Narco-dollars collapse Peru's economy

by Mark Sonnenblick

The Republic of Peru is being wiped off the face of the earth. Industrial production is more than 40% below last year's levels, with many sectors operating at less than one-fifth of installed capacity. Food production and consumption have also fallen drastically, bringing conditions in much of Peru down to African levels of human misery.

More and more of the country is falling into the hands of Soviet-backed narco-terrorists, who demonstrated their power July 27 by dynamiting 21 electric pylons, knocking out the entire nation's electrical grid. Hence, President Alan García's State of the Union message the next day could not be broadcast. The terrorists' impending domination of the Andean Spine poses a decisive security challenge to every country in South America—and to the United States.

"The Maoist Sendero Luminoso [the Shining Path terrorists] is already an important force," Citibank President John Reed noted in a May speech to the Business Council. "Mexico and Venezuela are moving along on economic restructuring and could rapidly negotiate a reduction of their foreign debt burden, while Peru has been transformed into the Lebanon of Latin America. The country is disintegrating and the government is incapable of functioning; it is a big tragedy." What has Citibank done to stop the tragedy? "We have eliminated almost all credits to Peru," Reed gloated.

What has the United States government done to stop the tragedy?

When Alan García became President on July 28, 1985, he courageously launched a two-front battle. He limited servicing on Peru's unpayable foreign debt to 10% of export earnings, and he ran the most aggressive war on cocaine traffickers in world history. His Operation Condor blasted to bits hundreds of cocaine labs and clandestine airports in the wilds of the Peruvian jungle. The traffickers fled into neighboring Brazil and Ecuador.

García's appeals for help were denied. The other Ibero-American countries refused to join his struggle to force new terms on foreign debts needed to ensure their nations' survival. The United States turned down his urgent requests for the equipment needed to preserve the gains of his military assault on the narcotics traffickers. Agustín Mantilla, now Peru's interior minister, came to Washington in late 1985 to ask for the means to airlift his anti-drug police to make their raids, rather than having them bushwhack through dense jungle. The State Department told him that then-Treasury Secretary James Baker had vetoed any aid to Peru's war on drugs, on the grounds that García had to be punished for daring to confront the international banks.

George Bush, then serving as head of the administration's "war on drugs," must have instructed officials to "just say no" to Peru's pleas for help. It is now recognized, in the United States and in Peru, that the war on drugs in Peru has practically been lost. In this light, the Aug. 13 report by Los Angeles police chief Darryl Gates that President Bush favors a "friendly invasion" of Peru, Colombia, and Bolivia by U.S. troops, illustrates the cynicism with which the administration treats the drug scourge.

When García began defeating the traffickers, Washington launched economic warfare to make a horrible example of Peru, so that no other country would dare to challenge the usury of the Wall Street banks. The most devastating effect of this assault was to encourage oligarchic Peruvians to send all the dollars they could get out of the country.

García, undaunted, fulfilled his commitment to pay Peru's "immense social debt." Production rose more than 8% annually in 1986 and 1987. The average Peruvian's food intake rose from 220 pounds to 304 pounds per year. The government provided cheap credit and parity prices to stimulate food production, while importing what could not be produced domestically.

García's economic policies were inadequate to bring more than short-term alleviation. His Keynesian demand-pull bonanza invested nothing in solving infrastructure bottlenecks nor in replacing obsolete industrial equipment. When the oligarchy of drug money launderers went onto a full-scale offensive in August 1987, García—and the economy—crumbled.

After an initial, correct, effort to go for the kill against the money-launderers, he surrendered to them, and lost the country to them and their terrorist allies. *EIR* signaled the political turning point in April 1988, when the García government accepted the out-in-the-open functioning of the Lima black market for dollars. Today, government-owned banks run ads in the newspapers inviting people to bring in their dollars to be bought at the black market rate, with "no questions asked." Even the state wants in on money-laundering. Economy Minister César Vásquez Bazán says the central bank is buying $1 billion a year off the street. The currency it is printing to do that, fuels the 7,000% hyperinflation.

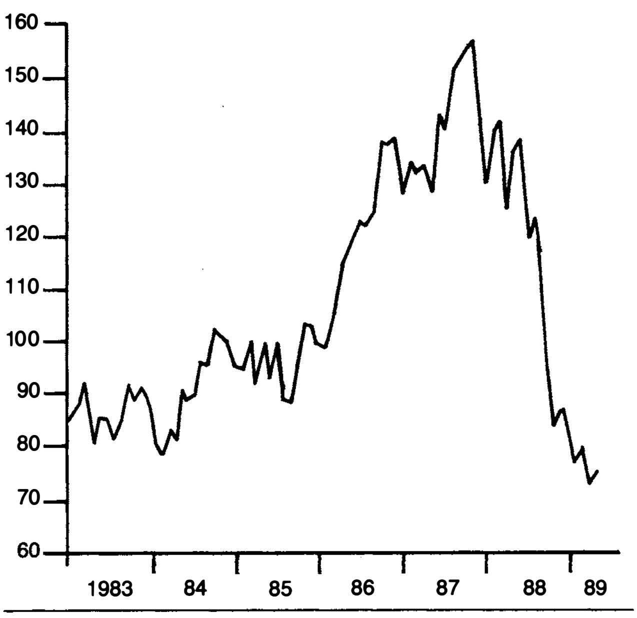
If García was induced to believe the myth that the cocaine trade was the key to Peru's economic survival, he was dead wrong. That myth is propounded in most "insider" articles about Peru's drug economy. For example, economist Guido Pennano wrote in Lima's *La República* on May 26, "Peru cannot, in the short term, do without the income from the drug traffic. It is against our interest to erradicate narcotics traffic."

The facts disprove this myth in pragmatic—as well as moral—terms. As *EIR* warned last year, opening up the economy for the free flow of dollars would *increase* capital drain from the country and would help destroy the value to the local currency. The facts prove 16th-century English economist Thomas Gresham's dictum: "Bad money drives out good."

Toward African levels

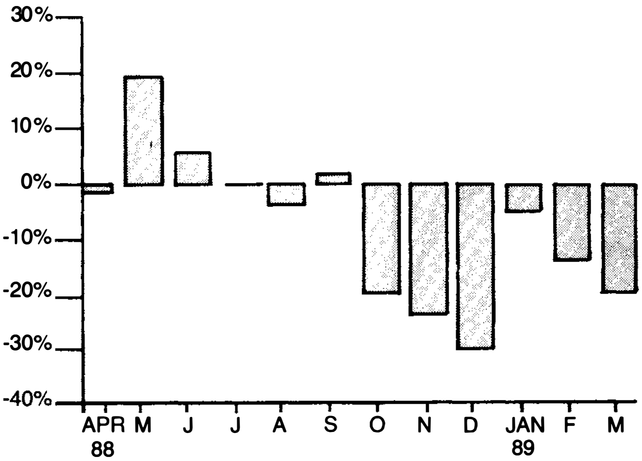
Graphs prepared by the Peruvian National Society of Industries show that Peru's industrial output rose dramatically during the period of García's intense confrontation with the international bankers, but went into free-fall shortly after he effectively allowed the "free market" to determine foreign exchange and foreign trade. **Figure 1** shows one of the world's most extreme boom and bust cycles: Industry thrived during 1986 and 1987, but collapsed in the middle of 1988, after the President turned toward "free market" economics.

FIGURE 1
Peru's industrial production 1983-89
1979=100



Source: The Peruvian Ministry of Industry, Commerce, Tourism and Integration Index. This is an index of physical volume, excluding fishmeal, petroleum, and derivatives.

FIGURE 2
Peru's industrial consumption of electricity, 1988-89



The bar shows the percentage of increase or decrease from the same month of the previous year.

Figure 2 also shows the dramatic turning point around July 1988, when industrial production turned from growth to collapse. If the absolute size of the decline on Figure 2 is slightly less, it is because this graph includes fishmeal production, which is up 48%; a certain amount of fixed electrical use by industry; and some increase in "off-the-books" production.

Did the legal banking system's opening its doors to laundering drug dollars increase its ability to provide credit to the economy? **Figure 3** shows bank credit contracting in real terms, to only about one-sixth of what it was a year ago.

That is not the whole picture. "There is a huge informal banking sector," a source close to the World Bank reports. These illegal money-laundering operations pay higher interest on deposits than the legal banks, and they charge higher interest. The National Industries Society reports the going rate for working capital is 35-40% monthly. With an estimated inflation of 29% in June, that means real interest rates of 6-11% monthly, or 100-250% annually. No legitimate business can operate long at such rates. Peru's nascent industrial capitalism has been strangled by the drug mafia.

The World Bank-linked source notes that the biggest of these "informal banks" is run by the oligarchic former owners

FIGURE 3
Bank credit to the private sector
in constant December 1980 intis

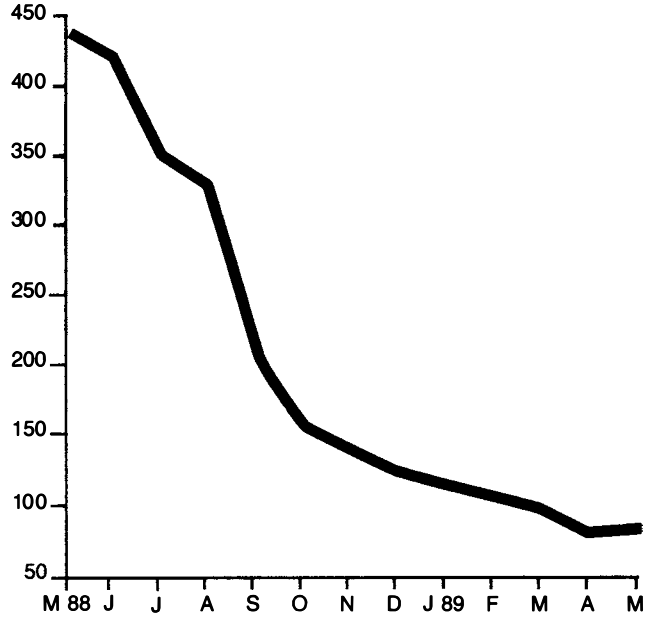
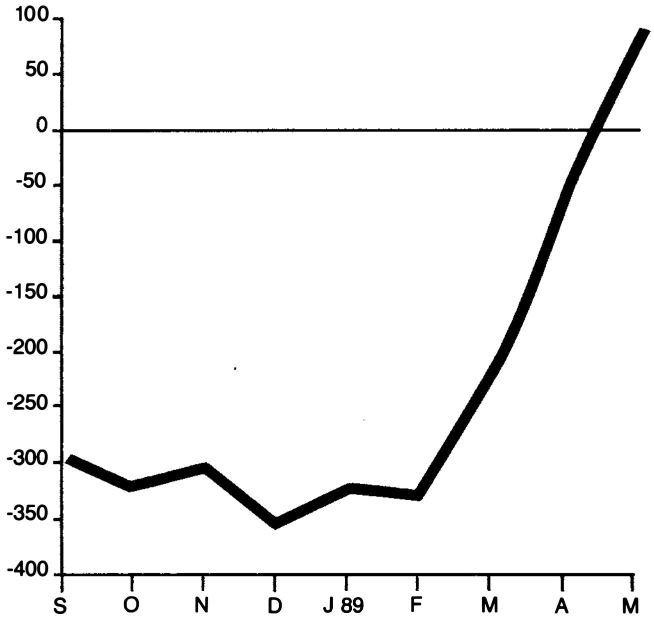


FIGURE 4
Net foreign reserves of Peru



The net cash position of the Peruvian Central Reserve Bank in millions of dollars. A negative figure means Peru foreign current liabilities are greater than its assets.

of Banco de Crédito, and is bigger than all but one of the legal banks. He says, "The government has no alternative" but to tolerate such totally unregulated money-laundering houses. This is "the vibrant Peruvian informal economy" which George Bush praised for its "heroism" last year.

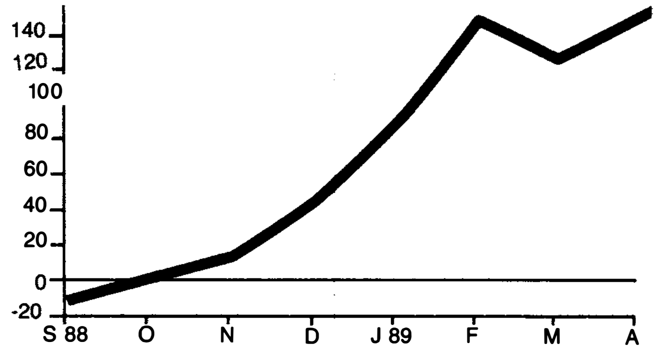
The World Bank projects a 15-20% decline in Gross Domestic Product this year. The source close to the bank laughed at García's July 28 assertion that "the worst difficulties have been overcome" and that "a growing reactivation of the economy is under way." There is nothing García can do to halt the collapse, the source stressed. "The country needs a new team and that's it." The new team is to be headed by the front-runner in the April 8, 1990 presidential elections, Mario Vargas Llosa, who "is willing to rejoin the international financial community." The source indicated that Vargas Llosa's election would be rewarded by an end to its loan embargo against Peru, even before Peru cleared up its arrears with the bank.

García fails to propitiate bankers

In the middle of last year, García foolishly decided to give priority to rebuilding his bridges to the international bankers. The size of Peru's dollar accounts abroad became the touchstone for economic policy. In those terms, he has been quite successful, as shown by **Figure 4.** Peru was roughly $300 million overdrawn on its accounts at the International Monetary Fund and foreign banks until March of this year, when the balance sprung up, going into positive numbers in May. García now says he will bequeath to his successor next year more than the $800 million gross reserves with which he entered office.

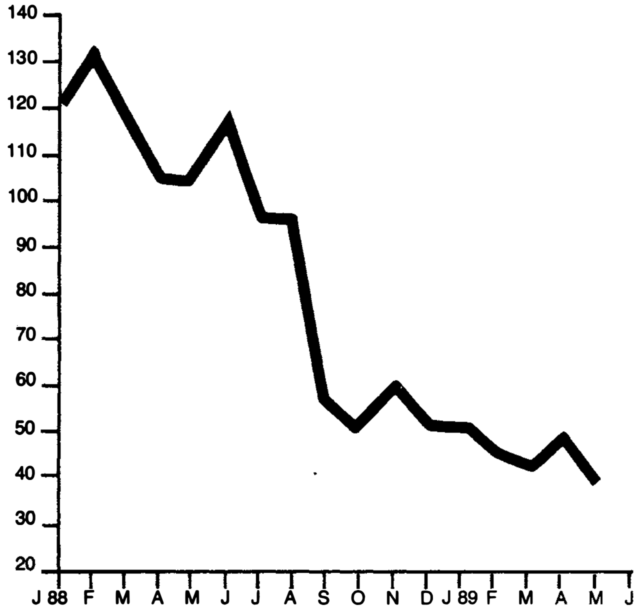
To build reserves, García sharply cut imports and increased exports. As shown in **Figure 5,** the trade balance turned from negative to increasingly positive. That was done through classic International Monetary Fund austerity polic-

FIGURE 5
Peru's monthly trade balance
September 1988-April 1989



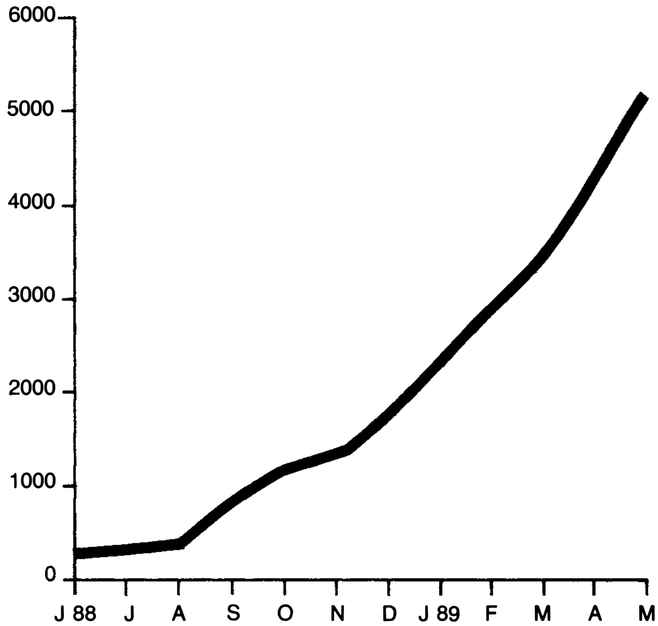
Monthly exports minus imports in millions of dollars.

FIGURE 6
Peru's retail sales, 1988–89
1980 = 100



The Ministry of Industry, Commerce, Tourism, and Integration's index of retail sales at the largest Lima stores, seasonally adjusted.

FIGURE 7
Inflation in Peru for the last 12 months
%



ies, although the IMF still will not give García the time of day, despite illusions he has nurtured since the beginning of 1989 that he could propitiate his way back into the "financial community."

The trade surplus was achieved by attacking the population's living standards, as measured by a 61.6% drop in retail sales (**Figure 6**). This was achieved through a series of economic "shocks" starting in September and November 1988. Each shock included a massive devaluation, major price increases on government services, and the elimination of food subsidies. Such radical austerity is the standard monetarist recipe for "fighting inflation." But, **Figure 7** shows how it was precisely such monetarism that sent Peru from inflation into economic implosion and hyperinflation. Prices can be expected to be 70 times higher on Dec. 31 than they were Jan. 1.

Anyone walking in the streets of Lima can see the anxiety written on the faces of workers whose wages remain frozen, while prices rise in tandem with the black market dollar.

Narco-economy ravages food supply

A decade ago, *EIR* published an issue headlined "The World Bank Pushes Drugs," in which various bankers were quoted saying that Bolivia, Colombia, and Peru could pay their debts by following their "natural" vocations and becoming vast cocaine plantations. That idea is shared by New York bankers and Soviet commissars. Their dream is coming true. The area planted in coca bushes in Peru has expanded from 160,000 hectares in 1985 to more than 200,000 hectares.

Most of the new coca plantings are on lands which previously produced food. Farmers are being forced from food into drugs by government austerity policies, since the government has cut agricultural credit by 66% in real terms. Parity prices are now gone. Fertilizer usage is down 24.3% since the shocks began in September. In the jungle area of San Martín, the cost of growing corn or rice soared to triple the price paid for it; farmers simply planted coca.

Also, the narco-terrorists have forced hundreds of thousands of peasants to abandon their fields and flee to the cities. They are systematically exterminating agricultural extension experts and anybody in rural areas who represents or supports the republic. Early this year, the Shining Path guerrillas moved into Lima's Andean garden, the fertile Mantaro Valley, and ordered peasants not to plant any food for the cities. In the semi-tropical Chanchamayo Valley east of the Andes, fruit trees and rice fields have been abandoned and replanted in coca. The collapsing productive economy has made millions of Peruvians willing to survive as slaves to the drug traffickers and willing to tolerate the increasing power of the narco-terrorist hordes.

Agriculture ministry figures indicate a 20% drop in domestic production. Food imports have been cut and food exports increased. Observers in Lima report that families are eating at least 40% less than last August. Meat has almost disappeared from middle-class tables. At a basic wage of $32 a month, workers can scarcely afford even rice and potatoes. The per capita food intake is far below the 2,500 calorie average which *EIR* calculated in 1985, and millions more have been thrown into concentration-camp nutrition levels. A study in March found 40-50% of children in the poor belt around Lima suffering chronic malnutrition. A few years ago, 90 out of each 1,000 children died in their first year. The death rate is probably over 120 now, worse than that recorded for Haiti.

This is the tragedy Citibank's John Reed enjoys, the horrible example Kissinger's friends are making of a debtor country which once tried to change their usury system.

Documentation

'We are almost hitting bottom'

The Economic and Social Studies Institute (IEES) of Peru's National Society of Industries produced a study for the monthly journal Industria Peruana, *published in the July issue. The cold figures and graphs show the stark reality of economic collapse. Excerpts follow:*

Production: National economic activity is submerged in deep recession. During this year's first quarter, the Gross Domestic Product fell 22%. *Industrial activity contracted 41.3%.* In both cases, this is in respect to the same period of 1988. Industrial production refers to the physical volume index of the Ministry of Industry, Commerce, Tourism, and Integration, which excludes fishmeal and petroleum derivates [emphasis added].

May's industrial activity level was below that of any month in 1983, a year of landslides in the center, floods in the north, and drought in the south. On the contrary, so far in 1988, we have not had these natural catastrophes.

The tendency for the next months, reflected in the moving average, the arithmetic average of the last 12 months' production index, is for a continued downward fall. However, although it is clear that production will decrease, the current rate of fall cannot be maintained much longer.

Current production levels are so low that we are almost hitting bottom, "dangerously close." So close, that many companies could be reaching the point of no return, which would be a generalized shutdown.

In many industrial sectors, capacity utilization levels have fallen dramatically. Production of radios and televisions, leather shoes, metal products, fertilizer and pesticides, and of cars and other vehicles, is practically paralyzed. It is estimated that in May, these sectors used the following levels of installed capacity: 7.0%, 9.7%, 11.0%, 12.7%, 13.5%

Unemployment: From August 1988 to March 1989, the central bank's industrial employment index fell 11.1%. The August 1988 index was already 8.7% below the January 1980 level.

The crisis which affects the industrial sector has had repercussions on the quantity of labor power utilized; small companies are the most affected. Employment indices from official sources, as well as those calculated by the IEES based on a survey, come up with a sharp contraction in the level of manpower utilization in the sector.

Heavy unemployment is also being generated in the commercial sector; 9.0% fewer people were employed in commerce in May than in the same month of the previous year. Temporary workers suffered the most. There were 19.5% fewer of them occupied in commerce in May than in April 1988.

Sales: The reduction in production directly originated in the fall in sales. Contraction in demand—an effect of the current hyperinflation—has brought stocked inventories of factories and of stores to above normal levels.

Retail sales have been falling continuously. The vice-minister of commerce indicated that in May of this year, *sales were 61.6% lower* than in the same month of the previous year [emphasis added].

The sector most affected was home appliances, whose sales fell 82.5% in May; even more, these sales were 86.3% less than those of 1980.

The sales which are falling the least are those of home furnishings and food. In May, they fell "only" 31.0% and 36.4% compared to the same month of 1988.

Food sales in the first five months of this year were 0.2% greater than those of 1980, while the Peruvian population has grown 26.0% in these nine years. Even worse is the case of clothing sales, which were 55.2% below 1980 during the first five months of this year. This clearly depicts the reduction of the quality of life of the inhabitants of our country. We are a badly fed and worse clothed country.

Parallel to the fall in total sales, sales on credit, which are traditionally low in our country, have almost disappeared. In May, only 4.2% of total sales were on credit. . . .

Inflation: . . . Annualized inflation (for the past 12 months) went from 356% in August 1988 to 817% in September 1988, reaching 6,126% in June of this year. Inflation has averaged 41.6% monthly during the first five months of 1989, given a 29% estimate for June. That is carrying the country toward an inflation of approximately 6,000% in 1989. This hyperinflation has eroded workers' incomes, decapitalized companies, whether in industry, trade, or any other productive activity, which is bringing a stagnation never before known in our country.