Government Policy and the Distribution of Income

In Peru, 1963-1973

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Discussion Paper No. 39
June 1973

* The research for this paper was begun in Lima with the support of a Ford Foundation fellowship, and later, with a grant from the Iowa Universities Mission in Peru. Part of the research, particularly on the urban traditional sector, was supported by the Population Council. An earlier version was presented at the Seminar on Continuity and Change in Contemporary Peru sponsored by the Center for Inter-American Relations. I am indebted to Carl Dahlman, Adolfo Figueroa, Charles Frank, Alfred Hirschman, Shane Hunt, Abe Lowenthal, Richard Mallon, Dieter Zschock, and to participants of the Peru Seminar for generous and valuable comments. The very large statistical task, summarized in Parts I and III of this paper, could not have been completed without the assistance of Roberto Abusada, Luis Camargo, Manuel Delgado, Lucia Hernandez and Priscilla Read.

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"Es tradición nacional que todo presidente se figure venir como un ser providencial que pega un tajo decisivo entre el hoy y el ayer" (Manuel Gonzalez Prada, Horas de Lucha, 1903)¹

"The inevitability of gradualness" (Sidney Webb, Presidential address to the annual conference of the Labor Party, 1920)²

This paper attempts to measure the impact of government policy on the distribution of income in Peru since 1963. Both the Belaunde (1963-68) and the Velasco (1968-) governments professed a deep concern with economic injustice, and both have been held up as models of peaceful progress towards social justice. During the last decade the government sharply expanded its size and its control over the economy. Both regimes can point to important redistributive measures. Belaunde stressed schooling and rural development. Velasco decreed a land reform and other property transfers. The objective of this paper is to quantify the distributive impact of those measures, and relate them to the size of initial inequalities. This comparison will include the effects of policies not primarily aimed at redistribution, and it will relate distributive changes to the changes that result from trends in the

¹ "It is a national tradition that every president sees himself making a decisive break between the past and the present."

² An interesting, if dubious attempt to reconcile the implications of these remarks was made recently by the Minister for Industry and Commerce, Admiral A. Jimenez del Lucio. Jimenez described current policy as both gradualista and revolucionaria: "El gradualismo...da pasos claros...Cada paso significa un nuevo avance revolucionario." (Speech, July 1972).
market distribution of incomes. How much of a dent has government made on income inequality?

To answer this question this paper will first describe the distribution of income - who are the rich and the poor, how unequal are their incomes, and what are the long run trends in those incomes? Next, it will sketch a model that explains the principal features of that distribution, and that provides a conceptual framework for analysing distributive policies. Third, it will discuss the incidence of specific policies and programs of the Belaunde and Velasco governments. Finally, it will draw some conclusions regarding the alternatives available to redistributive policy.

Before reviewing the evidence however, it would be useful to restate several generally held views on these questions. The past is seen by all in more or less the same terms: an exceedingly unequal distribution of income caused principally by the concentration of property ownership; and a trend towards growing inequality as the benefits of growth were entirely bottled up for the benefit of a small, powerful minority. The "domination theory" attributes this growing concentration to exploitation made possible by political power. Though some domination theorists speak of a "modern sector" and of "labor elites", the bulk of the labor force is pictured as exploited, impoverished, and often, as suffering a fall in real incomes.

Assessments of the current situation are less unanimous. The Velasco regime sees its many reforms and policy changes as a radical attack on social injustice, at some cost perhaps, to economic growth. Leftist critics however, see the survival of a large capitalist sector as evidence of no fundamental change.¹ And there is a growing awareness of the limited reach

of many recent redistributive measures. Most observers however, see current
policies as a significant break with the past; the pattern and amount of
redistribution is thought to have been altered substantially, chiefly through
measures which have nationalized or redistributed private wealth.

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1See for instance, A. Figueroa, El Impacto de las Reformas Actuales en la
Distribución del Ingreso en el Perú, (Lima: CISEPA, Universidad Católica,
1973)
I. The Distribution of Income

1. Principal features

Table 1 reveals an extreme degree of overall inequality. The top decile share in personal income of 49% is higher than that found in most LDC's, though comparable to that in Colombia, Brazil and Mexico. Also, the poor get slightly less in Peru; the bottom two deciles receive 2.5%, and the lower six deciles only 18.2%, well below the 30% that Kuznets cites as characteristic of both developed and underdeveloped countries. 1 Peru shares with those three countries a similar stage of early industrialization, a colonial heritage of highly structured social and class relations, and markedly contrasting modern and traditional sectors.

A wide range of incomes is associated with such dualism. The ratio between top and bottom decile shares is 49:1. More significant perhaps is that inequality runs much deeper than a high share received by a handful of very wealthy proprietors. If we deduct dividends, cash rents and interest from the top decile share, the spread between first and last deciles is still 32:1.

Wage and salary incomes of top decile recipients start at U.S. $970 2 p.a.; the median labor income in the group is $1270 p.a. This may be "middle class" or even modest by developed country standards, but over a third of the population receives incomes under $186 p.a.

---


2 In 1961 dollars.
Table 1

Percentile Shares in Income: Selected LDC's

<table>
<thead>
<tr>
<th></th>
<th>Bottom 20%</th>
<th>Bottom 60%</th>
<th>Top 10%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peru</td>
<td>2.5</td>
<td>18.2</td>
<td>49.2</td>
</tr>
<tr>
<td>Brazil</td>
<td>4.2</td>
<td>22.0</td>
<td>49.0</td>
</tr>
<tr>
<td>Colombia</td>
<td>2.5</td>
<td>26.0</td>
<td>48.0</td>
</tr>
<tr>
<td>Mexico</td>
<td>4.2</td>
<td>20.9</td>
<td>49.9</td>
</tr>
<tr>
<td>44 LDC Average</td>
<td>5.6</td>
<td>26.0</td>
<td>44.0</td>
</tr>
</tbody>
</table>

---

1 Table 2.


5 From a recent compilation in Irma Adelman and Cynthia Taft Morris, _An Anatomy of Income Distribution Patterns in Developing Nations_, International Bank for Reconstruction and Development, Economic Staff Working Paper No. 116 (Washington: 1971), which reports percentile shares of national income for 44 countries. Average shares for the top 5 and top 20 percentiles were 30% and 56% respectively, implying a top decile share in national income of 44%, and a share in personal income of around 40%.
Enormous vertical distances characterize more than Peru's geography. Almost any subdivision of the population is a sample with a high degree of income dispersion. "Social classes" such as the city wage-earner, or the Sierra peasant, turn out to be extremely heterogeneous with regard to incomes, as may be seen in Tables 2 and 3. City wages for instance, range from about $190 p.a. to $1,500 p.a., spanning three quartiles. As may be expected, the city self-employed are even more spread out: 15% are in the bottom quartile and 22% in the upper quartile; 8% reach into the top decile.

Table 2

**Labor Force and Income, by Type and Income Level, 1961**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - 75</td>
<td>349</td>
<td>0.7</td>
<td>17</td>
<td>1</td>
<td>30</td>
<td>400</td>
<td>23</td>
<td>1</td>
<td>24</td>
</tr>
<tr>
<td>76 - 112</td>
<td>229</td>
<td>5</td>
<td>21</td>
<td>3</td>
<td>29</td>
<td>289</td>
<td>27</td>
<td>1</td>
<td>28</td>
</tr>
<tr>
<td>113 - 186</td>
<td>253</td>
<td>14</td>
<td>83</td>
<td>8</td>
<td>63</td>
<td>429</td>
<td>63</td>
<td>3</td>
<td>66</td>
</tr>
<tr>
<td>187 - 280</td>
<td>128</td>
<td>16</td>
<td>201</td>
<td>15</td>
<td>84</td>
<td>459</td>
<td>106</td>
<td>5</td>
<td>111</td>
</tr>
<tr>
<td>231 - 373</td>
<td>72</td>
<td>25</td>
<td>107</td>
<td>19</td>
<td>80</td>
<td>312</td>
<td>102</td>
<td>6</td>
<td>108</td>
</tr>
<tr>
<td>374 - 466</td>
<td>52</td>
<td>23</td>
<td>86</td>
<td>20</td>
<td>45</td>
<td>233</td>
<td>98</td>
<td>6</td>
<td>104</td>
</tr>
<tr>
<td>467 - 559</td>
<td>34</td>
<td>17</td>
<td>72</td>
<td>28</td>
<td>26</td>
<td>183</td>
<td>90</td>
<td>5</td>
<td>95</td>
</tr>
<tr>
<td>560 - 746</td>
<td>26</td>
<td>23</td>
<td>82</td>
<td>59</td>
<td>37</td>
<td>240</td>
<td>156</td>
<td>9</td>
<td>165</td>
</tr>
<tr>
<td>747 - 1119</td>
<td>40</td>
<td>49</td>
<td>51</td>
<td>91</td>
<td>46</td>
<td>280</td>
<td>255</td>
<td>16</td>
<td>271</td>
</tr>
<tr>
<td>1120 - 1865</td>
<td>13</td>
<td>17</td>
<td>23</td>
<td>64</td>
<td>26</td>
<td>149</td>
<td>208</td>
<td>19</td>
<td>227</td>
</tr>
<tr>
<td>1866 - 2610</td>
<td>0.6</td>
<td>3</td>
<td>18</td>
<td>7</td>
<td>30</td>
<td>66</td>
<td>66</td>
<td>13</td>
<td>79</td>
</tr>
<tr>
<td>2611 - 3730</td>
<td>0.8</td>
<td>12</td>
<td>3</td>
<td>17</td>
<td>52</td>
<td>11</td>
<td>11</td>
<td>68</td>
<td></td>
</tr>
<tr>
<td>3731 - 18,650</td>
<td>0.2</td>
<td>11</td>
<td>0.3</td>
<td>13</td>
<td>80</td>
<td>43</td>
<td>43</td>
<td>123</td>
<td></td>
</tr>
<tr>
<td>18,659 +</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>1196</td>
<td>196</td>
<td>747</td>
<td>350</td>
<td>476</td>
<td>3034</td>
<td>1326</td>
<td>512</td>
<td>1838</td>
</tr>
</tbody>
</table>

Table 3. Distribution of Labor Force Groups by Percentiles of National Distribution, 1961

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>All Peru</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(40-120)</td>
<td>10%</td>
<td>30</td>
<td>3034</td>
</tr>
<tr>
<td>(120-260)</td>
<td>5%</td>
<td>12</td>
<td>433</td>
</tr>
<tr>
<td>(260-540)</td>
<td>1%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(540+)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sierra Rural</td>
<td>610</td>
<td>24</td>
<td>1136</td>
</tr>
<tr>
<td>Coast or Jungle Farmers</td>
<td>335</td>
<td>12</td>
<td>200</td>
</tr>
<tr>
<td>Wage-earners</td>
<td>8</td>
<td>14</td>
<td>196</td>
</tr>
<tr>
<td>White-collar</td>
<td>65</td>
<td>15</td>
<td>747</td>
</tr>
<tr>
<td>Urban Self-employed</td>
<td>67</td>
<td>25</td>
<td>414</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rural</td>
<td>659</td>
<td>69</td>
<td>1735</td>
</tr>
<tr>
<td>Urban</td>
<td>78</td>
<td>35</td>
<td>727</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lima</td>
<td>25</td>
<td>130</td>
<td>619</td>
</tr>
<tr>
<td>Mancha India</td>
<td>383</td>
<td>105</td>
<td>856</td>
</tr>
<tr>
<td></td>
<td></td>
<td>105</td>
<td>727</td>
</tr>
<tr>
<td>Modern Sector</td>
<td>23</td>
<td>411</td>
<td>587</td>
</tr>
<tr>
<td>Urban Traditional</td>
<td>83</td>
<td>158</td>
<td>1126</td>
</tr>
<tr>
<td>Rural Traditional</td>
<td>637</td>
<td>64</td>
<td>792</td>
</tr>
<tr>
<td></td>
<td></td>
<td>36</td>
<td>407</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2. The inconsistencies between labor force totals for different classifications is caused by the different numbers of workers classed as "unspecified" with respect to different categories: income, occupation, or industrial sector.
3. The average income for Lima (Line 8), Urban (Line 7), and Modern Sector (Line 10) exclude corporate profits. 1961 current soles data was converted at 1961 exchange rate of 26.81 soles.

Line 1 excludes rural white-collar and rural miners. Includes "urban" farm workers. The Census definition of urban includes all district capitals and other towns with a population greater than that of the respective district capital.

Line 3 excludes colonos (wage-earners on Sierra farms).

Line 5 includes domestic servants.

Line 9 covers Departments of Apurímac, Ayacucho, Cuzco, Huancavelica, and Puno; all are in Sierra.

Line 10 covers all Government, urban establishments with over 5 persons, sugar farms, miners, and self-employed professionals.

Line 11 all other urban not part of modern sector, but excludes "urban" farm labor force in Sierra.
The geographical poles of the income distribution are perhaps best represented by the city of Lima and by the "Mancha India," five contiguous Departments\(^1\) in the southern Sierra which concentrate much of the Indian population. Average incomes differ sharply: $230 p.a. in the Mancha India, $370 in Lima. Yet variance within these regions is equally significant. In both areas, incomes span the four quartiles (Table 3). The spread is greater in the Mancha India, where half are in the lowest quartile, 14% in the top quartile, and 6% in the top decile.

This marked degree of income dispersion, both within and between groups, may be studied by examining the composition of different strata within the national distribution. Who are the rich? The poor? The middle groups?

2. The rich

A major share of property income accrues to a few hundred families. Profits, including retained earnings of incorporated enterprises, net interest income, and cash rental income made up 25% of national income in 1961. Given the restricted nature of corporate stock ownership, and general knowledge regarding the concentration of wealth ownership in Peru,\(^2\) it is likely that almost all is received within the top 1% of recipients, and that the greater part, estimated here at 19% of national income, goes to some one or two hundred wealth-holders, with annual incomes over $40,000.

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\(^1\)Apurimac, Ayacucho, Cuzco, Huancavelica, and Puno. See Julio Cotler, "La mecanica de la dominación interna y del cambio social en el Perú," in Instituto de Estudios Peruanos, Peru Problema, Vol. 1, 1967. Cotler includes the Dept. of Ancash, where average income is 60% higher, and which therefore increases income dispersion within the region as he defines it.

\(^2\)See Carlos Malpica, Los Dueños del Peru (Lima: 1970) for a list of corporations, giving net worth and names of directors.
The next rung on the income ladder—under $40,000 (one million soles) p.a.—corresponds to what is usually described as "the middle class" and may be defined here as the top 1%, or some 30,000 persons. In 1961, the qualifying annual income was $2600. The handiest criterion for middle class status in Peru is car ownership: in 1961, some 30,000 - 50,000 cars were owned for private use.

The "middle-class" receives 11.4% of national income, of which two-thirds is high white-collar salaries and the earnings of self-employed individuals, mainly professionals. The one-third received as property income has very diverse origins: some is entrepreneurial, being the profits of small and medium sized business, and some is rent from urban real estate and from farms. Much of the net income generated on haciendas was spread out over multiple owners; large families had taken their toll on wealth concentration in the farm sector. Many "middle class" families in Lima enjoyed an income supplement from their inherited share of some large hacienda.

It may be relevant to observe that there has been a great deal of vertical mobility, in both directions, between the top wealth-holders and the middle class. Upward mobility was aided by rapid economic growth since 1950: probably a minority of the largest fortunes today are more than two generations old, a fact made plain by the large number of recent immigrant names among the very rich. And, as was said above, much landed wealth has diluted into middle class rentier incomes. The two groups are essentially the same social class, sharing for instance, the same race, families, schools, high degree of education, and residence—about three-quarters live in Lima.
Lower percentiles are more heterogeneous. The top 5% starts at $1270; half are white-collar employees, and the other half are a mixture of highly skilled wage-earners, merchants, artisans, prosperous medium farmers, (20-50 hectares), and other self-employed. Only about a third reside in Lima. Aside from profits and rents going to "middle class" families, property income within this, and lower income groups, is either imputed rental income, or is an indistinguishable component of small business net income. The next 5% reaches down to $970 p.a. and has a similar diverse occupational and geographical mix, but with a larger representation (26%) of farmers. This segment of the top decile is represented in many small towns, as by the wealthier businessmen in the Sierra town of Sicuani (pop. 10,000); and the local 'elite' of the town of Moyobamba, (pop. 3400).

Finally, the upper quartile consists of all incomes over $540. It has a strong, though not exclusive identification with Lima: 44% are in that city, and just over half of Lima's labor force is in the top quartile. All other economic or regional groups however, are also represented. Thus 14% live in the 'Mancha India,' while about 16% are in some 45 cities with population over 10,000 (excluding Lima. In terms of occupations, one-third are white-collar employees, most of whom (73%) are in this quartile.

1According to a household budget survey carried out by the Instituto Boliviano de Estudios Andinos (IBEAS) in 1968, and published in IBEAS, Sicuani, (1969).


3Based on unpublished data from surveys conducted by the Junta Nacional de Vivienda in 1963 in 41 cities.
Another 21% are wage-earners, mostly in modern establishments. There is an approximately equal number of farmers from the Sierra (10% of the group), and from the Coast and Jungle (12%).

3. The Poor

Workers in the poorest quartile, whose incomes range from about $40 to $120, are mostly subsistence farmers living in Sierra provinces. 1

80% are subsistence farmers, and 63% live in the Mancha India. Another 13% are non-farm wage-earners and independents in Sierra towns.

Many of the characteristics of these farmers are well known: 2 they are mostly Indian, quechua or ayamara speaking, and about 70% are illiterate. 3 Their principal source of livelihood is, on average, about 0.9 hectares of Sierra cropland, 3 head of cattle, and some other livestock. 4 Most earn some cash income by seasonal labor on larger farms or occasional sales of livestock products.

The preceding description however, conveys a misleading impression of group cohesion based on geographical concentration, and on a shared culture, source of income and poverty. From the point of view of redistributive policy, a crucial characteristic of the rural poor as a social group is precisely the opposite: their fragmentation. They are divided first

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1 The 1961 Census data on which these figures are based missed out much of the Indian population in the Jungle, estimated by the Census office at about 5% of the national population, most of whom live at subsistence income levels.

2 See Julio Cotler, op. cit., for a description.

3 DNEC, Censo 1961, Vol. III, Table 60 A.

4 DNEC, Primer Censo Nacional Agropecuario (Lima: 1965). Assumes that farmers in the bottom quartile correspond to those with farms under 5 hectares. A more exact estimate of the farm-size cut-off point for the lowest quartile would have been 4 hectares, implying smaller farms and fewer livestock.
into wage-earners tied to haciendas, and independent small farmers. But a more important division is that produced by social and income stratification at the level of every village and rural community. The uniform mass of poor, flattened out along a subsistence income level, is a statistical abstraction. Instead, rural society is a myriad of small and independent social pyramids, each with a different mix of rich and poor.

One measure of this fragmentation is shown below in Table 4: all Sierra provinces contain some rural poor, but in almost all provinces there is also a substantial proportion of middle income farmers and other rural self-employed.

**Table 4**

<table>
<thead>
<tr>
<th>Proportion of Provincial Rural Workers Earning Less than $120 (in percentages)</th>
<th>Number of Sierra Provinces</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - 20</td>
<td>9</td>
</tr>
<tr>
<td>21 - 40</td>
<td>20</td>
</tr>
<tr>
<td>41 - 60</td>
<td>32</td>
</tr>
<tr>
<td>61 - 80</td>
<td>30</td>
</tr>
<tr>
<td>81 - 100</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>93</strong></td>
</tr>
</tbody>
</table>

The bottom quartile also contains some urban poor who are mostly self-employed workers in smaller cities and towns; they are a small fraction of the quartile (10%), and likewise a small proportion of all urban workers (3%). Though cost of living differences inflate the apparent real incomes of urban residents, most urban incomes surpass the limiting income for the bottom quartile - $120 - by a margin much larger than any plausible correction. The common assertion that urban workers (except for a lucky few placed in modern establishments) are no better off than the rural poor, is an erroneous generalization derived from the case of the urban fringe: the poorest (and most visible) 5 or 10%.

A much broader measure of the poor - the lower 50% of income recipients, whose incomes range between $40 and $260 p.a. - does reach into the bottom quarter of the urban labor force: chiefly wage-earners in small establishments and the self-employed. Of these urban poor, about 20% are in Lima and 30% in smaller cities and towns. It also reaches into the lower levels of coastal and Jungle farmers, though most (81%) of this group have higher incomes. The lower half of the national income distribution however, misses out almost all white-collar workers, and almost all of the modern sector.

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1 Adjustment for cost of living differences would be exceedingly complex since consumption baskets differ by region, food prices vary by size of town, and prices of manufactures are higher outside the cities. An extreme correction would raise rural incomes by valuing farm output at Lima prices, which, in the case of Sierra products, were about 30% higher than farm-gate prices.
4. **Income Trends**

Estimates of income growth are summarized in Table 5 below. They point up some expected, and other less familiar aspects of the evolution of Peru's income distribution between 1950 and 1966.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Modern Sector</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wage-earners</td>
<td>191</td>
<td>4.9</td>
</tr>
<tr>
<td>Government employees</td>
<td>104</td>
<td>3.6</td>
</tr>
<tr>
<td>White collar</td>
<td>102</td>
<td>3.3</td>
</tr>
<tr>
<td><strong>Urban Traditional Sector</strong></td>
<td>696</td>
<td>2.1</td>
</tr>
<tr>
<td>Wage-earners</td>
<td>145</td>
<td>3.3</td>
</tr>
<tr>
<td>Self-employed</td>
<td>361</td>
<td>1.9</td>
</tr>
<tr>
<td>Non-manual employees</td>
<td>54</td>
<td>1.9</td>
</tr>
<tr>
<td>Domestic servants</td>
<td>136</td>
<td>1.6</td>
</tr>
<tr>
<td><strong>Rural Traditional Sector</strong></td>
<td>1443</td>
<td>1.3</td>
</tr>
<tr>
<td>Coastal wage-earners</td>
<td>163</td>
<td>4.1</td>
</tr>
<tr>
<td>Sierra wage-earners</td>
<td>240</td>
<td>1.5</td>
</tr>
<tr>
<td>Small farmers</td>
<td>1040</td>
<td></td>
</tr>
<tr>
<td>(a) Coast &amp; hinterland</td>
<td>(240)</td>
<td>(2.0)</td>
</tr>
<tr>
<td>(b) Other regions: Kulaks</td>
<td>(120)</td>
<td>(2.7)</td>
</tr>
<tr>
<td>; minifundios(680)</td>
<td></td>
<td>(0.0)</td>
</tr>
</tbody>
</table>

Source: R. Webb, *Trends in Real Income in Peru, 1950-1966*, forthcoming Discussion Paper. Research Program in Economic Development, Princeton University, Princeton, 1973. The concept of "modern" sector used to prepare this table is that of "reporting" establishments i.e. firms that provided statistical information to the Central Reserve Bank. In practice this coverage differs only slightly from that of establishments with 5 or more employees - the criterion for "modern" used in the rest of this study. Growth rates given here, and in other parts of this study, refer to real income.
The most evident conclusion is that labor incomes have become less equal. Though high growth rates are not fully correlated with high incomes, families in the upper half of the 1950 income distribution have by and large enjoyed faster rates of income growth. Most of the rural population, particularly that of the Sierra, and some groups of self-employed workers such as artisans and domestics, have become relatively poorer over the period.

The share of capital income in the national income has not grown, despite the evident growth of the more capital intensive modern sector over the period. Corporate profits and net interest totalled 22.1% of national income in 1950, and 22.5% in 1966. Though the poor statistics on these components of value added may conceal some trend towards a growing share, the possible error is not likely to alter the above result to a significant degree. If net rental income is included, the share of capital income declines from 29.9% to 28.0%¹ between 1950 and 1966.

The highest growth rates occurred in the modern sector, defined as covering all reporting business, plus government employees and professionals, and which expanded from 19% of the labor force in 1950 to 21% in 1966. Their earnings increased at an average of 4.1% p.a. during that period.

It is interesting to note that modern sector white-collar employees in the private sector fared less well than modern sector wage-earners, tending to equalize incomes within the modern sector. The average rate of increase of reported salaries was 3.3% p.a. vs. 4.9% for reported wages. One cause

¹Since house ownership is so widespread however, it is not appropriate to sum net rental income with profits and interest as a measure of capital income accruing to the very rich.
of this differential may be the fact that unions bargain hardest on behalf of their lowest paid (and most numerous) set of members, though most firms have separate "white-collar unions." But a more likely cause may be found in the large proportion of unskilled, and non-unionized white-collar workers: shop attendants and employees in service establishments are classed as "white-collar." Many are also female, and young. The small size of tertiary establishments, and the high turnover of most employees limits unionization. Moreover, the supply of workers with formal schooling—the most relevant qualification for such jobs—has been growing exceptionally rapidly.

Less expected are the positive trends found within the urban traditional sector, i.e. the employees in small, non-reporting establishments, domestic servants, and self-employed workers in a variety of occupations. As a group, they have grown more rapidly than the modern sector, from 18% to almost 24% during the period 1950-1966. And though the evidence on their incomes is weak—particularly for the self-employed—there is a sufficient variety of data to indicate the existence of positive, if moderate trends in income. These range from the 1.6% p.a. of domestic servants to 3.3% p.a. in the case of unreported non-farm wage earners.

These results conflict with the common extension of the marginality thesis to the urban traditional sector of Peru. Quijano, for instance writes that "the greatest part of people shown to be involved in tertiary activities are people who have neither employment nor income of any sort, and these people make up the great "marginal" masses of the principal cities."  

No data are cited to support this assertion, the frequent assumption that incomes in the urban traditional sector are close to rural incomes, and that they are stagnant or falling, is evidently a product of the easy perceptual confusion (for middle-class observers) between stagnation and changes at a very low absolute level of income, and of a generalization from the most visible cases of the urban poor, such as the street vendors and shoeshine boys that make up the tail of the urban income distribution.\footnote{According to the Fondo Nacional de Salud y Bienestar Social Survey, \textit{op.cit.}, about 3\% of all heads of slum families interviewed were street vendors (vendedores ambulantes). The 1967 CISM survey of Lima, \textit{op.cit.}, classified 3.9\% of the labor force as commerce independents, but many are small shop owners.} Our data did not allow a comparison over time of the incomes of the lower 10\% or 20\% of the city income distribution, and it could be maintained that their income has not risen. But the evidence suggests that stagnation could only have been the case for a minority of the urban traditional labor force.

It is difficult to explain growing incomes in the urban traditional sector. The probable sources of growth can be identified—improvements and cheapening of the small-scale technology used by artisans and many small service establishments, capital accumulation, growing education and skills, and demand generated by the very rapid growth of modern sector incomes. However, the rate of income change is the resultant of a balance between such factors, and the rate of growth of labor supply to this sector. A slowing in the rate of expansion of the modern sector, or an acceleration in the rate of migration could possibly reverse the trend in incomes of this group. The period studied, 1950-1966, was one of exceptionally dynamic growth in the modern sector, and of a lower rate of population growth than is now the case.
My conclusion regarding small farmer incomes must be considered highly tentative. The estimate that the average income of all small farmers grew at about 0.8% p.a. is based mainly on statistics that show some growth in Sierra farm output per farmer, and on the evidence of considerable commercial and urban expansion within the Sierra. It can be argued that such expansion, consisting of a growing expenditure on non-agricultural goods and services, necessarily implied increasing income levels. Also, some improvement in living standards was much more apparent in provinces of the Central Sierra, located close to Lima and to the central Coast.

The data was inadequate to support any further statement regarding income trends within the very large class of small farmers. The question is of such significance however, that it warrants speculation. Thus, it seems reasonable to hypothesize that, outside the Central Sierra, most income growth has been concentrated in the upper layer of small farmers, a class of relatively better-off peasants who account for between 10% and 15% of all small farmers but who own a much larger portion of the land and livestock held outside haciendas. The relative economic success of this group parallels the more frequently cited emergence of a small town class of traders, artisans and bureaucrats.

This hypothesis has two implications regarding income trends that are relevant to the policies aimed at redistribution in favor of peasant farmers: first, there is a growing inequality within the class of small farmers; second, for a large proportion of the population, which could plausibly range between 15% and 25%, there has been no absolute improvement in living standards. The extreme poverty of the latter group gives this statistical result an even greater significance than the fact
of growing inequality in the national distribution of income.

Though the overall distribution of income has worsened, there are two characteristics of the pattern of income growth that are less consistent with most expectations. Firstly, there is no sharp break between trends in the modern sector and those in the rest of the economy: the growth rates of different income recipients are continuous. Secondly, and as a corollary to the above, income growth has been more widespread than is generally implied in statements regarding income trends in Peru. Thus, Thorp states\(^1\) that despite rapid per capita growth, "large portions of the country and of the population appear to have been left untouched, if not worse off than they were before." Quijano is a more forceful proponent of the "dominant vs. marginal" view. From data on the 1961 distribution of income he concludes that there is a "process of 'marginalization' and pauperization of the large mass of the active population..."\(^3\) Also, that "the working masses in general have been unable to prevent the constant reduction of their real wages and standard of living."\(^4\)

These statements are not consistent with the evidence of this chapter. On the basis of the above data one could plausibly sustain that many peasant farmers and other self-employed workers suffered a fall in real incomes, but this does not appear to be true for any large category of workers, much less for "the working masses in general." The picture that emerges here is less dramatic and perhaps, more ambivalent: there

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has been some absolute improvement for most of the population—for about half the labor force, real earnings have grown at 2.0% or more p.a., and for 75 to 30%, earnings have grown at over 1.0% p.a. but, at the same time, there has been a growing degree of inequality, and those most in need of improvement have benefited the least.
II. The Model

The following model is designed to explain the principal features of the distribution of income described in Part I above, and to provide a conceptual framework for the study of the distributive impact of government measures. The basic premise of the model is the fact of technological dualism, i.e. the coexistence of a modern sector of large-scale, capital-intensive firms with a traditional sector of labor-intensive haciendas, small-scale firms and small farmers. An important distinction is also drawn between the urban and rural components of the traditional sector.

The model is built on the distinctions between modern-traditional, and urban-rural activities because these sectors define the boundaries of what seem to be the major discontinuities in access to political power, and in the coverage or reach of the key distributive policy instruments. There are discrete changes in power associated with (i) urban and (ii) modern (or high-productivity) sector status. Likewise, some distributive mechanisms, such as wage policies, taxes, and the allocation of bureaucratic favors have a differential impact on modern and traditional sector firms, while the coverage or impact of other policy instruments, such as public expenditures and price policies, differs sharply in the urban and rural sectors. These sectoral distinctions also coincide with key breakdowns in the market distribution of incomes of a dual economy. The three-sector model that is described below thus provides a

1 My definition of the "modern sector" cuts across industrial sectors; except for Electricity and Banking, which are all modern, there are modern and traditional components in all activities.
convenient framework for examining how incomes are determined jointly by market forces, and by political power working through specific instruments, each with a specific coverage or ability to discriminate amongst the population.

1. **The Value Added Curve**

   A dual economy is characterized by a highly skewed distribution of productivity levels. Use of machinery, equipment, mineral deposits and rich agricultural land are concentrated in a small segment of the population, whose value added per worker is much higher than in the rest of the economy. Such a distribution is described by the curve PP' in Figure 1, where the labor force is arrayed along the horizontal axis in descending order of value added per man, measured on the vertical axis. OL is the employed labor force; and the area under PP' measures national income. Since value added in each producing unit is determined by both physical productivity and prices, the shape of PP' will also depend on relative prices: price distortions that favor firms with high physical productivity (e.g. tariffs on manufactures) will increase the skewness of PP'.

![Figure 1](image)
The point $L_1$ can be used to separate modern and traditional sectors, where $L_1P_1$ is an arbitrarily\(^1\) chosen level of productivity. For purposes of our discussion the relevant feature of "modern" and "traditional" sectors is output per man, and not the historical dating of the technology involved. Also, both sectors may include urban and rural components.

The shares of property and labor income in total value added are also shown in Figure 1. \(WW'\) measures the level of labor incomes in each producing unit: (it is shown rising with productivity, but with no sharp break between the modern and traditional sectors). The area between \(PP'\) and \(WW'\) therefore, represents non-labor incomes. At some point along the \(PP'\) curve, productivity will decline to a subsistence income level. In Figure 1 this point is marked as \(P_s\).

The growth path of the modern sector (MS) in Peru, as in many LDC's, has become characterized by more capital-deepening than capital-widening: employment is growing slowly, as a proportion of the labor force, while investment and value added per worker are rising more rapidly than in the traditional sector (TS).\(^2\) In terms of the value added curve, MS growth can be described as being largely vertical, contrary to the horizontal, labor-absorbing growth.

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\(^1\)Productivity declines gradually but the modern and traditional sectors are sufficiently different in nature to make the distinction - using some arbitrary dividing line - a useful one for purposes of analysis. (cf. the distinction between urban and rural). To derive the statistics given in this study, I have used size of firm as a proxy for productivity: urban establishments with five or more employees were classed as modern; in agriculture, only sugar farms were defined as modern since value added per man in cotton and other commercial crops is close to that of very small-scale urban establishments.

\(^2\)MS employment grew rapidly between 1950 and 1961, rising from 19.0% to 21.1% of the labor force, but it remained almost constant between 1961 and 1970, rising to only 21.6% in the latter year. (See Table 6).
path predicted by the familiar labor-surplus models of economic development. The value added curve is becoming increasingly skewed, as shown by $P_1P'$ in Figure 2; a labor-absorbing path is described by $PP_2$. Migration into towns is thus transferring workers from the rural to the urban component of the TS.

Figure 2
Labor incomes are also becoming increasingly skewed: there is a growing differential between modern and traditional sector earnings.\footnote{See Table 5. Similar trends appear in data for Mexico, Colombia, and several countries in Africa: see Ifigenia M. de Navarette, "La Distribucion del Ingreso en Mexico. Tendencias y Perspectivas" in El Perfil de Mexico en 1980, Vol. 1 (Siglo Veintiuno Editores S.A: Mexico 1970) p. 38; A. Berry, Some Determinants of Changing Income Distribution in Colombia: 1930-1970, Economic Growth Center, Yale University Discussion Paper No. 137, 1972, p. 12; and C. Frank, The Problem of Urban Unemployment in Africa, Research Program in Economic Development, Princeton University, Discussion Paper #16, 1970, pp. 13-15.} Within the TS, wages are constrained principally by low absolute levels of productivity in the sense that even if a worker received his total average product, his income would remain very low. In the MS however, the value added "ceiling" is not a significant constraint on the earnings of labor. Instead, wage levels are more sensitive to the institutional rules that decide the functional distribution of income, that is, the income accruing to each factor of production. In the classical labor surplus economy with a competitive labor market, modern sector wage levels will be close to those in the TS, perhaps exceeding the latter by a small differential that compensates cost of living differences and the costs of migration. This assumption is reflected in the wage curve WW' of Figure 1. In socialist economies, direct controls produce a similar, relatively even curve. In most LDC's however, MS wages have risen significantly above their TS levels, resulting in a highly skewed wage curve. The range of wage levels observed in Peru, and their correlation with average productivity, is shown in Figure 3.
Figure 3
Wages and Productivity in Selected Sectors and Size Groups, 1963

- x Manufacturing
- o Mining
+ Fishing
S Sugar
C Cotton
* Construction
S' Services
C' Commerce
* Electricity

Value Added Per Worker p.a.
('000 soles)
The striking relationship observed between average productivity and wages is the point of departure for the discussion of MS incomes below.

2. The Modern Sector

Why are MS labor incomes rising, in the face of large reserves of surplus labor in the traditional economy? Two economic explanations are (i) rising skill levels, and (ii) unionization. Others refer to the political power of MS working groups. It will be argued below that each of these factors—"high" skill levels, strong unions, and direct political power—is a by-product of features that are inherent to MS firms. The most relevant of those characteristics are capital-intensity and urban presence.

One effect of capital-intensity is to make the demand for labor in the MS more inelastic. Elasticity of labor demand varies directly with the share of labor in total cost. Also, capital-intensity usually implies a large rent or quasi-rent component in the return to property, partly because large-scale capital assets tend to be long-lived, and partly because MS assets in LDC's are often complementary with natural resources. Quasi-rent also arises from the monopoly element that is present in much LDC manufacturing and other activities as a result of tariffs, licenses and other such privileges.¹

Capital intensive techniques generate "high wage" jobs for reasons that are often explained as the "high skill" requirements of modern technologies. Such firms for instance, seem to have a greater demand for schooling and white-collar skills. But capital intensive firms will pay higher wages whether or not they demand skills that are scarce in the long run, i.e. that require long

apprenticeships or scarce natural talents. Wage premiums will be paid in any case, first, to acquire "responsibility," and second, to reduce turnover. Errors or irresponsibility by people who work with expensive machinery are extremely costly. Firms therefore offer high wages, partly to seek persons who rank high in personal characteristics associated with carefulness and dependability, and partly to elicit responsibility through good will. High wages are also justified to reduce turnover. Turnover in such jobs is expensive first, because skills are largely acquired on the job, and thus represent a substantial investment by the firm, and second, because even a brief interruption in the availability of trained workers will be costly to firms with large fixed assets. Though some machine-complementary skills may not be difficult to learn, they are usually highly specific, perhaps to one or a few firms in any LDC, and therefore in short supply in the short run.\(^2\)

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\(^1\) This argument has benefitted considerably from comments by Charles Frank.

\(^2\) This relationship between capital intensity and wages has been called the "scale of operations effect": "...diamond cutters are paid more (per hour) than cutters of less precious materials; operators of more expensive machinery more than those of less expensive." Malvin Reder, "A Partial Survey of the Theory of Income Size Distribution" in Lee Soltow (eds.) Six Papers on the Size Distribution of Wealth and Income, National Bureau of Economic Research, Studies in Income and Wealth, Volume 33 (Columbia University Press 1969) p. 219. Reder disavows paternity of this concept, citing Adam Smith: "...the wages of labor vary accordingly to the small or great trust which must be reposed in the workman." The Wealth of Nations, Book I, Chapter X, pp. 93-94, Everyman's Library, 1910.
The link between capital-intensity and wages also works through the supply side of the labor market: unions in LDC's usually originate in, and are often limited to MS establishments. Such firms tend to hire more experienced and better-schooled workers, concentrate them geographically—in a small number of establishments and in one, or few cities—and provide them with an external environment of discipline and organization. MS firms in short, are natural breeding grounds for unions.

But the power of the MS labor force does not derive solely from unionization, nor does it work only through the collective bargaining process.¹ Much of that power is directly political, with origins in the same features of MS activity that favor unionization: viz. urban presence, susceptibility to organization, and disruptive potential. Unionization and direct political power also reinforce each other. Political power can be used to raise incomes directly, through minimum wage and social security laws for instance, and indirectly, by reinforcing labor in the collective bargaining process with legislation that is helpful in union activity; and by providing more sympathetic arbitration of wage disputes. It is direct political power, derived from some degree of control over MS sources of income, that best explains incomes in the bureaucracy.²

¹Some discussions of wage differentials in urban markets distinguish principally between the "organized" and "unorganized" sectors, thereby imputing most wage differences to unionization and political power. A contrary view, stressing the role of skills, is argued by J. Ramos in Labor and Development in Latin America, (New York: Columbia University Press, 1970), see especially pp. 174-178.

²Though government employees are here classed as MS, it would be more correct to exclude them from the analysis of the relationship between value added and income levels, since their wages and productivity levels cannot be distinguished.
In short, there are elements inherent to modern, capital-intensive technology that tend to generate high wage levels. Some wage increase represents a distributive gain made possible by the introduction of capital-intensive techniques or activities into a low-wage traditional economy. Additional wage increases are made possible by rising capital-intensity, caused in turn by the labor-saving nature of imported technological change. Finally, wage gains that do not result directly from shifting marginal productivity curves tend to reinforce themselves, by inducing further increases in capital-intensity.¹

How fast, and how far wages adjust to exogenous sources of increased capital-intensity will turn largely on the extent to which property incomes are rents or quasi-rents, and on politics. The process of income redistribution in the MS - from capital to labor - has gone very far in some countries, while it has scarcely begun in others. These differences are surely related to varying political stages or systems in different countries: the process seems more advanced in Latin America than in Asia for instance. Also, discrete changes in the balance of power may accelerate the process, as in Peru and Chile recently, or retract previous gains, as appears to have occurred in Brazil. These variations however, should be seen in the context of the broader forces that are continually pressing MS wages upwards.

This redistributive process can be contained by a strong property-owning class. But more commonly today, the wage share is being constrained

¹The link between productivity and wage increases is also reinforced by the setting of "non-inflationary" wage guidelines based on productivity changes.
by middle class elites whose interests have shifted from support for redistributive policies, to a concern with economic growth, as they have moved up the power ladder.\(^1\) Growth is seen as an assurance of longer run political stability; and growth requires that MS surplus be invested rather than used to increase wage-earners' consumption. Also, a strong middle class government can afford some concern for the broader constituency in the TS whose claim on resources also conflicts with further gains by MS labor.

3. The Urban Traditional Sector

The best point of departure for a study of UTS incomes is the close relationship between this sector and the MS. First, the UTS has a high degree of trade dependency on the MS: budget studies show that UTS families in Peru spend about half their income on food and about another quarter on factory goods or "modern" services such as medical and transport services. About three-quarters of their expenditure is therefore spent on "imports" into the sector.\(^2\) Though some UTS output is exported to the rural sector - chiefly in smaller towns - the bulk is sold to the MS.

\(^1\)Cf. S. Huntington, Political Order in Changing Societies, (New Haven: Yale University Press, 1968) on military governments: "Their historical role is to open the door to the middle class and to close it on the lower class." p. 222.

\(^2\)This estimate is based on data on low-income family expenditure patterns in Lima obtained from unpublished tabulations of the Lima household budget survey by CISEPA, Catholic University of Peru.
Assuming that any net capital inflow into the UTS is minor, and therefore that sectoral exports approximate imports, it follows that close to three-quarters of UTS income is derived from sales to the MS. Both the modern and the rural traditional sectors are much more self-sufficient.

Second, the relationship between the UTS and the MS is more complementary than competitive: most UTS producers do not compete with the MS. Competition is probably greatest in the case of small-scale manufacturing, where MS efficiency has overwhelmed many lines of craft production. The continued existence of artisans is partly a competitive phenomenon, since higher MS wages offset some of the competitive advantage created by more efficient technologies, but in part it reflects differentiation - carpenters and tailors who do custom work, whose output is valued as "hand-made", or who produce highly differentiated types of products. Further, two-thirds of the UTS labor force in Peru consists of people in service activities who compete only marginally with the MS.\footnote{This argument is in contrast with the stress placed on manufacturing, and thus on competition between sectors, by R. Nelson, T.P. Schultz and R. Slighton in Structural Change in a Developing Economy, (Princeton: Princeton University Press, 1971) Chapter V, "Urban Income Distribution in a Dual Economy." Yet, by their own figures (pp. 134-136), craft manufacturing accounts for only 0.4 million workers or 25% of the traditional non-farm labor force.} The two major service activities in the UTS - commerce, and domestic services - are affected more by technological developments, such as private cars (which make supermarkets possible), refrigerators and washing machines, than by direct price competition.
The relationship between the size (i.e. total income) of the UTS and that of the MS is therefore strongly dependent on the income elasticities of demand for UTS output. In terms of the value added curve, the UTS can be pictured as a foothill to the MS mountain (areas B and A in Figure 4 below).

Figure 4
In Peru, this foothill has been growing at about the same rate as the modern total economy: the ratio of value added in these two sectors, \((B+A)\), was 31.9% in 1961 and 32.5% in 1970. At the same time however, their shapes were changing. The HS grew vertically, with almost no increase in its share of total employment (21.1% in 1961 vs. 21.6% in 1970). The UTS grew in both directions: in that period, average income in this sector rose 26%, while employment grew from 28.6% to 33.1% of the total labor force.

If HS income is the chief determinant of total UTS income, what explains the breakdown of that total into (i) average UTS income and (ii) UTS employment? If providers of UTS goods and services were not differentiated, migration would presumably equalize incomes within the UTS, as well as between it and the rural sector. Any growth in the UTS economy would then take the form of increased employment only. But there is in fact a great deal of differentiation. First, physical productivity differs because skills differ, and because, over time, producers accumulate capital and acquire market knowledge. But more importantly, there is a strong quality aspect to much UTS output, in both service and artisan activities. Quality differentiation creates a link between the income distribution of the HS and that of the UTS. Domestic servants for instance, may earn twice as much in a rich residential district than in a pueblo joven. And the wage of an established "family" servant often rises over time.

Many benefit from rising modern sector incomes because of the strength of client attachment, or preference for established or better-ranked providers, despite a growing number of competitors. The demand for a proven and trusted tailor, maid or mechanic, for instance, is likely to have a low
price elasticity and a positive income elasticity. Lower ranked providers are less protected against new entrants; their incomes may rise or fall according to the strength of acquired market advantages relative to that of competition from entrants. Differentiation thus makes it possible for some UTS incomes to rise above their rural traditional sector (RTS) opportunity cost level, and at the same time reduces migration, by protecting earlier or better ranked producers from entrants.

4. The Rural Traditional Sector

In Peru, as in most LDC's, the rural sector is still the largest, and the poorest component of the traditional economy. A small part of the agricultural population works in highly capitalized farms - such as the sugar estates in Peru - which qualify as "modern" on the criterion of value added per worker. But value added per worker is generally low even in export and other commercial plantations. The extraction of large absolute property incomes requires large units of production, and institutional mechanisms which keep wages at minimum levels. A large segment of the rural population is dedicated principally to subsistence farming, where value added per worker, and earnings are lowest.

The rural population thus appears to be locked into relative poverty by its size and low productivity. The demand effect from the growing urban economy is weak, because of Engel's Law, and because the trickle-down effects

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are spread over a very large segment of the population. The large numbers involved also dilute the impact of redistributive transfers from the urban population, while the low value added ceiling limits the improvement possible by redistribution of income within the sector.

But the picture is not quite so gloomy, for several reasons. First, the impact of urban demand is a function of the relative sizes of the urban and rural economies. The rapid relative growth of the urban economy implies an acceleration of the demand effect that is not easily perceived at present, but which can become significant over time.¹ Second, government has more policy tools available for raising rural incomes than it has for the urban traditional sector. Total UTS income is largely constrained by MS demand. But autonomous growth in RTS output and income is possible because the sector consumes much of its own output, and because foreign trade creates opportunities for export and for import substitution. Policies directed at expanding productive capacity can thus be used to expand rural income.²

¹Imagine, for instance, an economy where 40% of the population is urban, and mean urban income is 50% higher than mean rural income: total rural and urban incomes will be equal. Assume that, over a period of two decades, migration raises the urban population share to 60%, while economic growth concentrated in the modern sector raises the mean urban income to a level that is twice the rural average. Total urban income will now be three times larger than total rural income. Even with low income elasticities of demand for farm products, there will be a large proportional increase in urban spending on the rural sector.

²It has been argued that this is not the case in Mexico, where foreign trade opportunities do not provide an outlet for the staple grain crops of small farmers. Programs that expand productive capacity therefore add little to small farmer incomes. See Roger Norton, A Model of the Agricultural Sector in Mexico, IRRD, 1972. Peru however, is not constrained by a lack of import substitution possibilities available to small farmers: food imports now account for about a quarter of domestic food consumption.
5. **Income redistribution**

The value added curve (FP') can be used to make the following distinction with regard to redistributive policies: income transfers can be considered **vertical**, when they redistribute within a productive sector, or **horizontal**, when the transfer takes place between productive sectors. The more dualistic is the structure of production, the greater will be the need for horizontal income transfers. Unfortunately, horizontal transfers are the more difficult to implement, for political, administrative and psychological reasons. As a result, income tends to remain bottled up within the modern sector.

The principal form of vertical redistribution is wage policy.¹ Wage levels are influenced by numerous policy instruments, including minimum wage laws, direct pricing (in the case of government employees), and legislation regarding union activity. Related forms of vertical transfer consist of social security laws and legislation regarding company benefits to employees. Finally, land reform and other "structural reforms" that transfer property ownership to workers, are radical forms of vertical redistribution.

Horizontal transfers are brought about chiefly through fiscal and price policies. Thus, the net tax burden (taxes less public expenditures) may differ significantly for modern and traditional sectors, causing net flows

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¹Wage policies also have secondary horizontal effects: higher LS wages may lower TS wages through a supply effect; and seasonal migration creates a LS source of wage income for TS labor. Indeed, most policies probably have both horizontal or vertical effects through their impact on factor and commodity markets. It is useful nevertheless, to distinguish between the direct and generally much larger primary impact of a measure, and its secondary effects through markets.
of income and wealth between those sectors. Price policies also redistribute income by raising or lowering the value added curve in the modern and traditional sectors. The most powerful influence on relative prices is usually the combination of exchange rate and tariff policies, though most taxes have some relative price effects. The financial system can also cause income transfers, partly because of the frequent existence of price distortions in the savings market, and partly because most forms of investment yield external economies that accrue to the borrowing sector.

The most obvious impediment to horizontal redistribution is the association between political power and various properties of modern sectors, chiefly income, wealth, education, and urban status. The UTS enjoys some of these sources of power, with a corresponding advantage over the RTS in its ability to press for horizontal transfers. But the traditional sector as a whole is weakened by the split into urban and rural components, since each is seeking different horizontal transfers: the UTS wants hospitals, secondary schools, urban infrastructure and low food prices; the RTS benefits from preventive public health systems, farm-related basic schooling, rural infrastructure and high food prices.

A related political liability of the traditional sector is that horizontal transfers cannot be taken by force: they must be obtained by voice; that is, by petition, persuasion or political bargaining within government. Workers who can strike, or seize a factory, or demonstrate for higher wages enjoy both a tactical and a psychological advantage over peasants seeking schools or roads for their communities. The availability of a visible and accessible target both facilitates mobilization, and makes it possible to
bargain with an immediate advantage in hand. A demand for a larger budget allocation for rural workers is not a banner that will mobilize peasant movements, nor are there accessible targets that could be seized by a dispersed rural population as bargaining counters relevant to that petition. The only available procedure is the exercise of voice within government. The effect of this procedure is to channel the petition into a single pool of competing claims where distributive decisions are more directly perceived as a zero-sum business. Peasants are in a stronger position to mobilize, and press for land reform; but in the typical dual economy, where most income now originates in the MS, substantial equalization requires much more than a redistribution of land.

Vertical transfers are not only easier to implement, they also enjoy a moral support that is not associated with horizontal redistribution. This moral support is expressed for instance, in the labor theory of value. It is rooted in those notions of justice that link rights to the creation of something of value, rather than to its use; in "historical" as against "pattern" or "instate" conceptions of justice. When Marxists and conservatives dispute the right to property income, the argument centers on the question of who really produced that income. Both parties are implicitly accepting the distributive claim arising out of the act of production. Catholic social doctrine has also defended the historical notions of justice; its appeal for a sharing of consumption has been based on the claims of charity, rather than justice.

By contrast, the ideal of income equality, which is required to sustain policies of horizontal redistribution, and more generally, to separate distribution from production, is a weaker moral precept. Horizontal transfers
are more commonly supported by feelings of charity than of justice, and charity is much the weaker of those sentiments. The communist precept - to each according to his needs - remains an ideal for a society of "new men," not a banner for political action today. Most of the indignation provoked by "inequality" is satisfied by removing the extremes in income levels; in poor countries, it amounts to a feeling of scandal at the existence of a few rich amongst the many poor, and levelling down those extremes of wealth can be achieved without horizontal redistribution. These moral feelings, along with administrative costs, reinforce the natural political difficulties of achieving horizontal redistribution.

There are however, two important exceptions to the rule that horizontal transfers are rare. First, there are many instances of redistribution from high productivity farmers to urban groups. In Africa it is done through marketing boards; in Latin America, through exchange rate and tariff policies. Second, horizontal transfers have favored the urban traditional population. Some of the transfer is an accidental spill-over of indivisible urban services, but much is clearly a political response.

Both types of horizontal transfer have occurred in Peru, but they do not substantially qualify the argument that horizontal redistribution is more difficult and more rare and that in consequence, redistributive policies have done little to correct the concentration of income associated with a dual economy.
III. Government Policies and the Distribution of Income

What follows is a discussion of how policies of the Belaunde and Velasco regimes have affected the income distribution. The principal questions that guide this discussion are: to what extent has redistribution been stepped up under Velasco? And, what is being done for the very poor? The answer that emerges below to both questions is—very little.

The analysis that follows is built chiefly on the sectoral framework developed in Part II, and on an aggregate statistical picture of the sectoral distribution of income that relates income transfers to the levels and changes in market incomes. Those figures are contained in Table 6, below. Lines 1 through 4 of Table 6 amount to a statistical version of the shape and composition of the value added curve in 1961 and 1970; they provide a perspective for judging the significance of income transfers that result from government policies. The principal forms of transfer are estimated in Lines 5 through 11. The following sections will discuss these figures in more detail, from the point of view of each of the three sectors.
Table 6

Market Incomes and Income Transfers per Worker by Sector, 1961 and 1970
(all values in 1970 U.S. $ per worker)

<table>
<thead>
<tr>
<th></th>
<th>1961</th>
<th></th>
<th>1970</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Modern</td>
<td>Traditional</td>
<td>Modern</td>
<td>Traditional</td>
</tr>
<tr>
<td></td>
<td>Urban</td>
<td>Rural</td>
<td>Urban</td>
<td>Rural</td>
</tr>
<tr>
<td>1. % of Labor Force</td>
<td>21.1</td>
<td>28.6</td>
<td>50.3</td>
<td>21.6</td>
</tr>
<tr>
<td>2. Value Added</td>
<td>2690</td>
<td>630</td>
<td>530</td>
<td>3590</td>
</tr>
<tr>
<td>3. Property Income</td>
<td>940</td>
<td>60</td>
<td>120</td>
<td>1070</td>
</tr>
<tr>
<td>4. Wage</td>
<td>1750</td>
<td>570</td>
<td>410</td>
<td>2520</td>
</tr>
<tr>
<td>5. Net Budget Transfer</td>
<td>-300</td>
<td>60</td>
<td>20</td>
<td>-540</td>
</tr>
<tr>
<td>6. Taxes</td>
<td>-530</td>
<td>-70</td>
<td>-30</td>
<td>-800</td>
</tr>
<tr>
<td>7. Education</td>
<td>60</td>
<td>50</td>
<td>20</td>
<td>100</td>
</tr>
<tr>
<td>8. Health</td>
<td>100</td>
<td>50</td>
<td>10</td>
<td>100</td>
</tr>
<tr>
<td>9. Public Investment</td>
<td>70</td>
<td>30</td>
<td>20</td>
<td>60</td>
</tr>
<tr>
<td>10. Price Effect</td>
<td>40</td>
<td>10</td>
<td>-30</td>
<td>80</td>
</tr>
<tr>
<td>11. Property Transfer</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Wage</td>
<td></td>
<td></td>
<td>140</td>
<td>0</td>
</tr>
<tr>
<td>(b) Profits</td>
<td></td>
<td></td>
<td>-120</td>
<td></td>
</tr>
</tbody>
</table>

Notes:


Line 2: 1961 data from Webb, The Distribution of Income (op. cit.), Table 4. 1970 from Webb, Tax Policy (op. cit.), Table 4.6, which estimates national income by sector for 1969, plus extrapolations to 1970 based on national accounts data of Central Reserve Bank.

Lines 3 & 4: 1961 data from Webb, The Distribution of Income (op. cit.), Table 3 and worksheets. 1970 data from (i) national accounts wage and profits series for establishments in modern sector and commercial agriculture, checked against Ministry of Labor wage series, (ii) UTS wage and profit breakdown approximated by multiplying ratio of employees to total UTS labor force by 1961 MS wage and profit shares.
1. The Modern Sector

Over the period under study, most of the income redistribution that has occurred in Peru has taken place within the MS. The net result has been some gain for labor, at the expense of capital, though some measures transfer in the reverse direction. The sector as a whole appears to benefit at the

Notes: (continued)

Line 5: Sum of lines 6-9.


Line 9: 1961 and 1970 government budgets, and Plan Nacional 1971-1975 used for breakdows by type of investment expenditure. Allocations are approximations based on assumption that housing went to MS families, irrigation and other agricultural infrastructure to rural sector, and trunk roads shared in proportion to income.

Line 10: Very crude estimates of order of magnitude based on (i) share of MS and UTS income spent on foods affected by price controls or by tariff and exchange rate policies (chiefly meats, dairy products, wheat and oils), (ii) conservative estimates of price distortion: 20% in 1951 and 40% in 1970 (increase reflects doubling of tariff level on non-food imports, increased price controls, recent rationing of meat, and trend in relative domestic to imported goods price levels.)

Line 11: From national accounts data on 1960-1970 profits in reformed sectors. Bracketed rural sector figures measure total eventual transfer on completion of agrarian reform; MS figures reflect current redistribution only; difference between wage gain and profits loss equals loss of direct tax revenue.
expense of commercial agriculture, and to lose to both the urban traditional
and the rural subsistence sectors. As may be seen in Table 6 however, any
such horizontal transfers are small in proportion to the size of the MS.

The MS transfers income to other sectors through the budget: it had
a net budgetary loss equal to 15% of value added in 1970, vs. small gains in
the other sectors. The MS has the highest tax burden: in 1970, 23% of MS
value added was paid in taxes, vs. 20% in the UTS, and 9% in the RTS. The MS
paid three-quarters of all taxes. However, the tax ratio has been rising faster
in other sectors, particularly in the UTS, thereby lessening the degree of pro-
gressivity that existed in 1961.

Government expenditures are also far higher in the MS, though not
sufficiently to offset the greater tax burden. Of the three components of
government expenditure whose benefits could be allocated by sector, (accounting
for about half the total budget), the 1970 per capita benefits were all signifi-
cantly higher in the MS: $260 per worker vs. $170 in the UTS, and $80 in the
RTS. In contrast to tax policy, the incidence of expenditures improved over the
period: their absolute growth between 1961-1970 was about equal in each sector,
implying a faster proportional growth in the poorer sectors.

On the other hand, it could be argued that most of the non-allocated
expenditures (chiefly defense, police, and some basic infrastructure) provide
services that are more relevant to the MS than to the rest, or, to some extent,
consist of subsidized wages that accrue to MS employees. More clearly, price
policy works in favor of the MS; though it is both conceptually and statistically
difficult to measure the amount of transfer involved, the estimates shown in
Table 6 indicate the direction and changing size of that transfer, both
favorable to the MS. The overall impact of government measures—the net budget transfer (−$540), plus price effect (+$80), plus unallocated expenditures (+$120 or more\(^1\))—may therefore be judged neutral or mildly negative for the MS.

The final shares of income accruing to capital and to labor within the modern sector are affected by wage policies, tax incidence, the allocation of public expenditures, and financial policy affecting the price and allocation of savings. Pricing policies also affect the outcome: some tariffs create monopoly profits; some price controls subsidize consumers. Finally, profit-sharing and wealth transfers have become additional instruments of vertical transfers. The MS, in short, is a busy distributive marketplace (or battlefield?); with so much trading going on, less significance should be attached to the progressive or regressive nature of any specific measure except as a means to understand the final outcome.

Between 1961 and 1977, MS wage levels rose at 4.1% p.a., exceeding the growth of productivity. In the private sector, the average wage rose even faster, at 5.0%, while employment lagged; in government the growth in employees contributed more than that in average wage. The overall result was that the share of wages in MS value added rose from 65% to 70%. It was argued above that this gain should be attributed to closely related technological and political characteristics of the MS. The political and union power of the MS labor force was well established by 1963. Indirect evidence of union power is reflected in the strong relationship between wage levels and productivity in

\(^1\)A minimum share of unallocated expenditures could be estimated by allocating on a per capita basis; this yields the figure of $120; an allocation proportional to income raises MS budget receipts per worker instead, to $280, while a higher figure would result from assuming, as suggested above, that the most non-allocated expenditures are primarily of benefit to the MS.
different sectors and size firms shown in Figure 2. That power may have increased under the Belaunde government. One index of political support is the number of unions granted official recognition: between 1962 and 1967 an average of 223 unions were recognized each year; between 1950 and 1961 the figure was 38. The exercise of working class power was, if anything, reinforced during the first years of the Velasco government, which allowed wages to rise at over 5% p.a. in large mining and manufacturing establishments between 1969 and 1971.

The budget also appears to redistribute from capital to labor. Tax rates are progressive within the MS, and health and education expenditures are probably pro-labor in their incidence, largely as a result of the use of private schooling and health care by the upper classes. Thus, the more easily allocated budget items are progressive in their net incidence. Many public investments, such as roads and ports, are complementary to private sector investment, but investments in housing, schools, irrigation of new lands, hospitals, etc., benefit middle or lower income groups more directly. There appears to have been little change in the mix of public investment, though more emphasis is now being given to "productive," and less to welfare related investments. Also, tax changes have slightly reduced the progressivity of the fiscal system within the MS.

The principal change in distributive policy introduced by the Velasco government consists of the redistribution of profits and property within modern firms. The effect is to reinforce the vertical redistribution that has already been taking place through wage and fiscal policies.
The gross transfer involved is very large for a few workers, but for the MS as a whole it currently amounts to about 6% of labor income.\textsuperscript{1} If the gradual transfer of share capital that will take place under the new Industrial Law, (up to 50% of each firm's net worth) were instead done overnight, the redistribution would increase MS labor income by between 20-25%.\textsuperscript{2} The planned redistribution is therefore relatively large, but the gross transfer may prove larger than the net because wages may now rise less than otherwise. There are indications that the government is at present seeking to restrain MS wage gains, but it will require a considerable change in political attitudes and behavior vis-a-vis organized labor to prevent workers from reaping the benefits that will grow out of the comunidades laborales created by the Industrial Law.

2. The urban traditional sector

Since about two-thirds of the UTS in Peru is self-employed, and the rest are employees in small businesses where profits per worker are low, vertical redistribution in this sector is largely irrelevant. Furthermore, minimum wages or similar legislation would be hard to enforce in small firms and households, and high price elasticities of demand for labor in this sector would cause a large employment effect.

Governments appear to have been aware of these constraints, since little stress has been placed on any form of vertical redistribution within the sector. Minimum wage laws were first introduced in 1962, by the Military Junta,

\textsuperscript{1}Table 6.

\textsuperscript{2}Table 6. Based on percentage transfers allowed for each sector, and on total 1970 property income, though much is not subject to transfer (e.g., rents, interest, State enterprises, etc.).
and generalized across the country by Belaunde, but there has never been a serious effort to police them at the level of small firms. Union legislation deliberately excludes small firms (under 20 employees). The Velasco government requires employers to pay social security contributions for domestic servants, but in an unregulated, competitive market of this kind legislation requiring the payment of supplementary benefits to employees is largely nullified by eventual readjustments in the market wage. Finally, the sectoral property transfers decreed by Velasco so far completely exclude the UTS.

What can be done for the poor in this group must therefore be done at the expense of other sectors. The major horizontal transfers received by the UTS are public services, and low food prices: both become available to all urban residents, though with varying degrees of discrimination.

Neither of the last two governments has a good record of transfers deliberately aimed at the urban poor. Both have given greatest publicity and money to housing, though it is the least effective way of reaching the very poor: costs per beneficiary are high, and in the best of cases few benefit. In practice, subsidized housing has gone almost entirely to middle-income employees. Recent government subsidized housing is on the average reaching poorer groups than under Belaunde, though prices still exclude the poorest, while credit worthiness standards still imply a bias against the self-employed.¹ Public expenditures on barriada roads, water, sewage, etc., have been minimal

¹See Alfredo Tapia, Acción de las Instituciones de Credito Especializadas en el Financiamiento de Vivienda en el Peru, (Lima: Imprenta del Hogar de la Clinica San Juan de Dios, 1971), for statistics on housing prices and urban income levels.
over the whole period. Between 1964-1970, the Faseo de la Republica absorbed half of the total investment by the municipal government of Lima: from 1970-1972 the extension of this expressway to the rich suburbs and beaches continued to be the largest municipal project.

Urban health services are far better than rural: in 1964 per capita health expenditures in 15 cities were $15 vs. $1 for the rest of the country. Urban health expenditures have risen since 1961, but neither government has seriously attacked the discrimination built into the three-tiered health system: the military, police and white-collar workers have better services than MS blue-collar workers, who in turn get more attention—from the social security system—than the self-employed or unregistered obreros of small-scale business who must resort to Ministry or charity hospitals. The Velasco government has made some moves in the right direction: it incorporated domestic servants into the social security system, and set up a commission to study the unification of the white and blue-collar social security systems. More than any other urban public service, the health system neatly discriminates between the modern and urban traditional sectors.

The nature of the UTS economy makes it difficult to raise UTS incomes by raising productivity. The single greatest public expenditure on the UTS is education, which is clearly of value as a current transfer. Whether it raises money incomes is less clear: would the MS spend less on UTS services and goods

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1 A 1967 survey of barriada residents by CISM revealed that 58% of the homes had no piped water, 61% had no sewers, 87% were located on unpaved streets. On the other hand, only 2% of the families had children who were not attending primary school, and what is more surprising, only 11% had children aged 13-21 who were not attending secondary school. CISM, Barriadas de Lima, Ministerio de Trabajo y Comunidades, Lima, 1967.
if UTS workers were less educated? My feeling is that total expenditure would be similar, but more persons would be employed in the UTS, thus increasing wage differentials between the MS and UTS, but reducing them between the UTS and ETS. In any case, governments since 1961 have been heavily committed to the provision of education to the urban population, with no significant discrimination against the poor. The only apparent change in emphasis between the two governments has been the reduction in the university budget under Velasco, though projected improvements in the quality of education are potentially much more significant.

On the debit side, the UTS has not fared well as a taxpayer. Its 1970 tax burden of 19.7% was almost as high as that of the MS (23.0%). Belaunde's tax policy was particularly regressive with regard to this sector: its tax burden rose from 10.2% in 1961 to 20.5% in 1969. Though the overall tax burden is unlikely to rise as fast under Velasco, current tax changes also appear to discriminate against this sector: recent tax reductions largely benefit the MS, while excise tax increases and the conversion of the sales into a value added tax hit low income consumers most. The net burden worsened for the UTS under Belaunde, despite a doubling of educational expenditure per capita; since 1969 it has probably changed little.

To summarize: the nature of the UTS economy makes it hard to help this sector; vertical redistribution is ruled out, and productivity-raising horizontal transfers in the form of education and productive infrastructure, probably change the distribution of incomes and employment within the UTS more than its total income. The UTS does receive substantially more welfare transfers than the rural population, though less than the MS. Also, income is
transferred from the rural population through food price policies. Most of the fiscal transfer is paid for through taxes, but the sector is clearly a net recipient of income from other sectors, once the effect of price policies and of unallocated public expenditures are counted. Finally, on all major aspects of distributive policy toward this sector, there has been considerable continuity between the Belaunde and Velasco governments.

3. The Rural Traditional Sector

The impact of distributive policies on the rural traditional sector is easier to assess if the sector is separated into its commercial and subsistence components.

(1) The subsistence sector can only benefit further, if we classify all haciendas and their colonos as commercial, the remaining subsistence minifundistas (about 20% of Peru's population) can only benefit via horizontal, chiefly fiscal transfers. Since most sell at least a small proportion of output, and purchase some taxed items, they are affected to a minor extent—in both cases negatively—by price policies and taxes. The tax burden is very low, but price policy is discriminatory: food imports continue to be exempt of tariffs while the average duty on all other goods has risen from about 30% in 1961 to over 70% in 1970. Cheap beef imports compete with what is often the principal source of cash income for small farmers. In 1961, over 70% of beef cattle were owned on farms under 5 hectares. Meat imports grew so fast during the last ten years that rationing has now been imposed to reduce demand. Yet most meat is consumed by middle-class families. Tariff-exempt wheat imports favor the consumption of bread; a non-discriminatory general tariff, or a
reverse discrimination in favor of domestic foods, would raise Sierra income from potatoes and other substitutes for bread. Potatoes in particular are thought to be in relatively elastic supply so that a potential exists for import-substitution with large benefits to small farmers.

On the other hand, government expenditures do benefit the subsistence economy. The largest direct transfer is education. Belaunde extended primary schooling to most of the rural sector, where enrollment rates now reach 70-80%.

Much more however, could be spent on education in backward rural areas, where school materials are scarce, teachers are poorly prepared, secondary schooling is unavailable, and illiteracy remains high. The 1971-1975 Development Plan recognizes all these needs, but its projections do not add up to a large financial effort. There is no indication for instance, of funding for a massive literacy program. Additional financial effort however, may be less important than improvements in the quality of rural education, which at present probably adds little to the welfare or future income of the campesino who does not emigrate. Since the administrative self-improvement required to make significant changes in the quality of rural education will surely be a long and uncertain endeavor, it seems unlikely that education will be a vehicle for a substantial additional transfer to the subsistence sector during the next few years.

Less money is spent on two more fruitful types of fiscal transfer to the small farmer: rural infrastructure, and agricultural extension plus credit. Small roads and small irrigation projects in the Sierra were minor components of Belaunde's investment program, and there has been no major change in the priority given to those programs. On the other hand, there is a larger
allocation for trunk roads and other major routes through or into the Sierra, and these also favor small farmers; about one-third of 1971-1975 projected road expenditures will be in the Sierra. Most of the national road program is a continuation of projects that were initiated or planned under Belaunde. Though the Sierra gets much less in per capita terms, road construction may well be the single most productive transfer to the poorer rural population. By contrast, potential small irrigation projects in the Sierra were, and continue to be, almost entirely ignored.

The record of agricultural extension and credit to small farmers in the Sierra is one of extreme neglect. The extension service claimed a total of 117,000 assisted families in 1969, but about two-thirds were on the coast or in the Montaña; thus only 40,000 families, or about 4% of Sierra small farmers received direct assistance. The distribution of farm credit was similar. It is difficult to judge how much more the present regime will do. The obvious fear is that the Plan’s preoccupation with land tenure changes and with large irrigation and colonization schemes will direct most effort and money to the 10-20% of the small farmer population who will receive land, including many on the coast. The 1971-1975 Agricultural Development Plan says very little about what is sure to be its principal constraint: the number of field workers who know more about Sierra farm techniques than the campesinos themselves, and who are also able to communicate with and persuade the campesinos to change. The official programs do not plan for a substantial increase in the size and quality of technical assistance to small farmers.

(ii) The commercial part of the rural traditional sector is defined to include most coastal and jungle farms (excluding sugar, here classified as Ms),
Sierra haciendas, and most small farmers in the Central Sierra. Market participation is a mixed blessing for these farmers, since it opens them to large negative transfers via price and tax policies. Political weakness plus vulnerability to tax and price policies have combined to make this the most victimized sector in Peru, as it is in many LDC's.

Since 1963 there has been a great deal of income redistribution, both within commercialized agriculture and from this sector to the urban economy. Large landowners were clear losers. In the case of small farmers and wage-earners, it is harder to determine the net incidence of better wages and public services on the one hand, and higher taxes and worsening terms of trade on the other. The sector as a whole was penalized by overvaluation, which reduced cotton and coffee earnings and cheapened competing food imports, and by the combination of food price controls and low tariffs on foods. Furthermore, some of the growing burden of indirect taxation spilled over to this group, while public investments complementary to existing commercial agriculture (e.g., improvement of existing irrigation systems and silos) received low priority.

Small farmers and wage-earners however, receive some compensation in the form of improved welfare services, chiefly education. And wage-earners, including Sierra colonos, benefitted from a favorable wage policy. During the late fifties and sixties, most coastal farm unions received official recognition and sympathetic official arbitration. As a result, coastal farm wages grew more rapidly than those of MS workers.1 Parallel gains were made during the period

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1Coastal farm wages grew at about 5% p.a. between 1950 and 1966. Sugar farms account for only 10% of this labor force: the rapid rise in wages in other coastal farms, here classified as "traditional," was possible partly because wages were very low in 1950 and partly because productivity on these farms is relatively high within agriculture—they are on the margin of the MS.
by Sierra colonos, despite the discriminatory treatment of Sierra farm unions: of the 279 farm unions given official recognition between 1961-1967, only 5 were in the Sierra. Nevertheless, though the evidence is partial and scattered, there appears to be general agreement that peasant mobilization and union activities in the Sierra resulted in a better deal vis-à-vis the hacendado during the late fifties and early sixties; bargaining for better wage rates was helped by the minimum wage legislation of the mid-sixties, but gains were also made in work conditions (days worked on the hacienda, provision of schools, etc.), and in the recovery of some communal lands.¹

There has been a remarkable continuity in the pattern of redistributive policy toward the rural sector, characterized by negative horizontal transfers, and a vertical redistribution of income and property from land-owners to wage-earners and some small farmers. Under the agrarian reform law, the vertical transfer has become radical. On the other hand, the negative incidence of both price and tax policies appears to have been heightened with the growth in excise and sales taxation, and a more rigid and extensive application of food price controls.² Also, positive fiscal transfers to the sector of both the productive and welfare type continue to be of relatively minor order of priority.

¹The retreat of the hacendado in one part of the Sierra during this period was pointed out for instance, by an ex-guerrilla leader, “Hecho incontrovertible: el latifundio decae en todas partes, cada día es más difícil mantenerlo...los ganonales venden sus tierras o se alejan abandonando a sus siervos la posesión de los cultivos.” Hector Bejar, Peru 1965: Una Experiencia Guerillera, Campodonico, Lima, 1969, p. 93.

²Estimates of the redistribution caused by price policy are very tentative, but the estimates in Table 6 (Line 10) indicate the order of magnitude of non-neutral tariffs and price controls on funds. To estimate the potential for raising rural incomes through price policy with a deliberate rural bias, one could assume, for instance, prohibitive tariffs on most imported foods, no food price controls, and possibly a higher exchange rate favoring agricultural exports. Rough calculations of the value of import-competing and exported farm products, and of the domestic price elasticity of demand for goods suggest that such policies could raise incomes of individual farmers in the order of 10%-50%, depending on the fraction of output that is marketed and by over 20% for the sector as a whole.
4. Conclusions

The two main findings of the preceding description of distributive measures since 1963 are first, their effects have been progressive on balance, and second, the pattern of redistribution under Belaunde and Velasco has been similar, characterized by redistribution downwards within sectors.

The progressive incidence of policy is most evident in the MS where the budget transfers income both downwards, and across to the traditional sector, and where the market share of labor has been pushed up by wage policies and profit-sharing. The UTS is a net recipient of income transfers, partly at the expense of MS taxpayers, but also partly from farmers as a result of food price policies. In the rural sector, the poorest families consist of subsistence farmers who have received a positive, and growing net budget transfer; their reduced market participation limits the negative impact of price policies and indirect taxation. Wage-earners in commercial agriculture have benefited instead through vertical redistribution: they appear to break even with the budget, but were favored by wage policies under Belaunde, and are now the principal beneficiaries of the agrarian reform. On the other hand, small and medium farmers producing for the market lose heavily from price policies, and do not gain from the budget: this "middle income" group is perhaps the major exception to the overall progressivity of distributive policy.

Though policy has worked in the right direction, the amounts transferred remain very small in relation to the large, and growing market income disparities shown in Table 6. Also, the allocation of benefits has been unfair. The largest transfers have gone to urban, and particularly, to MS employees, most of whom belong in the upper two or three deciles of
the income distribution. Even within the MS, the cumulative impact of wage and profit-sharing measures had an unequal incidence, heavily favoring workers in capital-intensive firms. The rural sector has gained much less, and again, the distribution of benefits has favored the better-off wage-earners within the sector. The most radical redistributive measures to date—the sectoral reforms—actually worsen the distribution of labor income. In per capita terms, the overall pattern of redistribution may be considered grossly unjust.

The basic feature of that pattern of redistribution has been the propensity towards vertical transfers. Policy has tended to parallel, rather than offset the dualistic structure of market incomes. In fact, market spillover has probably done more for the TS than has distributive policy. Horizontal transfers do exist; the budget appears to favor most of the traditional sector. In the case of the RTS, however, the budget transfer is more than offset by the reverse effect of price policies. While the net horizontal transfer to the TS as a whole is insignificant in relation to either TS or MS income. This is in contrast to the large per capita vertical transfers received by MS employees. The continuity of this pattern under the Velasco government suggests that the underlying political, administrative and psychological biases against horizontal transfers remain substantially unchanged. Though on balance, there may have been some acceleration in the degree of redistribution, as there was under the Relande government, the evidence does not point to any major change in either the amount or the direction of redistribution under the Velasco regime. Some very positive and dramatic measures must be set against several less visible, negative
changes in tax, social expenditure and price policies. While some recent redistributive measures have been favorable, the effects of other policies which are shaping the economic and political structure of the country are inauspicious for the poor. Those policies are increasing the dualism of the economy, and diminishing the political power of the poorer groups.

The dualism of the productive structure is being reinforced in several ways, of which the most important is the change in the projected composition of sectoral output, with much more priority being given to the highly capital-intensive heavy industries, and to mining. The race to establish a foothold in several branches of metal-working, petrochemical, and chemical industries, in advance of the complementarity agreements that are to be worked out under the Andean Pact, is giving an extra edge to the high degree of priority already enjoyed by those industries. The Andean Pact will also discourage efforts to sacrifice industrial efficiency in the interests of labor-intensity. In other activities, the government plan is strongly oriented towards large-scale investments that will be part of, or complementary to, the modern sector.

Dualism is also being reinforced by factor-price policies, which are not only maintaining, but are probably increasing the previous distortions favoring capital-intensive techniques. Wages have been allowed to rise substantially in high productivity establishments, while numerous incentives built into the Ley de Industrias and other sector laws, tend to cheapen the cost of capital. Finally, the newly created workers' communities in most of the private modern business sector will tend to resist employment expansion; they will seek to maximize dividends per worker by maximizing capital per worker. Greater dualism will increase the concentration of
value added in the MS, and the consequent need for horizontal transfers.

Corporativist elements in the military government's approach to organization, such as the deliberate weakening of class associations, and the stress on productive sectors as prime social units, appear to parallel the bias toward vertical redistribution. Sharing of effort and rewards within each productive sector is to be the antidote to class conflict, but it will also reinforce the "bottling-up" of income within the rich sectors. The agrarian reform has removed the most effective instrument for peasant mobilization; the reform itself is a sizeable transfer to some peasants, but for most peasants it will not be more difficult to press for a share in MS productivity. At present for instance, farmers seem powerless even to defend themselves from the worsening rural-urban terms of trade that have resulted from the price and import policies of the government. Much attention is also being given to dampen any potential for mobilization in the UTS by the closely supervised, vertical organization of separate barriada communities and, as in the countryside, by granting land titles to remove the major potential instrument for mobilization.

The Velasco government has shown some awareness of the negative redistributive implications of its economic and political model. The gross unfairness of redistribution under the Industrial Law was not repeated in subsequent legislation which introduced sharing arrangements between firms in the Mining and Fishing Laws. The early rejection of the "family farm" concept, and the shift to ever larger units of farm organization are, in part, motivated by a desire to spread benefits. The most visible, and embarrassing, case of exclusion—that of the sugar farm contratistas—has been publicly discussed by government officials. These concerns
underlie the proposed Ley de Propiedad Social, which would socialize at least some of the rights to the control of, and income from private property. If a strong version of this law is eventually approved, it could significantly improve the potential for building-in flows of horizontal redistribution, though many other changes (and reversals) in policy--in sectoral investment priorities, for instance--would also be needed.

Thus far however, there is little to indicate that the government is willing to undergo, and impose, the political, administrative and psychological changes that would be necessary for a substantial and prompt alteration in the degree and direction of income redistribution. Indeed, the necessary changes appear to be so large, and so far from current policies, that they would amount to a revolution.
IV. Implications for Redistributive Policy

1. The nature of the problem

A focus on recent history, and on the very poor tends to highlight the inequity of the economic system, and the insufficiency of redistributive policy. One in four Peruvians today survives on less than $100 p.a., a standard of living that has scarcely been touched by the expansion of the economy, or by government measures over the last two decades. Despite greater government control and an evident distributive concern, the policies of the current regime, including the agrarian reform, are doing little for the very poor; those policies appear to reinforce, rather than reduce the major income cleavages of the society. "Radical" redistributive measures are giving large dividends to workers whose wages are already between 5 and 10 times the average income of subsistence farmers, while less visible tax and price changes since 1969 have been regressive, and no major initiatives have been made in expenditure programs for the rural poor.

Yet, a longer view of the economy as a whole provides grounds for a less somber evaluation. In particular, the breadth of income growth throughout the economy conflicts with the "domination:" view which pictures growth as being entirely bottled up for the benefit of a small, powerful MS which, like the divinity, fathers, inherits and is the very spirit of growth. That view is premised on weaker linkages, fewer sources of autonomous productivity growth within the TS, and a greater concentration of power
(and of the benefits of government policy) than seem to be the case. The following propositions are more consistent with actual income trends in Peru.

First, demand spilled over from a dynamic MS benefitting many small farmers, and workers absorbed by the construction industry, and by commercial and service establishments in the UTS. Derived demand has generated slower rates of income growth than those in the MS, but it has spread to a large proportion of the population. Second, less-publicized forms of modern technology raised productivity directly in the TS: knitting machines in rural communities, power hand-tools and oxyacetylene welders in the shops of urban artisans, and cash registers in small stores probably add up to a quiet revolution in small-scale business.¹

Third, government policy worked to raise incomes of many groups of workers outside the MS. Coastal farm workers for instance, even in smaller, non-reporting farms, now tend to be paid the minimum wage. The same is true of employees in many small enterprises in Lima. Road construction connected Sierra communities to city markets. The shift from automatic support of landowners to a more neutral position, and even, during the early sixties, to open sympathy for peasant organizations and their claims, helped many Sierra communities to recover land, and to obtain higher wages and reduced obligations. More recently, the agrarian reform has added a further transfer to the rural sector.

¹ See R. Webb, Trends in Real Income (op. cit.) for evidence of economic change in much of the TS.
These gradual developments over the last two decades follow the pattern of the long-run drift in distributive policy towards ever-larger groups which has been documented by Hunt.¹ No claim is being made that government policy was strongly redistributive; most of this study tends to demonstrate the contrary. But the data does not support the extreme view that, until recently, government policy and the economic system worked almost exclusively for the benefit of a narrow minority, pre-empting any economic improvement for a majority of the population. A more accurate picture is one of trickle-down, through both the market and government measures; growing inequality has been accompanied by some improvement in the living standards of the majority, and by social and cultural changes that have mobilized and spread power to larger groups. If this trend continues, the present slow rate of change for the very poor will accelerate.

But, must the poor wait on this gradual spread of income? In the best of cases, trickle-down—even in its current “revolutionary” version—will mean a long period of persistent poverty and growing inequality. Certainly, the potential exists to achieve a dramatic improvement in the living standards of the very poor: a selective transfer of 5% of the national income, taken from the richest 1% of the population and given to the poorest quartile, would reduce absolute income at the top by only 16% and would double incomes at the bottom. By contrast, a highly successful development effort consisting of sustained 3% p.a. growth in all incomes would require over 20 years to achieve the same improvement for the bottom quartile, and much longer, if one discounts for the waiting involved.

What would be involved in a program of substantial redistribution aimed at the very poor? Two approaches to this question are those provided by the "domination" thesis, and the employment approach. The first imputes income inequalities to the use of power, and suggests that much equalization will follow from a destruction of exploitative mechanisms. The second relates inequalities to the structure of production, and seeks to reduce income differences by equalizing productivity levels.

2. The domination theory approach

The observed pattern of unequal growth has been attributed to a concentration of power which permits the rich in urban, "modern" centers to grow "at the expense of backward, archaic, and traditional zones."¹ Stavenhagen states the analogy that characterizes this argument: "..... the backward, underdeveloped regions of our countries have always played the role of internal colonies in relation to the developing urban centers of the productive agricultural areas."² This thesis is usually expressed in terms of "domination" and "marginality," adding force to the political explanation of inequality.³

²Ibid, p. 18.
Most of this literature is vague, or ambiguous on two central propositions of the argument: to what extent is "marginality" attributable to the exercise of political power in internal economic relations, and to what extent is it a result of market mechanisms such as the "polarizing" effects described by Hirschman, or the similar processes of "cumulative causation" analyzed by Myrdal? And second, to what degree is it a sectoral phenomenon, involving the exploitation of a backward by a modern sector, or a class phenomenon, wherein labor is exploited by capital in both sectors? These issues are most clearly recognized by Pinto. More often, however, they are not distinguished, and the supporting evidence is impressionistic.

The confusion on the second question, (sectors vs. classes), derives largely from attempts to reconcile Marxist preconceptions with common sense observation; the usual answer is to claim both forms of exploitation.

The Marxist interpretation of exploitation within the capitalist sector seems out of place in the Peru of the last decade. Both absolute wages and the share of labor have been rising in the US over the last twenty

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2 In Pinto, especially pp. 32-42; and more recently in Diagnóstico, Estructuras, y Esquemas de Desarrollo en America Latina, (Santiago: Escola Latinoamericana da Sociologia, Nov. 7, 1959) pp. 23-30. Though Pinto at least clearly points out the issues, his answers on both questions are offered as opinions. His answers—"markets contribute more than power," and, "capitalists in the modern sector reap most of the benefits"—are consistent with Marxist theory.

years. Labor has also gained in commercial agriculture. Further, much of this gain can be attributed to a shift in the distribution of power. Not only has the distribution of market incomes improved, but there is a net budgetary transfer of income downwards within the modern sector. Finally, the relative improvement in the position of MS workers has been occurring under a variety of governments, ranging from the rightist Odría dictatorship, to the current reformist military regime. In the case of Peru at least, one is tempted to posit a Marxist law in reverse: of increasing amelioration of the MS working class.

More plausible is the alleged exploitation of the traditional by the modern sector. The evidence of unequal sectoral growth is well established, but exploitation implies the use of political instruments to transfer income.\(^1\) The more commonly cited transfer mechanisms are regressive taxes, pro-rich public expenditures, the financial system, pro-urban price policies as well as tariff and other protection of MS capital.\(^2\) Griffin, for instance, writes "Peru’s banking system, its land tenure arrangements, and its social institutions are so organized that savings are siphoned from the poorer region to the rich one."\(^3\)

The case of Peru however, provides only weak support for the theory of internal colonialism between sectors. First, the budget has favored the TS on balance. The budget transfer is offset by a negative

\(^{1}\)Unless one uses the Marxist definition by which, since all value is produced by labor, any property income constitutes exploitation.

\(^{2}\)See Pinto, La Distribución del Ingreso, \textit{op.cit.}, pp. 28-29.

price effect, but the net loss to the TS from the two types of transfers was negligible in 1970.\textsuperscript{1} If large hacienda owners are defined to belong in the MS, the TS loss is increased by the value of most RTS property income that is therefore "transferred" to the MS. Even by this definition,\textsuperscript{2} the loss was under 9%\textsuperscript{3} of TS income in 1970, and after the agrarian reform the transfer is minor. "Exploitation" is more significant if one looks at the RTS alone, where the net loss before the agrarian reform was in the order of 10% to 15%.\textsuperscript{4} This burden is proportionately greater on the commercial part of the farm sector which suffers most of the negative tax, price and property income effects. On the other hand, part of this

\textsuperscript{1}The net loss equals budget transfers per person, \((10 \times 33.1 + 30 \times 45.3)\div 78.4\), plus price effect, \((30 \times 33.1 - 70 \times 45.3)\div 78.4 = 21 - 23 = -7\).

\textsuperscript{2}In a strict sense, these incomes constitute class, rather than sectoral exploitation ("exploitation" being imputed to the extent that power has been used to acquire property and/or reduce wages). Their transfer to the MS is thus a market, not a political phenomenon. In the preceding discussion of distributive policy, the redistribution of farm property to workers was treated as a vertical, not horizontal transfer.

\textsuperscript{3}The high figure of 9% equals 1970 RTS farm profits (52) plus TS price effect (2%) less TS budget transfer (21) as a proportion of TS value added (689) i.e., \(59 + 689 = 8.6\%\). All figures are weighted averages of UTS and RTS. A better measure would exclude (a) that property income accruing to medium size farmers who live on their farms, or, alternatively, that part of property income reinvested or consumed in the farm; and (b) that part of the negative price effect which reduces property income rather than small farmer or wage incomes.

\textsuperscript{4}It equals 11% if one assumes (a) that the MS share of RTS property income equals the amount that will be transferred by the agrarian reform (60), and (b) that half the price effect is borne by MS recipients of hacienda profits and rents, and half by RTS labor.
"exploitation" was a transfer to the UTS; also the total RTS loss was falling between 1961 and 1970, due first to a squeeze on property incomes and a growing favorable budget transfer and later to the agrarian reform. Finally, the MS gained little from these transfers which equalled less than 6% of MS value added.\(^1\) Nor can one point to the availability of cheap labor as a form of subsidy to the MS since MS wages are much higher than those in the TS.\(^2\)

In conclusion, "domination" appears to explain a small part of income inequality in Peru during the last decade.\(^3\) The Marxist, or class version of the domination hypothesis is the least tenable, since the data point to a reverse phenomenon--vertical redistribution in favor of labor, in both modern and traditional sectors. There is evidence of some sectoral exploitation--of the RTS by the urban sector as a whole--but \(^{"internal colonialism"}\) accounts for a small part of sectoral disparities in income levels or trends. The elimination of those negative transfers out of the RTS would be significant by the standards of most redistributive measures.

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\(^1\)Equals high estimate of TS loss per worker, 59 (see footnote 3, p. 64), divided by ratio of MS to TS workers (21.6 = 78.4), as a proportion of MS value added. (3590)\(^{-1}\) = .59 x 78.4 + 21.6) / 3590 = 5.9%.

\(^2\)Oliveira stretches the Marxist concept of exploitation by arguing that the MS extracts a surplus from the UTS (op. cit.,) p. 434. He does not claim however, that the transfer results from any form of government intervention; his argument is presumably based on the notion that, in the market for UTS services, most of the gains from trade accrue to the MS, which is plausible given the greater price elasticity of the supply than of demand for such services. Some price policies, chiefly tariffs and capital subsidies, favor MS factories over UTS artisans, but since most UTS earnings are complementary with MS income, the negative effect of tariffs and other MS protection on UTS incomes cannot be large relative to the positive income effect from MS growth.

\(^3\)Power probably had a larger role in earlier periods, and thus explains more of the present inherited income disparities.
but it would make a small dent on the existing income disparities. The domination theory also exaggerates disparities in income trends, while underestimating the role of spillovers and other market forces that benefit the poor. Exploitation is less important than the nature of technology and of market mechanisms as a cause of the unequal pattern of growth. The distributive problem is less a transfer of income as its absence. Most income now originates in the modern sector, and remains there.

3. The employment approach

The employment approach seeks to improve the distribution of income by redistributing non-labor resources over the work force; if wages are linked to average productivity then incomes can be equalized by reducing productivity differentials in a dual economy. In terms of Figure 1 (p. 22) this amounts to flattening the value added curve PP'. Poverty is thus diagnosed as an employment problem by defining low productivity jobs as "non-jobs": the employed and unemployed are discussed in a way equivalent to the distinction between modern and traditional sectors.¹ Open unemployment is seen as only the tip of an iceberg made of a mass of low-productivity, low-income underemployment in the TS.

Employment policies can be categorized as directed either at broadening the MS, or at raising value added in the TS. These alternatives have different distributive implications: expanding employment in the MS gives the few workers who are annually incorporated into the MS a large wage increment, while the majority wait their eventual incorporation into

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the MS, or until MS employment is large enough to pull up TS wages through a supply effect. This strategy clearly means a postponement of income change for most of the poor. Further, the last to benefit are likely to be the illiterate, non-Spanish-speaking, most remote rural families who make up the poorest quarter of the population. The second approach—rural "job-creation"—will do the reverse: a larger, and poorer group, will receive a smaller per capita wage increment.¹

Employment policy is not a good proxy for an attack on poverty. It has the political advantage of simplifying and dramatizing poverty: the poor have always been with us, but suddenly there is massive "unemployment." An allusion to the political implications of unemployment breathes life into the tiresome recommendations of either distributive-minded, or allocative-minded economists. But simplification is two-edged since almost any measure or project can appear to be job-creating. In practice, the employment goal easily biases political action towards promotion of urban and MS activities.

One reason for this bias is that open unemployment, which is the more acute form of "the employment problem," is mostly urban. Emphasis is therefore given to mopping up the urban jobless through construction or industrialization, thereby providing more urban-level income to a minority, and adding to urban rather than rural infrastructure. Policy proposals are also biased towards a "broaden the MS" approach because growth and redistribution seem to coincide in measures that expand MS employment, chiefly

¹The smaller the MS-TS wage differential, the less will be the difference between these two approaches. At the extreme, where there is no differential between modern and traditional sectors real incomes (i.e., capital intensity does not generate higher wages), employment policy will have no distributive implication, except insofar it reduces open unemployment.
through the correction of factor price distortions.

Furthermore, the simple calculus of "jobs" and "non-jobs" is a clumsy and misleading way to approach the problem of raising TS income. First, much of what has to be done involves small changes in productivity or income, within the category of "non-jobs." Second, a preoccupation with employment rather than income leads to a partiality for labor-intensive techniques within the rural sector, when, if seen from a larger perspective, it is obvious that what is required is an increase in capital per worker in the sector as a whole. Third, the problems of raising current and future incomes should be distinguished more clearly than they are in discussions of employment. Government spending for labor-intensive construction of rural infrastructure attacks both problems at once. But there is no need to constrain rural incomes policy to this simultaneous solution. It may sometimes be administratively easier, or more economic, to subsidize current incomes by direct transfers, and use capital-intensive technology to build up rural infrastructure. Finally, the desirable transfer from current MS to current TS incomes has no necessary relation to any estimates of "labor surplus" in the TS.

4. Conclusions

In a dual economy, equalization will not go far without large horizontal transfers. Distributive policy in Peru has been biased towards vertical redistribution. Most social policy during the last decade—both the "reformist" measures of Belaunde, and the more radical wealth transfers of the Velasco regime—has redistributed income within the richer productive sectors, bypassing the poorest groups. To redistribute income in a dual
economy, it is necessary not only to destroy systems of exploitation, but to create systems for extracting from the richer sector, and for channeling that income to the very poor. Yet both governments have regressed with respect to horizontal transfers: the net transfer to the TS fell between 1961 and 1970. Further, they have both followed industrial, pricing and other policies that tend to reinforce income inequality by increasing the dual structure of the economy. The fact that Peru is now well advanced in terms of vertical redistribution is likely to make it politically more difficult to develop horizontal transfers, partly because more of the transfer must now come out of MS wages, rather than property income, and partly because land reform is de-mobilizing.

There is some awakening in Peru to the limited impact of past and recent distributive measures; mostly this takes the form of a growing concern with "the employment problem." Employment policies can make an impact on income inequalities by reducing dualism. But equalization through a change in the structure of employment is not an alternative to substantial current redistribution for two reasons. First, to reach the poor quickly, stress must be placed on raising TS productivity, rather than on fostering labor-absorbing growth in the MS; otherwise, the last to benefit are likely to be the very poor. But rapid change in the TS requires large transfers of current and/or capital resources from the MS; bootstrap effort will do little in the short run: substantial redistribution of current resources is therefore a pre-condition for an increase in TS productivity. Second,

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1 See Table 6. The net budget transfer plus price effect to the TS (Weighted average of UTS and RTS was 19 in 1961 and -7 in 1970).
dualism will at best be reduced slowly; aside from the weight of existing capital, this strategy must probably swim against a current of capital-intensive, technologized change.¹

If substantial redistribution is to occur in the context of dualism, the political system must develop in such a way as to overcome the many forces that tend to retain income in the richer productive sectors. Political change would need to be paralleled by new approaches to distributive planning, stressing horizontal transfers (i.e., fiscal and price policies) and targeting for the very poor. Economic planning should start with income growth targets for specific groups, and work back to the allocative, pricing and transfer implications. Such planning would reduce the reinforcement that now occurs between production, distribution, and the consumption patterns of the rich, and it would reduce the leakages that result, through political pressures and bureaucratic biases, when distributive policy is aimed at proxy targets, such as employment or regional development. Finally, substantial redistribution seems to require changes in attitude, the elimination of poverty must precede a concern for equity per se, and the needs of the very poor must acquire the status of rights rather than a claim to compassion.

¹Hirschman, op.cit., pp. 125-132 on reasons for the persistence of dualism in LDC's