

PERU: POLITICAL SITUATION

In 1985, Alan Garcia Perez became President of Peru after receiving almost 50 percent of the popular vote; a record of popular support in Peruvian history. Garcia was 37 years old. His party, the American Popular Revolutionary Alliance (APRA) was swept to victory after 60 years of trying, also winning control of both houses of the Congress. The highly ideological party founded by Victor Raul Haya de la Torre follows a nationalist, "anti-imperialist" line that rejects Marxism-Leninism and argues for Latin American integration. APRA is internally autocratic and demands strict discipline from its members.

Garcia adopted highly nationalistic stances, especially with regards to limiting payments on its foreign debt, that appealed to the masses but carried unforeseen economic consequences. Garcia's popularity during his first two years in office started falling because of poor economic performance and the adoption of several measures, like the nationalization of the banking industry in 1987, that started eroding the confidence Peruvians had in Garcia's government. Since then, industrial production has dropped steadily (almost nine percent in 1988 and about 22 percent in the first six months of 1989). Inflation has skyrocketed. It was close to 2,000 percent last year and estimates for 1989 range from 8,000 to 20,000 percent.

Peru is gearing up for municipal elections in November 1989 and presidential elections in April 1990. The two principal political contenders are the Democratic Front (FREDEMO) and the United Left (IU). FREDEMO is a coalition formed by the Popular Action Party (AP), headed by former president Fernando Belaunde Terry, the Popular Christian Party (PPC) of Luis Bedoya Reyes, Solidarity and Democracy Party (SODE) of former multi-minister Javier Silva Ruete, the Independent Civic Union under Deputy Francisco Diez Canseco, and the Liberty Movement led by Mario Vargas Llosa. The Peruvian right and center-right had suffered a humiliating defeat in 1985 and had been inactive until public mobilization against the banking measure of 1987 revitalized the old parties and gave birth to the Liberty Movement. In June 1989, the FREDEMO started its official campaign for the presidency with Mario Varga Llosa leading the ticket. Eduardo Orrego from AP and Ernesto Alayza of the PPC will run as his first and second vice presidents, respectively.

PERU - Background

BACKGROUND NOTES - ECONOMIC SECTION

The Economy

After two years of rapid growth, Peru's economy entered a period of severe economic downturn in early 1988. The downturn has been accompanied by unprecedented levels of inflation, eroding the standard of living of the population and causing shortages, unemployment, labor strife, and considerable strain on the country's social framework. To make matters worse, the crisis is building at a time when Peru has little access to international credit as a result of three years of foregoing most payments on the country's \$16 billion in foreign debt. Inflation, recession, and shortages of consumer goods and foreign exchange are now expected to dominate the economic picture for most of 1989.

Peru's era of positive growth and moderate inflation during the 1950s and 1960s was followed by a period in the late 1970s of negative growth and declining terms of trade under two successive military governments. The Administration of former President Belaunde endeavored between 1980 and 1985 to rebuild a market economy by dismantling structural inefficiencies inherited from 12 years of military rule. Nonetheless, a swollen bureaucracy, ill-chosen and often non-productive investment projects, a heavy external debt burden, increasing budget deficits, and growing inflation kept this reformist government from meeting its goals. Popular dissatisfaction with the failure of the Belaunde presidency led to its replacement by the more interventionist and populist Garcia Administration in the 1985 elections.

Immediately upon assuming the Presidency, President Garcia sought to reactivate the stagnating economy by cutting inflation through strict controls on prices and non-essential government spending, while at the same time promoting consumption and increasing production through increased salaries and temporary work programs. He also announced that Peru would limit medium- and long-term external debt service payments to 10 percent of export revenues. These policies originally appeared successful: the economy grew by 8.5% in 1986 and 6.9% in 1987. The inflation rate, which had risen to some 250% on an annual basis during the last months of the Belaunde Government, dropped to 63% in 1986 before rising to 114% in 1987. Employment increased along with real incomes and profits as demand soared and manufacturers stepped up production at little additional cost because of existing idle capacity. The result was a surge in production of consumer goods and an increase in industrial activity overall. Construction activity also increased as higher family incomes found their way into new or improved housing.

domestic demand have varied widely. Government regulation, the growth of the public sector, and persistent inefficiency have kept production below potential, and output has dropped substantially since the onset of the economic downturn this year.

Mining and Petroleum

Peru's economy has traditionally been based largely on the nation's rich and varied mineral resources. Mining is still extremely important today both as a source of badly-needed foreign exchange and employment, particularly in the impoverished Andean highlands. The sector contributes approximately 10% of GDP and 50% of total export earnings. Peru is one of the world's leading producers of silver, lead, zinc, copper, gold and iron ore. Nonetheless, the mining sector has declined since 1986, when falling international prices for mineral products and hydrocarbons led to a drop in the sector's output. Labor unrest in the mines took a toll on production, and several small and medium sized mines closed. Metal prices improved in 1987, but the sector continued to confront serious internal problems: inflation, lack of foreign exchange for imports of necessary spare parts and supplies, terrorism, and the Government's exchange policies. This situation continues at present. In late 1988, while world mineral prices rose to record levels, Peru's mining workers staged two prolonged strikes. These strikes have robbed the country of \$400 million in foreign exchange earnings.

Peru was a net petroleum exporter from 1978 until 1987, when domestic consumption of artificially cheap gasoline outstripped production, which declined from 1986 through 1988. Much of the 1988 drop was caused by long delays in payment to petroleum producers by PetroPeru (the State petroleum enterprise), as well as problems with remittance of profits and obtaining imports necessary to the production process. Although the nation's crude oil reserves are not great -- only 500 to 550 million barrels -- Occidental Petroleum has made a number of important discoveries both in the eastern jungle and on the northern part of the continental shelf. Shell discovered a major gas deposit at Camisea in the eastern jungle, but the Government has so far been unable to conclude a contract with a firm for the field's development.

Fisheries

Before 1982, Peru was one of the world's largest fishmeal producers, but the climatic effects associated with the El Niño phenomenon resulted in the death of schools of fish or their movement far offshore or into deeper water. Overfishing has also had negative effects in some years. The sector began to recover in 1985, and during 1986 -- with the best catch in years -- grew by 25%. In 1987 and 1988, the sector has declined, constrained by the general economic downturn. Although it contributes only a small amount to total gross domestic product, Peru's

resulting from the country's unorthodox debt service policies, the current economic downturn and inflationary spiral, and the lack of a clear set of "rules of the game". Potential investors will also follow closely the Garcia administration's commitment to following through on its oral offer of compensation to the Enron Corporation and its insurers, AID, for the assets of Enron's Belco Oil subsidiary, which were taken over at the end of 1985. Finally, investment is also hindered by restrictive Peruvian labor laws, as well as national labor unrest.

The Outlook for the Future

The economy is likely to contract sharply in 1989, while inflation will continue to build in the absence of a comprehensive, coherent economic stabilization plan supported by the World Bank, IMF, and other members of the international financial community. Runaway inflation will severely test the socioeconomic fabric of the country. Falling production, combined with high population growth, will lead inevitably to much higher unemployment and underemployment rates and further drops in per capita real income -- already below that of any year since 1968. Shortages of food and other basic consumer goods are like to intensify, especially for the poorer urban residents. The lack of foreign exchange reserves, along with capital flight and absence of new external credits, will severely complicate the task of economic stabilization and eventual recovery.

January 1989

All phase one security goals and objectives, which include upgrades of existing facilities and barriers, have been met. PEAH construction equipment was transferred to Santa Lucia on June 30 and will be used to level ground for Porta Kamps, dig the moat, and construct the airstrip. PEAH staff has commenced construction of phase 2 goals and objectives which deal with the campsite security defensive system.

Despite high levels of violence directed against eradication workers, CORAH manually eradicated 1,285 hectares of coca and destroyed 5,603 square meters of coca seed beds from January to February 10, 1989. In 1988, CORAH manually eradicated 5,130 hectares of coca and destroyed 184,000 square meters of coca seed beds. Fifteen times as many hectares of coca and 23 times as many seed beds were destroyed in 1988 than in 1987. A significant part of the increase in eradication was due to the dedicated USG-provided helicopter support that could be supplied. The GOP formed a multi-disciplinary commission under the Ministry of Interior to continue the scientific evaluation of the coca herbicide tests being conducted in the UHV. The USG, through a private sector US company, is supporting GOP efforts to collect soil and water samples for analysis and to conduct inspections/evaluations for herbicidal efficacy at the test site used in March 1989. Up to now, results in developing an effective and safe herbicide have been encouraging.

2) INTERDICTION: Another key component of USG strategy in Peru includes interdiction operations. The USG, under the auspices of DEA, assist the Peruvian police in locating and destroying clandestine laboratories, airstrips and cocaine storage sites; interdicting the flow of drugs and essential chemicals, equipment and drug related money on the roads and water ways; and assist the police in developing information for the immobilization and prosecution of cocaine trafficking organizations operating in Peru.

The USG increased its support for enforcement efforts in 1988, expanding the INM airwing contingent in Peru to nine helicopters, while also expanding the force of DEA agents who assist the interdiction operations. The augmented airlift capability allowed more flying time to target clandestine laboratories and airstrips, as well as to conduct more operations against trafficker facilities. In 1989, the National Police (NP), in cooperation with DEA, seized (as of the February 10 stand down) a total of 744 kgs of cocaine base, 147 kgs of cocaine paste and 395 gallons of liquid sulfate and detected/destroyed one cocaine HCL lab, four cocaine base labs, 25 maceration pits and 17 decantation pits. In addition, a total of 9,230 gallons of liquid precursor chemicals were destroyed that consisted of acetone, ether, sulphuric acid, and ammonia. A total of 1,341 gallons of bulk dry precursor chemicals were destroyed that consisted of potassium permanganate, lime,

NARCOTICS ASSISTANCE UNIT (NAU) PROJECTS

The U.S. Department of State was assigned the primary responsibility for developing a U.S. International Narcotics Control Program in 1971. The Bureau of International Narcotics Matters (INM) was established under the direction of an Assistant Secretary in 1978 to strengthen the policy and management role of this program. The program is funded under annual appropriations of the Foreign Assistance Act. These funds are used to develop cooperative drug control programs in principal drug-producing or trafficking countries and to augment drug enforcement in those countries.

NAU is responsible for administering the funds provided by the U.S. Department of State for the joint drafting, organization, execution and implementation of bilateral agreements with its counterpart (the Peruvian Government) to suppress narcotics traffic. The Deputy Chief of Mission is in charge of overall narcotics coordination.

CORAH - National Police Central and High Huallaga: Coca Eradication Project and Anti-Narcotics Police have a camp in Santa Lucia (Uchiza) with personnel hired for eradication of coca crops and to run interdiction operations and provide security for eradication workers. Program uses C-123 aircraft and uses (as of Sept. 1, 1989) 9 UH-1H Huey Helicopters for police operations and logistical support. Equipment, vehicles, replacements, etc. are provided.

NAU also maintains the vessel Mariano de los Santos for river control, NAU is responsible for building quarters for GOP and U.S. field personnel and pilots. NAU is also responsible for security upgrades and airstrip construction at Santa Lucia.

Investigative Police (PIP): Responsible for follow-up of major traffickers and conducts traditional investigations, through the Sub-Directorate for Illicit Drug Traffic Investigation (S-DINTID).

Customs (Sub-Directorate of Customs Police):
Carries out control at border checkpoints, airports and ports throughout Peruvian territory, through the Narcotics Control Division.

OFECOD (Executive Drug Control Office): Responsible for supervising and controlling anti-narcotics agreements signed by the Peruvian Government, with the support of a Multisectoral Committee.

All these agencies have received:

- Vehicles and Vessels
- Communications Equipment
- Per-Diem Allowances
- Field Equipment
- Logistic Support

Total NAU budget for FY 89 is \$10.5 million.*

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