘trade surpluses and private financial inflows [mainly through FDI] financing overall current account deficits due to large deficits on the services and income accounts’. As mentioned earlier, besides their role in current account outflows, rather than contributing to the development of the country’s productive structure these foreign investments reinforce its enclave-economy features. Based on official data released by the Ministry of Mining, Salazar Vega (2021) shows that 96.4 per cent of copper-extraction activities in Peru are concentrated in 10 multinational foreign companies, mainly from China, Canada, the United States, Mexico, Luxembourg and South Africa.

Sectoral disaggregation of private debt (only available since 2005) shows a number of other noteworthy elements. First, long-term debt issuance by NFCs more than doubled its share in total external liabilities between 2005 and 2022. Second, the long-term liabilities of the private financial sector also increased from less than 1 per cent of total external liabilities in 2005 to more than 5 per cent in 2022, having peaked at 10 per cent towards the end of the commodity boom. As shown in Figure 6, this also led to an increase in the private share of the income account deficit. Finally, the lower share of public debt in total external liabilities is worth noting; it went from being the most important component to explaining a relatively minor part of the liabilities. Bortz (2023) also points out, in relation to external public liabilities, that the share of public debt denominated in foreign exchange fell from 90 per cent in 2004 to slightly below 30 per cent in 2019. All these facts show that while the current account deficit remained roughly unchanged (if the effect of terms of trade is netted out), there was a shift in the source of financing of these deficits and the type of agent taking external debt. Specifically, the private sector has replaced the government as the main debtor to the rest of the world, the main type of liabilities being FDI and long-term assets.

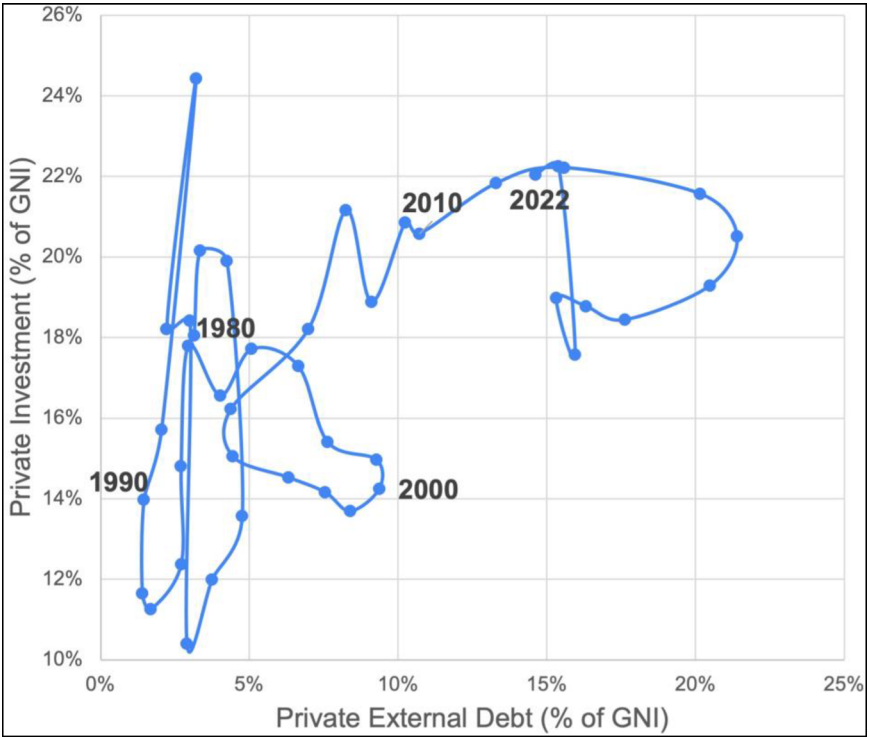
Despite the fragilities that an increase in external liabilities can bring about, as briefly reviewed in the previous section, running financial account surpluses should not be seen as a sign of future instability per se. Fischer (2018), for example, contrasts the successful example of South Korea with the unsuccessful case of Brazil, underlining how, while both countries had similar levels of current account deficits compensated by similar dynamics of external liabilities, good management and transformation in the structure of external financing allowed South Korea to generate the funding the

Figure 6. The Changing Structure of External Liabilities-related Payments, Peru, 1980–2022



Source: authors' elaboration based on BCRP data (<https://estadisticas.bcrp.gob.pe/estadisticas/series/>)

Figure 7. The Use of External Financing, Peru, 1980–2022



Sources: authors' elaboration based on data from BCRP (<https://estadisticas.bcrp.gob.pe/estadisticas/series/>) and INEI (www.inei.gob.pe/estadisticas/indice-tematico/economia/)

economy needed to pursue a process of change in the production structure, a change in development finance and a higher growth path.

Has External Financing Promoted Structural Change?

This relates to the second question motivating this section, namely whether — regardless of the sustainability of Peru’s external liabilities and their corresponding income outflows — there are any signs that Peru is going through a development process that could reduce the external fragility shown by the flow-based indicator. With this in mind, Figure 7 plots the joint dynamics of the private investment rate and private external debt between 1980 and 2022. While an analysis of these end points shows that private external debt (as a percentage of gross national income) has increased almost five-fold, with the investment rate exhibiting lower growth (from 19 per cent to 22.8 per cent), the dynamics of the series show that in 2006 investment took off,

reaching a maximum of 22.2 per cent in 2013 (the end of the commodity boom). In 2022 private investment was at record high levels, while private external debt was high by historical standards but lower than in the second half of the 2010s. The joint growth of private external indebtedness with private investment would suggest, in principle, that Peru made good use of a potentially destabilizing tool.

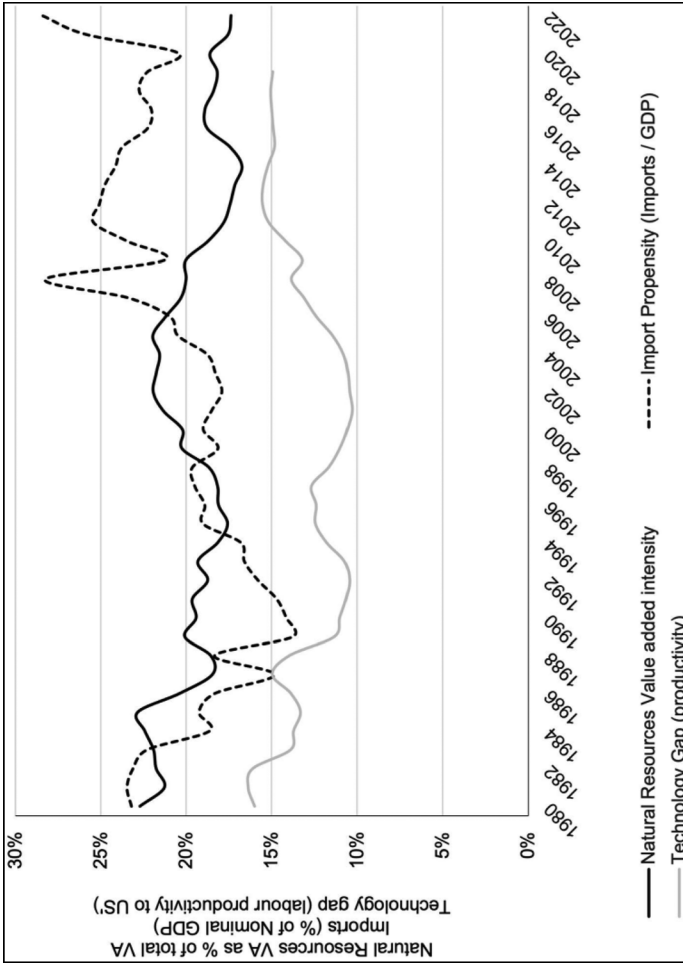
The indicators assessing the evolution of the structural features of the economy show that these temporarily higher investment rates, which coincided with the increase in private external debt, might have helped to diversify Peru's economic structure, but without changing its characteristic extractivist pattern significantly. Figure 8 shows the evolution of the technology gap,¹⁷ the natural resources intensity of value added,¹⁸ and the average import propensity. The evidence is mixed. While the productivity-based technology gap improved after the trough of the late 1990s (although this does not represent an increase in economic complexity or productive diversification) and the share of natural resources in value decreased (by 4 percentage points), the reliance on imported goods strengthened to the point that it reached a record high in 2022. Another interesting measure showing how investment might have improved Peru's productive capabilities is the share of high-complexity activities in value added, which grew from 3.6 per cent in 2007 to 5.8 per cent in 2022.¹⁹ When investment is broken down, it is found that while both construction and machinery and equipment (the component most directly associated with technological development) grew at the same rate (260 per cent comparing 2022 with 2000), the share of imported capital goods in investment went up from 21.8 per cent to 27.0 per cent, which matches the increase in the import propensity previously observed. Overall, we conclude that the Peruvian economy ended the second decade of the 21st century with more external debt and slightly better productive capabilities to sustainably face its financial implications than was the case in the previous decades.

To conclude this section, it is worth remembering Kregel's (2004) warnings of the risks involved in excessive reliance on external financing:

[W]hen the foreign borrowing is not used for expenditures that create net foreign exchange earnings (it makes little difference if this is domestic infrastructure investment, or purchase of basic or luxury consumption goods, or military equipment) it means that the country's

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17. To compute the technology gap based on productivity we use the Penn World Table to compute the technology gap as the ratio of Peru's average labour productivity (value added divided by total hours worked) to that of the USA.
 18. We compute the natural resources intensity of value added as the share of the value added of agriculture, livestock, forestry, fisheries and the extraction of oil, gas and minerals, in total value added (at constant prices).
 19. We compute this as the share of the following sectors in total value added: manufacturing of IT-related products; manufacturing of machinery and equipment; manufacturing of transport equipment; and IT-related services. The availability of data makes it impossible to compute this indicator before 2007.

Figure 8. Production Structure Indicators, Peru, 1980–2022



Sources: authors' elaboration based on data from BCRP (<https://estadisticas.bcrp.gob.pe/estadisticas/series/>); INEI (www.inei.gob.pe/estadisticas/indicadores/tematico/economia/) and Penn World Table (<https://estadisticas.bcrp.gob.pe/estadisticas/series/>); and Penn World Table (<https://febpwt.webhosting.rug.nl/>)

development planning is subject to maintaining the steady rate of increase in capital inflows and becomes hostage to international financial markets. (Kregel, 2004: 11)

Does the apparent mismatch between the increase in external liabilities (including external debt and FDI) and Peru's capacity to genuinely generate the foreign exchange required to honour its external commitments imply that the economy is vulnerable to suffering a crisis? The lower dependence on traditional debt, added to the fact that most debt is now denominated in domestic currency, makes it unlikely that Peru will suffer a debt crisis like those observed in Latin America in the 1980s. Also, the exchange rate flexibility, combined with reserve accumulation and macro-prudential policies, make the economy more resilient to a currency crisis like those experienced in Southeast Asia in the late 1990s. However, the persistence of current account deficits (for example, Peru still being a net debtor to the rest of the world) and the dynamic implications of FDI identified by Minsky and Kregel, require careful and continuous analysis of Peru's external sustainability, as well as a critical assessment of the secondary effects derived from this specific form of financing.

DISCUSSION

As a peripheral economy, Peru exhibits a structural tendency to register current account deficits, the main components of which are interest and dividend payments. These persistent outflows are dynamically related to the current account deficit, as they derive from the past acquisition of external liabilities on the one hand, and require continuous financial inflows from abroad to keep the growth cycle going, on the other. It is in this sense that Peru's external position is characterized by a Ponzi-style profile, as shown in the flow-based indicator presented in Figure 1. The persistent dependency on external financing, be it in the form of external debt or FDI, puts peripheral economies like Peru in a subordinate position with respect to their creditors, who can at any time choose to stop financing the country and, in the worst case scenario, withdraw their investments. This subordination, which builds on the historically established technological and financial dependencies highlighted by Tavares (2000) and pointed out earlier by Prebisch (1949) and Furtado (1961), limits policy makers' room for manoeuvre to deploy any strategy departing from the macroeconomic consensus. Instead of changing the structural determinants of the peripheral economy condition and alleviating the most urgent needs of the population, state-of-the-art policy mixes tend to maintain the status quo, only producing improvements in the social and productive dimensions when the external context allows it. Hence, Peru's acquired macroeconomic stability hides the same gaps that worried the Latin American structuralists back in the mid-20th century and, ultimately, explain why the anticipated 'catching up' has not yet happened.

Reliance on external financing, FDI in particular, can reinforce the structural determinants of the peripheral economy condition. Botta et al. (2016) suggest that FDI might deepen the specialization pattern of a country, moving it further away from the structural change that structuralist scholars claimed to be necessary. Furthermore, considering that FDI inflows often become 'horizontal expansions', they might further exacerbate the tendency towards a Ponzi-type situation. As Fischer points out, 'once subsidiaries are well established in a host country, they could draw on domestic public and private resources to expand operations without necessarily needing new injections of FDI' (Fischer, 2015: 722), suggesting that these horizontal expansions stop creating financial inflows but continue creating financial outflows in terms of remittances. This means that the country would need to increase its financial liabilities further to obtain sufficient resources to cover the outflows through the income account, thus reinforcing the reliance on external liabilities and the Ponzi-profile dynamics.

Subordination is not the only consequence of the persistent dependence on external financing. Another consequence of the continuous increase in external liabilities is external vulnerability, which has historically taken different forms both in Latin America and in Peru, depending on the domestic macroeconomic framework and the type of liabilities used to finance the deficits. To mitigate the risks of increasing external vulnerability, three types of responses are normally adopted. First, in the context of subordination to world markets, peripheral economies are tempted (or forced?) to pursue macroeconomic policies aligned with the mainstream consensus. The scope to make significant improvements in the population's standard of living is therefore limited to the size of the budget and current account deficits that foreign creditors are willing to finance or, if external conditions are favourable, to the temporary gains from increases in the terms of trade. In this way, persistent dependence on external financing could generate pressures toward regressive redistribution issues. In particular, in order to attract FDI, 'structural reforms' have often been implemented in the form of labour market liberalization and deflationary wage policies. Mkandawire (2005) underlines how deflationary macro policies have been adopted in African countries to attract FDI, and shows how these policies have often been counterproductive, contributing to investment reduction and growth reduction, and thus frustrating the strategy to attract significant FDI inflows. In the same way, Latin American countries have largely pursued liberalization policies in the labour market (Bibi, 2020).

In the case of Latin American countries, it is striking to note how reductions in poverty rates (measured as the share of the population living with less than US\$ 6.85 a day) coincided with the commodity boom, which in turn reduced current account deficits, even producing temporary surpluses in Brazil and Peru until 2007, in Ecuador until 2009, in Chile until 2010 and in Bolivia until 2014. In these cases, poverty fell significantly (28 percentage points in Chile, 27 points in Ecuador, 25 points in Peru, 24 points

in Bolivia, 23 points in Brazil and 20 points in Colombia) until 2013, the end of the commodity supercycle. In terms of extreme poverty (measured at US\$ 2.15 a day, 2017 purchasing power parity), Peru achieved great improvements: extreme poverty declined from 19.3 per cent in 2000, to 5.4 per cent in 2013, and 2.9 per cent in 2021.²⁰ Functional distribution of income changed only marginally with the wage share increasing from 28.6 per cent to 31.2 per cent between 2000 and 2019 while the profit share fell slightly from 38.1 per cent to 37.9 per cent during the same period (Castillo García, 2022). According to the WDI (see footnote 20), inequality has fallen sharply in Peru with the Gini coefficient declining from 49.1 in 2000 to 40.2 in 2021.

When the tailwind stopped blowing and the main fuel for Latin American economies became, once again, external financing, the room for deploying both demand expansion policies and income redistribution policies became tighter. As a result, the region entered the growth slowdown process that characterized the second half of the 2010s, and Peru was no exception. The reductions in poverty and inequality continued, but at a slower pace. Hence, although none of the countries just mentioned suffered from a balance of payments crisis when the external context worsened, we suspect that the price they had to pay for this macro-financial stability was the pursuit of a macroeconomic policy framework that prioritizes fiscal and monetary discipline over economic growth and income distribution.

The second approach that peripheral economies pursue to reduce external vulnerability consists of holding large stocks of foreign exchange reserves as self-insurance. While this does not improve the international investment position for countries with a persistent current account deficit like Peru (because reserve accumulation is the mirror of capital inflows that increase external liabilities), they can improve their economies' macro-financial stability by increasing their central banks' powers to weather a temporary capital outflow. As shown in the stock-based indicators of Figure 1, this has indeed been the case in Peru, and explains why the Ponzi position shown by flow-based indicators is not considered a cause for concern.²¹ The downside of this strategy, however, is the low return earned on these reserves and, most

20. Data from the World Bank World Development Indicators (WDI); see: <https://databank.worldbank.org/source/world-development-indicators>. During the same period, poverty and inequality reduction occurred not only in Peru, but throughout the region. Some countries saw even greater reductions: for example, during the period 2000–21, extreme poverty fell in Peru by 16.4 per cent, in Bolivia by 22.2 per cent, and in Ecuador by 24.8 per cent (*ibid.*).

21. In researching this article in April 2023 we had meetings with the technical staff of Peru's Ministry of Economics and Finance and the BCRP, in which we showed them the external stability indicators and shared our concerns about the economy's external position. In all cases we found awareness of the potential problems of persistent current account deficits, but very low levels of concern about the likelihood of tensions in the balance of payments leading to a currency or a debt crisis. The strong net foreign reserve position was always a key pillar of our interlocutors' confidence in the external stability of the economy.

importantly, their opportunity cost compared to the benefits of using the reserves to finance a structural change in the country's productive capacity.

Finally, the third strategy to mitigate external vulnerability comprises a change in the composition of external financing, passing from a structure mainly dominated by private or public debt to one in which FDI acts as the major source of financial inflows. The positive claims for this source of financing are twofold, namely the general stability of FDI with respect to indebtedness, and the fact that it does not involve interest payments on contracted debt obligations. The price to pay for this allegedly more stable financing tool, as stressed by Sunkel (1972) in the context of Latin American economies more broadly, is the denationalization of key industries and the subsequent lack of flexibility for the government to implement industrial policies which allow a change in the productive structure of the country.

External vulnerability and a constrained role in macroeconomic policy are not the only downsides of a peripheral economy's growth model that relies on persistent financing from the rest of the world. When financial account surpluses are driven by FDI, as in the case of Peru, there are important secondary effects that need to be accounted for. These effects could go well beyond the denationalization of strategic resources pointed out by Fischer (2015, 2018), which is already a serious and structural problem. The experience of Peru shows that in economies with important endowments of natural resources, the use of FDI as a source of financing could bring important social conflicts, due to the environmental degradation caused by extractive activities and the poor redistribution of the benefits obtained from them.

Mining activities, which is where most of Peru's FDI is concentrated, make intensive use of water to process minerals, suppress dust in work areas, and meet the utility needs of camps. According to a report published by Defensoría del Pueblo (DP) — the Ombudsman's Office of Peru — the majority of social conflicts were related to water resources management and protection (Defensoría del Pueblo, 2015).²² The monthly reports published by the DP (e.g., Defensoría del Pueblo, 2021, 2023) shed light on the increasing incidence of conflicts during recent years, especially socio-environmental conflicts, both active and latent.²³ In March 2021, 143 active conflicts were

22. In principle, the consumption of water in mining activities is regulated. However, the lack of meters or equipment which would allow the state to measure the amount of water being used by mining companies often results in huge discrepancies between the volumes declared and the volumes actually consumed. Furthermore, estimates of the use of water by the extractive industries will always fall short because they do not include the water that is lost in open pit pumping, or the drainage works undertaken by the companies to keep the area dry and avoid infiltrations in their projects (Salazar Vega, 2017).

23. 'Active conflict' is defined as social conflict expressed by any of the parties or by third parties through public lawsuits, formal or informal. A 'latent conflict' is defined as a social conflict that is not expressed publicly. The concurrence of factors that could cause open hostility may be observed but at the point of observation, conflict remains hidden, silent or inactive (Defensoría del Pueblo, 2021).

reported, of which 93 (65 per cent) were socio–environmental in nature. A further 32 latent conflicts were also classed as socio–environmental, bringing the total to 125. Of these, 64 per cent (80 cases) corresponded to conflicts related to mining activity while 19.2 per cent (24 cases) were conflicts related to hydrocarbon activities (Defensoría del Pueblo, 2021). In March 2023 these numbers had increased: of 162 active conflicts, 110 (68 per cent) were classed as socio–environmental, as were 32 latent conflicts. Of the total 142 active and latent socio–environmental conflicts registered during March 2023, 66.9 per cent (95 cases) were conflicts related to mining activity while 19.7 per cent (28 cases) were conflicts related to hydrocarbon activities (Defensoría del Pueblo, 2023).

As well as generating environmental degradation and social conflict, it seems that FDI directed to the mining sector did not even fundamentally improve the fiscal space in the long term. Flores Unzaga et al. (2017) show that the rise in government revenue from the mining sector from 2003 to 2016 was basically explained by the increase in metal prices and the start of the commodity supercycle. Once that period was over, the share of mining in tax revenue for the government dropped, from 50.9 per cent in 2007 to 4.5 per cent in 2016. In other words, the temporary improvement in tax revenue during the supercycle was not the product of any reform or change in the tax system aimed at socializing the benefits of the exploitation of natural resources (or compensating the damages derived from it), but rather a consequence of increases in the prices of raw materials (ibid.). The mining sector went from contributing 0.4 per cent of total government revenue in the years immediately before the supercycle (2000–02) to contributing 3.4 per cent in 2007. However, this increase was reversed at the end of the supercycle, from 2013, falling to 0.7 per cent in 2015 (ibid.). More recently, the decline in tax revenue has been so strong that the sector's tax contribution has been negative, since the government's tax revenues from income tax (IR) and tax general sales (IGV) were lower than tax refunds received by the companies as a result of the so-called 'balance in favour of the exporter' (ibid.).²⁴

It is in this context of increased controversy around mining activities — which are the main driver of FDI, which is in turn the dominant external financing mechanism of Peru's growth model — that ex-president Castillo's 2021 victory in 88 per cent of localities with mining conflicts has to be understood. Castillo had announced his intention of renegotiating mining contracts, increasing corporate taxes, and even potentially nationalizing

24. 'When any company sells something it produces or sells, it has to pay the VAT, which generates a tax debit. ... What about companies that sell to external markets? In Peru — as in most of the world — we are guided by the principle that "taxes are not exported"; consequently, exports are not taxed with the VAT and therefore are sales that do not generate tax debits. In the case of mining companies, when selling abroad without paying VAT, the debit–credit chain is interrupted. In tax jargon, what is known as "balances in favor of the exporter" (SFE) is generated. The tax legislation allows companies to use SFE against the payment of Income Tax and/or request its refund' (De Echave, 2016).

mines. He argued that the current system perpetuated an unfair status quo that failed to translate into community development, damaged the environment, and was prone to corruption (Schalit et al., 2021).

Given that mining is at the core of Peru's growth model and its financing strategy, its sustainability needs to be examined with a broader lens than that provided by macroeconomics. The fact that Peru's external financial position displays Ponzi characteristics when FDI is included in the analysis should be a source of concern. But of at least equal importance are the by-products that accompany FDI when it is oriented towards an extractive industry for the purposes of rent seeking. According to Diego Macera, General Manager of the Instituto de Estudios Peruanos — the Peruvian Institute of Economics — and now on the board of directors of the BCRP:

If we want to support the legitimacy of the mining and extractive industry in general, a fundamental component is for the population to see that the benefits and rents that come from the extractive activity effectively translate into a better quality of life for them If the inhabitants only see mining that in theory pays mining canons and royalties, and that these resources do not improve their quality of life, then there is a greater potential conflict with mining. Dialogue channels are required between the three parties, the state, the company and the communities, but also clear rules of the game. (Quoted in *La República*, 2021)²⁵

In sum, whether FDI is a more stable source of external financing than external debt when it comes to covering persistent current accounts deficits is an open question. While some authors argue that its longer-term orientation makes it more desirable than issuing securities or taking loans, our indicators show that this does not avoid the external position of the economy looking like a Ponzi scheme. This echoes Kregel's (2004) concerns about the dynamic implications of a 'development strategy' based on external financing. Moreover, Fischer (2018) points out the implications of FDI in terms of ownership of strategic assets, and also the dynamic implications in the current account of the horizontal expansion of foreign companies. Most importantly, however, in the absence of adequate environmental regulation, the use of FDI directed to extractivist activities carries very negative implications in both social and environmental terms. Alongside the latent external vulnerability, this is part of the price that Peru might have had to pay to achieve its much-praised macro-financial stability.

CONCLUSIONS

The case of Peru in the period 2000–19 provides a useful illustration of how a peripheral economy can manage to reduce its external vulnerability through a series of macroeconomic policies without necessarily tackling the fundamental roots of its peripheral economy condition. In this article we showed that even if Peru has not reduced its reliance on external funding,

25. Authors' translation of the interview published in *La República* (2021).

it has managed to reduce its external vulnerability. It has achieved this by changing the structure of its liabilities toward FDI and domestic currency denominated debt while increasing its stock of foreign exchange reserves. Additionally, the pursuit of state-of-the-art macroeconomic policies increased the market's confidence in Peru's growth model and capacity to comply with its external commitments. However, as there is no such thing as a free lunch in economics, the acquired macroeconomic stability (low inflation, low exchange rate volatility and no macroeconomic crises) which derived from the reduced external vulnerability seems to have come at the cost of limiting improvements in the social and productive sides of the economy. Although there were some improvements during the commodity boom (mainly in poverty reduction, less in income distribution and productive capabilities), Peru's structural and social indicators are still far below desirable levels — hence the social unrest seen on the streets of the country over the last few years.

While a solid macro-financial position can be seen as a necessary condition for a structural change process that, ultimately, renders a productive structure with more and better employment opportunities and enhanced state capabilities to protect its citizens, it can by no means be considered a sufficient condition that can do away with other long-term oriented initiatives, such as industrial, scientific and technological policies. Whether Peru's governments over the past 20 years had enough room for manoeuvre to deploy bolder economic policies that, at least in theory, could have brought higher gains in structural and social dimensions is an open question. It is impossible to know whether external creditors would have been willing to continue financing the current account deficit, especially considering the higher imports that the structural change process would entail. It should therefore always be kept in mind that, even if apparently solid, Peru's macroeconomic stability will always ultimately depend on exogenous factors, as its tendency to run current account deficits has not changed. In this sense, it is important to note that the period covered in this article was one of favourable external conditions, which might not hold forever. Neither should FDI be seen as an unambiguously superior form of external financing, since it often leads to the deprivation of a country's strategic resources while continuing to generate income account deficits and, if not adequately regulated, can have devastating effects at the social and environmental levels.

In the end, if it is to significantly reduce its dependence on external creditors and global conditions, Peru needs to go through a process of structural change. This was noted by the structuralist school in the 1950s, and it is still a pending issue for Peru, and for its Latin American neighbours. The Gordian knot is formed by the fact that the transformation of the productive structure requires external financing, which implies that, while the process takes place (if there is a deliberate attempt to undertake it), the country would still be at the mercy of the financiers, whose interests rarely coincide with the goal of implementing a series of measures that could, in

the long run, lead to economic development. Thus, rather than working as a bridge towards development, external financing ends up being at best a guarantor of the status quo, and at worst a source of macroeconomic instability and social conflicts, and even environmental degradation. This might explain why an allegedly successful economy like Peru, viewed as trustworthy and reliable to invest in, has been struggling to transform the proceeds of macroeconomic stability into better living conditions for its population and has had to deal with high levels of social unrest.

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Samuele Bibi (corresponding author; samuele.bibi@northumbria.ac.uk) is an Assistant Professor at Northumbria University Business School, Newcastle, UK. He conducts research on heterodox post-Keynesian macroeconomics and development economics, particularly of Latin American countries. He previously lectured in economics and worked for international organizations in Latin America, mainly in Peru.

Sebastian Valdecantos (sebastianval@business.aau.dk) is Assistant Professor at Aalborg University Business School, Aalborg, Denmark. His research field is macroeconomics, focusing on the problems of peripheral economies. Most of his work is applied to Latin American countries. He has also contributed to the literature on stock-flow consistent models at the theoretical and empirical levels.