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## PERU AND THE U.S. BANKS: PRIVATIZATION OF FINANCIAL RELATIONS

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## Introduction

The dominant trend in U.S.-Latin American financial relations during the 1970's has been "privatization."[1] After 40 years of hovering in the wings, while bilateral and multilateral agencies took center stage, the private bankers have once again assumed the dominant role in providing funds to the governments of Latin America (and other Third World nations as well). These governments have borrowed large sums from the private capital market, and they have also begun to float bond issues in Europe and New York. At the same time, multilateral aid has risen only slowly, and U.S. bilateral aid has fallen off, so that private bank funding now constitutes over 50 percent of total development finance, more than twice as much as it did a decade ago. In addition, bilateral and multilateral funding agencies are bringing the private banks into their loan arrangements, so that public-sector loans themselves are being privatized.

This trend toward privatization in Latin American finance has been characterized by three main features. First, privatization has enabled the banks to maintain and even bolster their profits during the most serious global recession since the 1930's; this has occurred in spite of the so-called "country risk" problem. The banks are taking whatever steps they deem necessary in order to protect and extend these profits, including reliance on public institutions. Second, privatization, while certainly not eliminating its public-sector loan activity, has produced a shift in emphasis. Thus U.S. government agencies, the World Bank, the International Monetary Fund (IMF), and similar institutions now place more stress on supporting the private sector than on taking the lead in providing funds. When necessary, this includes support for the stability of the international financial system as a whole. Third, privatization, far from benefiting Latin American countries, has squeezed them--and especially their working classes--even more than before. Terms on the new private loans are more stringent than on loans from public institutions, and private lenders are less patient about repayment. The hope (or fear) present a few years ago--that governments would gain new leverage as a result of their indebtedness--is being proved a myth.

Of all Latin American countries, Peru exhibits these trends most clearly. There, in 1976, a consortium of six U.S. banks imposed conditions for the management of the economy and undertook to monitor their implementation. In return, the banks extended a $200 million loan to tide the beleaguered Peruvian government over a growing balance-of-payments crisis.

The following year, in response to widespread criticism, the banks retreated from such direct intervention and called in their ally, the International Monetary Fund. The policies the banks and the IMF imposed have left the Peruvian working class with only a fraction of its former purchasing power as the two sets of lenders--with the help of the Peruvian government itself--strive to make sure that Peru pays its debts.

Before turning to the Peruvian case, I want to present a more general historical analysis of the changing role of private banks in U.S.-Latin American financial relations. Once this is done, I will describe the economic policies of the current military regime in Peru, showing the buildup of the crisis that faced the country in mid-1976. The agreement with the banks will then be discussed, together with the effects of the banks' measures on Peru. One of those effects was the entry of the IMF into Peruvian policy-making in 1977, when the banks imposed this as a requirement for refinancing their loans. I will attempt to explain the bankers' decisions--why they moved in to monitor the Peruvian economy in 1976 and, equally important, why they then stepped back and called in the IMF in 1977. The final section offers some tentative conclusions on the meaning of the growing role of the private banks in Latin American finance--for the countries and for the banks themselves.

## The Role of Private Banks in U.S.-Latin American Financial Relations

It is useful to think of the history of U.S.-Latin American financial relations as divided into three periods: 1898-1945, 1945-70, and 1970 to the present. The 1898-1945 period was characterized by the dominant role of private U.S. bankers and the U.S. government, often acting in concert. In the postwar period, by contrast, the panorama became much more complex as the financial actors multiplied. The private bankers mainly retired from the field, to be replaced by the International Monetary Fund, the World Bank, the Inter-American Development Bank, the Export-Import Bank, and U.S. aid agencies. A division of labor between the various institutions was gradually worked out, as we will see below. In the 1970's, this division of labor has begun to break down as the private banks have again assumed a more important position. Although in some ways the new situation appears to be a throwback to that in the period before the Second World War, in reality it is quite different--as befits the much more complex international context.

## The 1898-1945 Period

Before the twentieth century, financial activities in Latin America were predominantly the affair of European banks, especially those of England. The United States was a net importer of capital, mainly concerned with developing its own territory. The turning point was the Spanish-American War. With U.S. acquisition of control over Cuba in 1898, and with the further maneuvers to secure territory for building an interocean canal in 1903, the attention of banks in the United States began to be directed toward the south.

The main activity during the 1898-1945 period was the floating of bonds for Latin American governments by major U.S. banking houses.[2]

Between 1898 and 1914, Latin American securities sold in the United States amounted to $236 million; the outstanding value as of December 31, 1914, was approximately $156 million. Between 1915 and 1935, such sales increased more than tenfold to $2,672 million--$674 million in short-term and $1,998 million in long-term securities. Outstanding value as of December 31, 1935, was $1,622 million.[3] Lending was slow until the First World War, but afterwards the pace picked up rapidly as New York became the world's principal financial center. By the mid-1920's, agents for major U.S. banks were out scouring the world for prospective customers, often convincing foreign governments to take loans in excess of their needs and funding borrowers who were poor risks. At one point, for example, there were 29 representatives of U.S. banks in Colombia alone trying to negotiate loans with public and private entities. This led the commercial attaché in Bogotá to write to the Department of Commerce: "I think Colombia is going wild on borrowing. She has started too many railroads and too many highways, and she has not any idea where she is going to get all the money, except that the money is coming in so readily now that she just thinks she can borrow ad infinitum."[4] By the early 1930's, however, the bubble had burst in Latin America as in the rest of the world. Bolivia defaulted on her loans in December 1930, and she was followed by Peru, Chile, and Brazil in 1931, and by Uruguay, Colombia, and various Central American countries in 1932. By the end of 1933, almost every Latin American country was in default except Argentina and Haiti. Thus ended Latin America's access to private capital markets for almost four decades.

It is necessary to look at the stories behind these loans to understand the nature of the relationship between bankers and client governments and also the relationship between the banks and the U.S. government. Apart from the last half of the 1920's, when a borrower's market existed, conditions imposed were harsh--frequently to the point of impinging on the sovereignty of the borrowing countries. The collaboration between banks and the U.S. government was often a key factor in these operations.

One example was the Dominican Republic.[5] In 1907, the U.S. Senate approved a treaty between the two countries that provided (1) for the issuance of $20 million in bonds to pay the Dominican Republic's public debt (the loan was handled by Kuhn, Loeb & Co.), and (2) for the collection of the Dominican Republic's customs revenues by a U.S. government appointee in order to insure the servicing and repayment of the loan. Following up on these financial manipulations by President Roosevelt, his successors (Taft and Wilson) ordered direct military intervention to protect American financial and "security" interests. In 1911, Taft sent two special commissioners and 750 marines to investigate the assassination of the Dominican president and the establishment of a provisional government. At the "suggestion" of the commissioners, the provisional president resigned. This intervention by the United States led to further revolutionary outbursts over the next five years and further U.S. gunboat diplomacy. Finally, in 1916, the marines landed and established a military dictatorship. The Dominican Congress was dissolved, Dominican officials were ousted, and a rear-admiral of the U.S. Navy became military governor.

Repression was the order of the day in political terms, while the military government floated bonds through U.S. bankers in the name of the

Dominican Republic. In 1921, Speyer & Co. and Equitable Trust Co. of New York handled a $2.5 million bond issue; in 1922, Lee, Higginson & Co. handled one for $6.7 million. A circular issued in connection with the former said that the bonds would contain the following clause:

> With the consent of the United States there is secured the acceptance of and validation of this bond issue by any government of the Dominican Republic as a legal, binding, and irrevocable obligation of the Dominican Republic, and the duties of the General Receiver of Dominican Customs as provided in American-Dominican Convention of 1907, are extended to this bond issue. . . . Until all these bonds shall have been redeemed, the Dominican Republic agrees not to increase its debt, nor to modify its customs duties, without the previous consent of the United States Government; and its customs revenues shall continue to be collected by a General Receiver of Customs appointed by and responsible to the President of the United States.[6]

The military dictatorship ended in 1924, when the Dominicans agreed to ratify a treaty providing for U.S. control of customs, treasury, army, and police. Similar events occurred in other Central American republics.

Another example shows that the bankers did not always need government help to impose harsh conditions on desperate Latin American governments.[7] In 1921, the Bolivian government was in serious need of money to refund its foreign debt and develop its railroad system. Therefore it took a six-month $1,000,000 loan from a St. Louis banking house called Stifel-Nicolaus. Rather than pay a stiff $90,000 commission, the government agreed to give Stifel-Nicolaus a preferential option on any external loans taken over the next three years. Because of the option, Bolivia was unable to seek the best terms for a longer term refunding loan in 1922; instead, Stifel-Nicolaus provided a $ 33 million loan--far in excess of the government's desires. The security for the bonds covered over half the national income in 1922 and almost two-thirds of it by 1925. Included were the entire customs receipts and certain indirect taxes (on alcohol and tobacco) and direct taxes (on net profits of mining and of corporations, and on net income of banks). In addition, the government's (majority) shares in the National Bank and in an as-yet-unconstructed railroad were mortgaged. To insure the collection of taxes, and thus the servicing of the debt, the loan terms stated that a three-member Permanent Fiscal Commission must be appointed (two members nominated by the bankers) to be in charge of tax collection over the 25-year period of the loan. The Commission had the power to supervise tax collection on both the national and the departmental levels and to revise the national accounts. One of the bankers' representatives was named chairman of the Commission, Inspector-General of Banks and Monopolies, and a director of the Bolivian National Bank. The other banker member was made Director-General of Customs.

Virtually no new Latin American bonds were floated in the United States between 1930 and the 1960's, and the nominal value of externally held government debt was substantially reduced in many countries. Already by 1945, a large portion of Latin American bonds had been repurchased by

individuals and Latin American governments. Further reduction came from normal amortization and from the direct scaling down of the nominal value of foreign-held bonds, especially by Brazil and Mexico. In Brazil, the principal of many bonds was reduced by 20 to 50 percent; in Mexico a debt resettlement plan lowered the nominal value of debt by 80 percent.[8]

The banks' experience with Latin American debt was reflected in regulations imposed by the United States and many European countries on the further purchase of Latin American bonds. Barriers to entry were of four main kinds: (1) regulations relating to the balance of payments; (2) the necessity of obtaining permission from national authorities (especially in Europe and Japan); (3) information-disclosure requests that increased costs; and (4) restrictions on the buying institutions (in many U.S. states and in almost all European countries, banks, insurance companies, and pension funds are prohibited from or strictly limited in buying Third World issues). In the United States, many of these barriers are informal, involving the complex regulatory apparatus of the Securities and Exchange Commission and of the individual states, which make the securities market too costly for most Latin American issues. Such regulations are as effective as the more stringent legal limitations in European countries, substantially if not entirely closing the U.S. market to Third World securities, whether debt or equity.[9]

The 1945-70 Period

As the private banks and other purchasers of Latin American securities retired from the financial arena, their place was taken by international institutions and U.S. government agencies. The immediate aftermath of the Second World War saw the creation of the Bretton Woods twins--the International Monetary Fund and the World Bank. The purpose of these institutions was mainly to revive international trade among the developed nations, and specifically to rehabilitate Western Europe. It was only later that the Latin American countries began to participate in this international network.

In Latin America, the IMF has become the kingpin around which other multilateral, and even bilateral, economic agencies function.[10] The Fund itself gives short-term (three- to five-year) loans, for the specific purpose of alleviating balance-of-payments difficulties. The size of the loan is directly related to a country's quota in the Fund. The first 25 percent of the quota--the so-called gold tranche--can be drawn almost automatically. Succeeding tranches carry greater restrictions, in the sense that the Fund can and does prescribe policy changes (embodied in a Letter of Intent) that must be made before a tranche is released. The nature of the prescriptions tends to be highly deflationary: wage cuts, budget cuts, and devaluations usually form the heart of the recommendations. In addition, the IMF "seal of approval" is usually required by other agencies before they will consider giving loans to the country concerned. It is in this sense that the Fund constitutes the center of financial operations.

The World Bank is composed of several parts, the most important of which are the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA).[11] The IBRD,

which was formed at the same time as the IMF, makes long-term loans (15-25 years) at commercial rates (6.5 percent in the late 1960's, now about 9 percent). Most loans are for specific projects, especially economic infrastructure, although about 10 percent of World Bank loans through 1970 were more general program loans. In 1962, the IDA was formed to make development loans on soft terms. IDA loans are for 50 years and carry a 0.75 percent service charge. Both types of World Bank loans are for similar uses, with the decision on whether a loan should come from the IBRD or the IDA based on a country's ability to service debts. This has meant that the vast majority of IDA money has gone to Africa and Asia, and that little has been left for Latin America. Total World Bank loans to Latin America through 1970 were $4,495 million, with $4,352 million from the IBRD and only $143 million from the IDA (see Table 1).

TABLE 1

FLOW OF BILATERAL AND MULTILATERAL FINANCIAL CAPITAL TO LATIN AMERICA, 1945-77
(Millions of U.S. $)

| | 1945-60 | 1961-70 | 1971-77 |
|---|---|---|---|
| World Bank | 1,053 | 3,442 | 7,941 |
| IBRD | 1,053 | 3,299 | 7,698 |
| IDA | — | 143 | 243 |
| Inter-American Development Bank | -- | 4,069 | 7,942 |
| Export-Import Bank[a] | 2,925 | 1,695 | 3,150 |
| Agency for International Development | 1,829 | 8,754 | 4,044 |
| Private capital | | | 37,363 |
| Bond issues | n.a. | 1,284 | 4,293 |
| Euroloans | -- | n.a. | 33,070 |

SOURCES: World Bank--World Bank, Annual Reports; Inter-American Development Bank--Inter-American Development Bank, Annual Reports; Export-Import Bank and Agency for International Development--AID, U.S. Overseas Loans and Grants; Bond Issues--U.N., External Financing of Economic Development, International Flow of Long-term Capital, 1962-66, and World Bank, Annual Reports; Euroloans--World Bank, Borrowing in International Capital Markets.

[a]Credits only, excludes insurance and guarantees.

The Inter-American Development Bank (IDB) began operations in 1961.[12] Its structure is quite similar to that of the World Bank, giving hard and soft loans, both long term. Originally the sectoral distribution of loans in the two banks was different, with the IBRD concentrating on infrastructure and the IDB more involved in the productive sectors, especially agriculture; but both have now developed

a more even spread of loans across sectors. Remaining differences are that about one quarter of IDB loans are to the private sector, whereas IBRD/IDA loans are to governments or governmental agencies, and that the Latin American countries have a majority of votes in the IDB. Structural changes in the IDB, however, as well as the operation of the "soft loan window," need a two-thirds majority, thus giving the United States a veto.[13] Total IDB loans through 1970 were $4,069 million (see Table 1).

The other main participants in Latin American financial relations in the 1945-70 period were two sets of U.S. government agencies: the Export-Import Bank, and the various aid agencies. The Eximbank was formally created in 1934 but it did very little business in Latin America until after the war.[14] Although often considered part of the U.S. aid apparatus, the Eximbank is actually designed to increase the export business of U.S. firms by providing lines of credit and insurance for U.S. exporters. Several kinds of assistance are available: (1) credits (especially long-term) provided to the buyers of U.S. goods so that they can make purchases; (2) insurance (especially short-term) provided to U.S. exporters to cover commercial and/or political risks; and (3) guarantees provided to private banks to insure goods being shipped by U.S. exporters. Total Eximbank authorizations affecting Latin America in all forms through 1970 amounted to $10,429 million; this was divided into credits of $7,052 million, insurance of $2,299 million, and guarantees of $1,078 million.[15]

The final actor that played an important role in providing financial capital to Latin America was the U.S. aid agencies.[16] The aid office was reorganized--and renamed--at various times during the postwar period, with the designation Agency for International Development being adopted in 1961. During the 1960's, AID was the most overtly political of the agencies we have discussed. It openly discussed its attempts to influence the overall economic policies of Latin American countries, and a large portion of its funds were distributed because the U.S. government had decided to support a given country, regardless of specific projects presented for AID loans. In addition to project loans, AID established several program loans in Latin America during the 19t0's (to Brazil, Chile, and Colombia); these loans had general macroeconomic conditions that were similar to those stipulated by the IMF and that were also spelled out in a Letter of Intent. Because of AID's openly political criteria, it worked fairly independently of the other aid agencies--though general lines of agreement were maintained. Loans--generally long-term and with low interest rates--were often tied to purchases of U.S. goods, so that in this sense AID was similar to the Eximbank in providing business for U.S. exporters. AID (and its predecessor agencies) made loans and grants to Latin America totaling $10,582 million through 1970 (see Table 1).

During the 1960's, private bankers again began to play a role, though not a very large one. As mentioned previously, both formal and informal restrictions in the United States and other major capital markets prevented most Latin American countries from floating bonds. Nevertheless, certain nations managed to overcome these difficulties. Mexico, especially, was a heavy borrower in the U.S. bond market during the entire decade of the 1960's, floating $383 million worth of bonds. Argentina was second with $107 million, all borrowed between 1955 and 1970. Other Latin American countries that floated securities in New York during the 1960's

included Panama ($52 million), Venezuela ($35 million), Peru ($15 million), Colombia ($4 million), Nicaragua ($2.5 million), Brazil ($800,000), and the Dominican Republic ($200,000).[17]

During the latter half of the decade there was a strong switch away from New York toward the newly developed Eurobond market, where restrictions were minimal. Thus between 1966 and 1970, only 37 percent of all bonds floated by Latin American countries were in New York. The total amount of bonds floated in New York during the decade was $603 million, whereas the total in Europe was $646 million.[18] In addition to floating bonds, Latin American countries also began to take advantage of short-term loans in the Eurodollar market, though the amounts involved are unclear since systematic statistics date only from the 1970's. (See Table 2.)

TABLE 2

PRIVATE CAPITAL FLOWS TO LATIN AMERICA, 1971-77 (Millions of U.S. $)

| Year | Loans | Bonds | Total |
|---|---|---|---|
| 1971 | 506 | 79 | 585 |
| 1972 | 1,889 | 377 | 2,266 |
| 1973 | 3,386 | 315 | 3,701 |
| 1974 | 4,374 | 95 | 4,469 |
| 1975 | 5,715 | 375 | 6,090 |
| 1976 | 8,391 | 635 | 9,026 |
| 1977 | 8,809 | 2,417 | 11,226 |

SOURCE: World Bank, Borrowing in International Capital Markets, and Morgan Guaranty Trust, World Financial Markets.

Thus in theory there were a variety of different institutions involved in providing financial resources to Latin America during the 25 years after the Second World War, with each performing a different function in the process. The World Bank provided long-term development loans for specific development projects, with the IBRD lending at close to commercial conditions and the IDA lending on concessional terms. The IDB played a role similar to that of the World Bank, with both commercial and concessional loans. The Eximbank provided trade credits to highly solvent clients, and IAD and its predecessor agencies provided soft loans and some grants to a broad range of countries, rich and poor, mainly selected on political criteria. The private sector provided long-term financing through bonds and short-term loans to highly reputable clients. The IMF, meanwhile, provided short-term balance-of-payments financing as well as the general seal of approval required before many other organizations would lend. In practice, of course, this clear-cut picture became much fuzzier as various institutions began to assume functions that had originally been "assigned" to others. Nevertheless, some semblance of a division of labor could be observed.

## The 1970's

The last half of the 1960's began to foreshadow new trends in U.S.-Latin American financial relations; privatization began with the reemergence of the private banks, mainly working through the Euromarket. The Euromarket consists of two sectors--the Eurocurrency market and the Eurobond market. It is these private markets that have dominated the current decade, while bilateral and multilateral forms of assistance have diminished in relative importance.

The Eurocurrency market consists of a group of banks operating in London and other financial centers that takes deposits and makes loans in currencies other than those of the local economy. Most deposits and loans are denominated in dollars--hence the shorthand term "Eurodollars." The dominance of U.S. currency is paralleled by the dominance of U.S. banks. The market originated in the late 1950's, although the exact cause is a subject of debate.[19] Whatever its origins, however, it has flourished because it has been able to pay higher rates for deposits and charge lower rates for loans than its domestic competitors in Europe and the United States.

Smaller margins exist for various reasons. First, because the Euromarket is a wholesale market, with the minimum size of transactions generally $1 million, economies of scale mean lower unit costs. Second, there is greater competition in the Euromarket than there is among domestic banks, which tend to be oligopolists. Third, restrictions that hobble the domestic banks are lacking in the Euromarket. On the supply side, the lack of reserve requirements means that Euromarket banks can lend out a greater percentage of their deposits than can domestic banks. In addition, regulations in domestic markets--the best known of which is U.S. Regulation Q, which places a ceiling on the interest rates U.S. banks can pay on time deposits--have led them to have a smaller supply of money available to be lent out. Similarly, U.S. banks cannot pay interest on deposits of less than 30 days' maturity. On the demand side, U.S. regulations have also helped the growth of the Euromarket; for example, the Interest Equalization Tax, which existed from 1963 to 1974 effectively closed the New York market to foreign borrowers. Moreover, the Voluntary Foreign Credit Restraint program (1965-68) and the mandatory controls on capital export (1968-74) meant that U.S. corporations wanting to invest abroad had to secure capital outside the United States.

In their early phase (i.e., in the 1960's), Eurodollar loans were almost exclusively short-term credits, primarily working capital for U.S. and European multinationals. The risk on this type of loan was minute. During the 1970's, however, the pattern changed substantially. Comparisons are difficult because of the lack of data before 1971, but in that year 24 percent of publicized Eurocurrency loans went to Third World countries; such loans increased to 36 percent in 1972 and 1973. In 1974 there was a dip as advanced countries took out huge loans to finance balance-of-payments deficits caused by the increase in oil prices, but by 1975 a majority of all loans were going to Third World countries. Loans to Latin America as a percentage of all Third World loans ranged from 34 percent in 1971 to 47 percent in 1975.[20]

Other changes accompanied the new geographical distribution of loans. Third World countries wanted credits for financing development projects, so these had to be medium- or long-term loans rather than short-term ones. More recently, Third World countries have been borrowing to meet balance-of-payments deficits and to refinance old loans. The net result has been that commercial loans, which were typically for one year or less in the 1960's, have often been made for 8-10 years in the 1970's. Every six months, however, the interest rate can be revised.

Interest rates are calculated as a percentage above the London Inter-Bank Offer Rate (LIBOR), with this spread varying according to the availability of money, the competition between banks, and the creditworthiness of the borrower. Thus in times of abundant liquidity a highly creditworthy borrower can get a loan at 0.5 percent above LIBOR, whereas in tighter periods a less creditworthy borrower may have to pay 2.5 percent. Management fees are in addition to interest rates.

The other sector of the Euromarket--the Eurobond market--is of more recent origin than the Eurocurrency market, having been an important force in supplying funds only since about 1968. Only during the last three years have bonds begun to match loans in amounts of money provided. For Third World countries, however, bonds are still of minor importance as a source of capital. During the 1975-77 period, funds raised in the Eurobond market as a whole were 48 percent of total funds, whereas for Third World countries the figure was only seven percent.[21] The main difference between Euroloans and bonds, in terms of the mechanics involved, is that the latter are long-term debt instruments with fixed interest rates in contrast to the former, which are medium-term, floating-rate credits.

Why the sudden importance of Third World countries to the Euromarket? In part, the demand for loans increased, but more important was the impetus from the supply side. Loan demand in the United States and Europe fell off in the early 1970's, meaning that the banks had excess liquidity. This problem was greatly exacerbated after the 1973 oil price hike as (1) recession hit the advanced capitalist world, further dampening loan demand (after a spurt in 1974 to finance transitory balance-of-payments deficits), and (2) the OPEC countries deposited the majority of their new revenues in U.S. banks.

Faced with a potential falling rate of profit if they could not loan out this money at an adequate interest rate, the banks turned to a new set of clients: a small group of Third World countries whose export possibilities were considered sufficiently good that obtaining foreign exchange to repay the loans was not felt to be a major problem. (In practice, of course, this did not always turn out to be true.) The narrow range of the group is indicated by the fact that Brazil and Mexico account for almost half of all Euroloans to the non-OPEC Third World. Fewer than a dozen other countries make up the bulk of the remaining half: Argentina, Chile, Hong Kong, the Ivory Coast, Malaysia, Morocco, the Philippines, South Korea, and Taiwan.

The desire for profits also led to another important characteristic of the Euromarkets. Politics is less of a deterrent to obtaining money there than is the case with the bilateral and multilateral agencies. Thus

Cuba and the socialist countries of Eastern Europe have borrowed considerable sums on the Euromarket in recent years; Vietnam and North Korea obtained smaller amounts; and Peru resorted to the Euromarket when the United States imposed a credit blocakde in 1968-74. In addition, the private bankers have placed fewer restrictions on the use of their loans than have official agencies.

The result of this splurge of borrowing has been that the countries involved have piled up huge debts that they may not be able to handle. For the non-oil exporters among those Third World countries that have borrowed heavily on the Euromarket, debt service ratios (interest plus amortization payments divided by exports) for public-sector debt alone often approach 20 percent or more.[22] Special problems may occur at the very end of the 1970's, since repayments are bunched in this period. Bankers deny that they are overextended in terms of Third World loans, but it is clear that many would like help from public-sector instistutions in managing problem loans.

One type of public-private cooperation is the introduction of "co-financing." Co-financing refers to loans jointly arranged by a bilateral or multilateral agency and one or more private banks. In effect, the official agency assumes the risk of the loan in return for greater participation of private funds in Third World financing. Co-financing was first introduced by the Export-Import Bank in 1970. Thus Eximbank often no longer provides 100 percent of the credit for export financing, but divides the package between itself and the private banks. In addition, for a small fee, the Eximbank provides a financial guarantee that covers all commercial and political risks and that assures full repayment of principal plus most interest payments.

In 1976, the co-financing was extended to the World Bank. The first situation involved a $150 million loan to a Brazilian steel company arranged by the Bank of America and involving a syndicate of 16 commercial banks. According to the New York Times, "The World Bank will be the channel for the payments on the loan, and a default to the private creditor will be considered a default on the Bank, one of the best possible guarantees for the private loan."[23] More recently, calls have also been made from various sources for co-financing operations between the International Monetary Fund and the private banks.[24]

Thus it is obvious that the private banks have been expanding into the various activities formerly considered the "turf" of other institutions. They have moved into medium-term project loans, formerly handled by the IBRD and the IDB. They have joined the Eximbank in financing large U.S. export deals. And they have been giving balance-of-payments loans, an area that used to be the IMF's exclusive domain. The climax of this trend was the 1976 Peruvian loan, when the banks took over the IMF's other traditional role of setting macroeconomic conditions for a loan and monitoring the economy to assure compliance. It is to this case that we now turn.

## The U.S. Banks in Peru

Background: 1968-75.--In October 1968, General Juan Velasco Alvarado led a coup that overthrew the civilian government of Fernando Belaúnde Terry. The subsequent military government broke with the tradition of military governments in Latin America in that it did not support the established socioeconomic structure, but rather proposed to radically restructure Peruvian society.

Under an ideology that promised a "third way" between capitalism and communism, the new government undertook (1) an extensive agrarian reform centering on the creation of cooperatives, (2) an industrial and mining reform introducing worker participation and profit-sharing (the communidades industriales and mineras), and (3) the nationalization of some key foreign firms, including branches of Standard Oil, ITT, W.R. Grace, Cerro, and Chase Manhattan. The government was not opposed to foreign capital, but it did want to change the nature of foreign investment. On the one hand, it wanted to decide what types of investment were desirable; on the other hand, since it planned to have the state itself become the principal investor, it was interested in attracting foreign loans more than direct investment.

Despite the redistributive rhetoric, the reforms actually benefited only a small part of the population: recipients of land, workers in those production units where the comunidades were actually introduced, and elements of a domestic industrial bourgeoisie that was fostered by the military as another part of its strategy. Even these groups did not wholeheartedly support the military government, which was thus unable to consolidate a strong political base. The government's program remained very much a "revolution from above," or perhaps more accurately an attempt at modernization from above.[25]

During the regime's first five years, despite the changes going on and the lack of political support, the Velasco government managed to maintain a "health" economy in terms of traditional economic indicators. Growth in Gross Domestic Product between 1969 and 1973 averaged 5.5 percent, while that in industry averaged 7.1 percent. Unemployment fell from 5.9 percent in 1969 to 4.2 percent in 1973. Real wages and salaries both increased by an average of 6.6 percent, while inflation was held to an average of 7.2 percent. The trade balance was positive, and the service balance, though it generally dragged the current account into deficit did not create any serious problems with financing. Net reserves, in fact, increased from almost $131 million in 1968 to almost $411 million in 1973. (See Tables 3-9.)

TABLE 3

GROWTH RATES OF THE PERUVIAN ECONOMY, 1969-77

| Year | GDP | Industry | Agriculture |
|---|---|---|---|
| 1969 | 2.3% | 0.5% | 5.5% |
| 1970 | 7.7 | 11.4 | 5.8 |
| 1971 | 5.9 | 8.7 | 2.2 |
| 1972 | 5.8 | 7.3 | 0.8 |
| 1973 | 6.2 | 7.4 | 2.4 |
| 1974 | 6.9 | 7.5 | 2.4 |
| 1975 | 3.5 | 5.0 | 1.0 |
| 1976 | 2.8 | 2.9 | 3.3 |
| 1977 | 0.3 | -1.4 | 0.3 |

SOURCE: Banco Central de Reserva

TABLE 4

INFLATION RATES IN PERU, 1969-77

| Year | Lima Cost of Living | GDP Deflator |
|---|---|---|
| 1969 | 4.6% | 7.9% |
| 1970 | 5.1 | 6.8 |
| 1971 | 6.8 | 3.7 |
| 1972 | 7.2 | 6.0 |
| 1973 | 9.5 | 17.7 |
| 1974 | 16.9 | 14.4 |
| 1975 | 23.6 | 17.8 |
| 1976 | 33.5 | 37.4 |
| 1977 | 40.0 | 38.6 |

SOURCE: Banco Central de Reserva

TABLE 5

UNEMPLOYMENT AND UNDEREMPLOYMENT IN PERU, 1969-77

| Year | Unemployment | Underemployment |
|---|---|---|
| 1969 | 5.9% | 46.1% |
| 1970 | 4.7 | 46.0 |
| 1971 | 4.4 | 44.4 |
| 1972 | 4.2 | 44.2 |
| 1973 | 4.2 | 41.3 |
| 1974 | 4.0 | 41.9 |
| 1975 | 5.2 | 40.7 |
| 1976 | 5.3 | 44.7 |
| 1977 | | |

SOURCES: Banco Central de Reserva and Caretas, Apr. 5, 1977.

TABLE 6

WAGE AND SALARY INDEX FOR LIMA, 1968-77

| Year | Wages | Salaries |
|---|---|---|
| 1968 | 100 | 100 |
| 1969 | 103 | 114 |
| 1970 | 101 | 115 |
| 1971 | 112 | 122 |
| 1972 | 122 | 126 |
| 1973 | 133 | 133 |
| 1974 | 126 | 122 |
| 1975 | 126 | 122 |
| 1976 | 106 | 95 |
| 1977 | 85 | 76 |

SOURCES: OAS, "Study on Remunerations in Peru," as cited in Caretas, Apr. 5, 1977; and U.S. State Department, Foreign Economic Trends and Their Implications for the United States: Peru.

TABLE 7

PUBLIC SECTOR CAPITAL FORMATION IN PERU, 1968-77
(Millions of 1970 soles)

| Year | Central and Local Government | Public Enterprises | Total |
|---|---|---|---|
| 1968 | 3,516 | 4,106 | 7,622 |
| 1969 | 4,014 | 5,038 | 9,072 |
| 1970 | 6,427 | 4,470 | 10,897 |
| 1971 | 7,927 | 4,654 | 12,581 |
| 1972 | 8,236 | 5,438 | 13,674 |
| 1973 | 7,154 | 8,976 | 16,130 |
| 1974 | 9,599 | 15,730 | 25,239 |
| 1975 | 9,636 | 20,024 | 29,660 |
| 1976 | n.a. | n.a. | 26,740 |
| 1977 | n.a. | n.a. | 21,567 |

SOURCE: Banco Central de Reserva.

TABLE 8

PERUVIAN CENTRAL GOVERNMENT ACCOUNTS, 1968-77
(Millions of Soles)



| | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977[b] |
|---|---|---|---|---|---|---|---|---|---|---|
| Current Income | 30,206 | 33,952 | 38,844 | 41,382 | 45,636 | 53,363 | 68,560 | 87,896 | 111,397 | 152,000 |
| Current Expenditure | 27,218 | 27,949 | 32,361 | 37,071 | 42,333 | 51,995 | 62,444 | 90,507 | 122,718 | 180,600 |
| Saving on Current Account | 2,988 | 6,003 | 6,483 | 4,365 | 3,303 | 1,368 | 6,116 | -2,611 | -11,321 | -28,600 |
| Capital Expenditure[a] | 6,087 | 6,385 | 10,093 | 12,468 | 14,134 | 15,416 | 20,206 | 27,452 | 37,111 | 42,400 |
| Deficit | -3,099 | -382 | -3,610 | -8,103 | -10,831 | -14,048 | -14,090 | -30,591 | -48,432 | -71,000 |
| Financing | 3,099 | 382 | 3,610 | 8,103 | 10,831 | 14,048 | 14,090 | 30,591 | 48,432 | 71,000 |
| External-Net | 1,300 | -1,241 | 2,630 | 9,070 | 8,976 | 7,151 | 3,342 | 13,778 | 32,796 | 49,600 |
| Internal-Net | 1,799 | 1,623 | 1,250 | -967 | 1,855 | 6,897 | 10,748 | 16,813 | 15,636 | 21,400 |
| Deficit/Total Expenditure | 9.3% | 1.1% | 8.5% | 16.4% | 19.2% | 20.8% | 17.1% | 25.8% | 39.5% | 46.7% |

SOURCE: Banco Central de Reserva.

[a]Not including amorization.

[b]Estimate.

TABLE 9

PERUVIAN BALANCE OF PAYMENTS, 1968-77
(Millions of U.S. $)

| | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 |
|---|---|---|---|---|---|---|---|---|---|---|
| Trade balance | 167 | 221 | 335 | 159 | 133 | 79 | -406 | -1,099 | -741 | -327 |
| Exports f.o.b. | 840 | 880 | 1,034 | 889 | 945 | 1,112 | 1,503 | 1,290 | 1,359 | 1,768 |
| Imports f.o.b. | 673 | 659 | 700 | 730 | 812 | 1,033 | 1,909 | 2,390 | 2,100 | 2,095 |
| Services & transfer balance | -208 | -211 | -150 | -193 | -165 | -252 | -322 | -456 | -451 | -484 |
| Services | -57 | -36 | -1 | -68 | -44 | -89 | -149 | -275 | -80 | -48 |
| Profits, interest | -151 | -185 | -149 | -125 | -121 | -181 | -219 | -240 | -371 | -436 |
| Current account | -41 | 0 | 185 | -34 | -32 | -191 | -807 | -1,538 | -1,192 | -811 |
| Long-term public capital | 81 | 124 | 101 | 15 | 119 | 375 | 710 | 764 | 480 | 596 |
| Long-term private capital | -13 | 20 | -77 | -43 | -5 | 69 | 202 | 342 | 196 | 69 |
| Short-term capital, Errors & commissions | -42 | -109 | 49 | -14 | -33 | -240 | 178 | -145 | -351 | -189 |
| Capital account | 26 | 35 | 73 | -42 | 81 | 204 | 1,090 | 961 | 325 | 476 |
| Deficit/surplus | -15 | +35 | +258 | -76 | +49 | +13 | +282 | -577 | -867 | -335 |
| Net reserves | 130.6 | 165.8 | 423.2 | 347.0 | 397.3 | 410.6 | 692.5 | 115.8 | -751.8 | -1,086.8 |

SOURCE: Banco Central de Reserva.

Under this prosperous surface, however, potential problems lurked. On the one hand, the threat of accelerating inflation existed. Real wages, which were increasing faster than the food supply, were one warning signal. So was the budget deficit, which averaged between 15 and 20 percent of total central government expenditures between 1971 and 1973. Such a deficit was not surprising, of course, for a government taking a greater role in the economy. Expenditures increase, but taxes cannot be increased enough to offset them, owing to the political resistance of the local landowners and bourgeoisie. Rising inflation rates, in addition to making economic planning more difficult, tend to cut real wages, thus creating political unrest as well as human suffering.

More serious from the government's point of view were potential problems with the balance of payments. The outlook appeared to be favorable, but this was because of very optimistic forecasts about mineral exports. Although few went as far as the state oil company spokesman who declared when Petroperú struck oil in 1971 that Peru's economic future was assured, Peruvian and foreign analysts alike put an increasing emphasis on oil. Great stress was also placed on the expectation of major volume increases that would raise the value of copper exports. The volatility of prices for primary exports--traditionally one of the key problems for Third World countries--was seemingly forgotten.

At the same time, plans were being laid for an industrial development strategy that would rely heavily on capital-intensive technology. Such a strategy not only would have reduced the job-creating potential of industrialization but would also have necessitated large imports of capital goods and intermediate inputs. Meanwhile, the Peruvian military was importing large amounts of expensive military equipment from the Soviet Union and various Western countries, and these imports, together with the debt service payments to be discussed below, had the potential of locking Peru into a balance-of-payments crisis if the export boom failed to materialize.

At the same time, the question arose of how to finance the industrialization program and the equipment necessary to produce the additional exports. The United States and its allies in the multilateral agencies refused to supply funds, since the Velasco government had incurred their wrath by nationalizing Standard Oil's subsidiary (the International Petroleum Company), defending the 200-mile fishing limit, establishing close relations with the socialist countries, and generally denouncing capitalism. In concrete terms, this meant that foreign investment dried up and Peru received almost no loans from AID or the Export-Import Bank between 1969 and March 1974 (although the Hickenlooper amendment was never formally invoked).[26] Loans from multilateral agencies were also conspicuously small. Between 1968 and late 1973, Peru received only one loan from the World Bank. Getting credits was slightly easier from the Inter-American Development Bank, but a significant portion of the IDB loans was in response to a serious earthquake in Peru in 1970.[27]

There appeared to be only one source to which the government could turn to finance its investment projects--the international capital market. Realizing that Peru was going to need good relations with the private bankers, the government took early steps to prepare the ground. When it took control of the domestic banking sector (including Chase Manhattan's Banco Continental), it sought favor with Chase--and presumably the rest of the financial community--by buying its shares for five and a half times their stock market value and three times their book value.[28] Thus, Peru was able to escape the official credit blockade by raising $147 million on the Eurocurrency market in 1972 and $734 million there in 1973. In the latter year, Peru was the third-largest borrower among Third World nations.[29]

Despite its leftist rhetoric, Peru seemed to the banks a good credit risk because of its copper and oil. Since Peru's need for money coincided with the banks' excess liquidity, what appeared to be mutually advantageous deals were possible. However, these loans added to Peru's debt burden, which almost doubled between 1968 and 1973, and which nearly tripled by 1974. Debt service (interest plus amortization) surpassed 20 percent of export earnings by 1973 (see Tables 10 and 11). Neither borrower nor lenders were concerned, though, since it was presumed that Peru's mineral wealth would provide repayment.

TABLE 10

PERUVIAN DEBT AND DEBT SERVICE, 1968-78
(Millions of U.S. $)

| Year | Public Debt[a] | Service Payments[b] | Service Ratio[c] |
|---|---|---|---|
| 1968 | 1,100 | 146 | 14.6% |
| 1969 | 1,132 | 126 | 11.8 |
| 1970 | 1,196 | 168 | 13.7 |
| 1971 | 1,309 | 209 | 19.6 |
| 1972 | 1,606 | 213 | 18.5 |
| 1973 | 2,155 | 434 | 32.2[d] |
| 1974 | 3,008 | 449 | 24.4 |
| 1975 | 3,466 | 402 | 23.0 |
| 1976 | 4,383 | 505 | 29.0 |
| 1977 | n.a. | 811 | 45.9 |
| 1978 | 4,800 | 1,000 | 55.0 |

SOURCE: World Bank, "Peru: Informe Socio-ecõnomico," Jan. 1978 (1968-1977); television speeches by the President and Finance Minister (1978).

[a]Disbursed and disbursed public and publicly guaranteed debt.

[b]Interest plus amortization.

[c]Service payments ÷ exports.

[d]Includes prepayments without which ratios would be 23.6% (1973) and 18.1% (1974).

TABLE 11

OUTSTANDING EXTERNAL PUBLIC AND PUBLICLY GUARANTEED DEBT OF PERU, 1971-75 (Millions of U.S. $)

| | 1971 | 1972 | 1973 | 1974 | 1975 |
|---|---|---|---|---|---|
| International Organizations | 244 | 265 | 274 | 281 | 296 |
| World Bank | 132 | 133 | 133 | 133 | 139 |
| IDB | 112 | 132 | 141 | 148 | 157 |
| Governments | 285 | 341 | 406 | 591 | 806 |
| Japan | -- | 7 | 40 | 216 | 357 |
| U.S. | 113 | 159 | 190 | 166 | 154 |
| Canada | 26 | 28 | 35 | 53 | 80 |
| Germany | 76 | 68 | 63 | 52 | 34 |
| Others | 70 | 79 | 78 | 104 | 181 |
| Private banks | 233 | 302 | 605 | 1004 | 1401 |
| U.S. | 95 | 101 | 249 | 463 | 476 |
| U.K. | 3 | 8 | 153 | 122 | 155 |
| Luxembourg | -- | 10 | 30 | 123 | 147 |
| Japan | -- | -- | 17 | 108 | 107 |
| Multiple | 117 | 124 | 104 | 103 | 406 |
| Others | 18 | 59 | 52 | 85 | 110 |
| Publicly issued Bonds | 17 | 14 | 10 | 6 | 3 |
| Suppliers' credits | 294 | 278 | 287 | 336 | 317 |
| Italy | 146 | 142 | 131 | 116 | 97 |
| Yugoslavia | -- | 7 | 23 | 64 | 67 |
| Japan | 34 | 27 | 34 | 51 | 44 |
| U.S. | 15 | 20 | 19 | 17 | 17 |
| Others | 99 | 82 | 80 | 88 | 92 |
| Unclassified | -- | -- | -- | 70 | 227 |
| Total | 1,073 | 1,200 | 1,582 | 2,288 | 3,050 |

SOURCE: IMF, "Peru--Recent Economic Developments," February 1977.

By 1974, the potential problems outlined above began to appear. Although growth rates continued high and unemployment low, the inflation rate shot up to 17 percent, causing real wages to fall. Moreover, for the first time since the military took power, the trade balance showed a deficit: while exports increased 35 percent between 1973 and 1974, imports almost doubled. In percentage terms, the main culprit was the oil price increase, which made the cost of Peru's fuel and lubricant imports nearly triple. Of greater significance in absolute terms, however, were volume and price of inputs and capital equipment for industry (see Table 12). The former was accounted for mainly by increases in international prices, and the latter by big increases in the government investment program.

Between 1969 and 1973, capital formation by the public sector (central government and public enterprises) had increased by an average of 15.6 percent per year; in 1974, this figure jumped to 56.5 percent (see Table 7). Major increases included central government investment in agriculture (44 percent) and public enterprise investment in Petroperú (88 percent), Mineroperú (139 percent), Sideroperú (1016 percent), and Pescaperú (which increased from nothing to $32 million. Most of the equipment involved in this investment spurt was produced abroad--hence the increase in imports. This marked a qualitative change in the government program. The "cheap" phase of the reforms (expropriation of agriculture and some industrial enterprises) was over; the "expensive" phase (creating new heavy industry) was beginning. Like the trade deficit, the deficit in services also increased, such that the current account deficit in 1974 totaled $725 million (up from $174 million in 1973).

This deficit was financed by going to the Euromarket for another $366 million in medium-term loans and a large amount of short-term money. In addition, AID, the Export-Import Bank, and the international agencies also poured in large sums when the credit blockade was lifted after the signing of the so-called Greene Agreement in February of 1974.[31]

In 1975, both the inflation and the balance-of-payments problems became more acute. In addition, the budget deficit doubled. The situation was so serious that emergency measures were introduced at the end of June. The most important of these was an average increase 20-to-30 percent in prices of basic consumer items as many subsidies were lowered in an attempt to cut the budget deficit and thus eventually the inflation rate. Trying to forestall opposition from workers and to partially offset the fall in demand, the government announced a general wage increase. The minimum wage, however, was increased by only 20 percent, and the poorest groups (the unemployed, "informal" sector) did not benefit.[32] As a result of the June measures, the growth rate faltered as demand fell; unemployment also rose.

The growing economic crisis provided justification for the August 1975 "coup within a coup." General Francisco Morales Bermúdez, Velasco's Prime Minister, took over as president. Although Morales Bermúdez characterized his regime as a continuation of his predecessor's, it was obvious that the change meant a move to the right. Repression increased, leftist military officers were forced to retire, and more orthodox economic policies were

TABLE 12

EXPORTS AND IMPORTS OF PERU, 1968-77
(Millions of U.S. $)

| | 1968 | 1969 | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 |
|---|---|---|---|---|---|---|---|---|---|---|
| Exports | 866.1 | 965.6 | 1,034.3 | 889.4 | 945.0 | 1,111.8 | 1,503.9 | 1,290.9 | 1,359.4 | 1,768.1 |
| Fish products[a] | 232.0 | 320.4 | 346.3 | 327.7 | 265.9 | 157.2 | 261.4 | 208.1 | 200.7 | 242.0 |
| Mineral products[b] | 452.0 | 475.3 | 471.8 | 365.2 | 427.3 | 631.2 | 753.0 | 590.9 | 744.0 | 969.2 |
| Agricultural products[c] | 164.9 | 145.1 | 160.0 | 152.1 | 188.1 | 216.7 | 322.4 | 386.7 | 281.8 | 355.5 |
| Others | 17.2 | 24.9 | 55.8 | 44.4 | 63.7 | 106.6 | 156.5 | 105.2 | 132.9 | 201.4 |
| Imports | 631.4 | 603.3 | 622.1 | 751.7 | 796.2 | 1,018.5 | 2,028.7 | 2,584.8 | 2,100.0 | 2,095.0 |
| Consumer goods | 97.1 | 90.4 | 88.3 | 97.2 | 109.2 | 154.4 | 185.9 | 238.7 | n.a. | n.a. |
| Fuel & Lubricants | 23.3 | 18.9 | 12.2 | 24.8 | 44.8 | 56.6 | 224.5 | 317.7 | n.a. | n.a. |
| Raw materials & Intermediate goods | 301.9 | 288.7 | 296.5 | 695.6 | 401.5 | 407.5 | 879.0 | 1,088.3 | n.a. | n.a. |
| Capital goods | 206.9 | 204.3 | 224.2 | 226.8 | 236.8 | 381.2 | 733.0 | 936.8 | n.a. | n.a. |
| Others | 2.1 | 1.1 | 0.9 | 3.8 | 4.2 | 18.8 | 6.2 | 3.4 | n.a. | n.a. |

SOURCE: Banco Central de Reserva.

[a]Fish meal and fish oil.

[b]Copper, iron and iron ore, silver, zinc, lead, and petroleum.

[c]Cotton, sugar, coffee, and wool.

introduced. Balance-of-payments problems nevertheless remained, despite $433 million in loans from the Euromarket and the World Bank, and net reserves fell from $693 million to only $116 million by the end of 1975.

A further round of austerity was introduced in January 1976, when the new finance minister, Luis Barúa Casteñeda, announced a series of changes similar to those of the previous June. More price increases on basic consumer items were introduced, and wage increases were again authorized to try to limit opposition and maintain demand. A second set of measures--tax increases and budget cuts--was designed to reduce the government deficit. Attempts were made to lower imports by a system of licensing, and a set of production incentives was promised.

The aims of the measures were threefold: to increase production, to control inflation, and to keep the balance-of-payments deficit from getting out of hand. If the economy could manage to limp through the year, the government hoped that the balance of payments would improve through an increase in copper and oil exports and that other difficulties would thus be mitigated.[33] Meanwhile, further international credit would be needed to cover the deficit.

The Bankers Intervene: 1976.--By early 1976, then, the Peruvian economy faced a serious crunch, owing to a combination of bad luck, bad planning, and the inevitable dilemmas of dependent capitalist development. The bad luck had to do with the failure of the expected oil bonanza, the disappearance of the anchovy schools that had provided a major Peruvian export, and the fall of copper prices. Bad planning reinforced these problems through over-fishing and borrowing money to build a billion-dollar pipeline before the extent of the oil reserves was known.[34] As mentioned previously, however, export revenues always exert a disproportionate influence on the economies of small dependent countries that specialize in primary exports.

The key problem from the government's point of view was the balance of payments, which could not be brought into equilibrium in the short run because exports could not be increased and imports could not be cut without bringing the economy to a standstill. The only possible flexibility seemed to center on manipulating debt service payments (which were about $500 million compared with the trade deficit of $740 million--see Tables 9 and 10. Outright suspension of payments would end access to the international capital market, so refinancing was necessary.

The traditional way to solve a balance-of-payments crisis would have been for Peru to go to the IMF and sign a Letter of Intent. This would have given Peru access to certain IMF funds. More important, it would have opened further doors to bilateral, multilateral, and private banking sources that wanted an IMF "seal of approval" before lending. The problem was that the IMF would demand a drastic stabilization program that even the Morales officials could not and would not accept. They realized that the results would alienate workers (through wage and employment cuts), industrialists (through a fall in demand, and thus profits), and the military (through curbs on the purchase of arms). Given the regime's relative lack of support, the potential was too explosive: the government might be brought down.

The Peruvians therefore approached the major U.S. banks in March 1976 and asked for a large balance-of-payments loan without having signed a prior agreement with the IMF. The bankers ultimately accepted the Peruvian position, reasoning that, if a crunch were to come, General Jorge Fernández Maldonado and the left-wing faction of the government might come out on top and lead Peru back toward a radical nationalist position. It seemed safer to support the Morales government, with its new rightist tendencies, than to risk such a leftist outcome. One New York banker involved in the negotiations put the point very clearly. He said the "main reason" for the loan was "to perpetuate Morales Bermúdez in power," since the banks considered this the best man for getting their money back.[35]

Having accepted the Peruvian position vis-à-vis the IMF, the banks then faced a dilemma. On the one hand, they wanted to refinance the Peruvian loans for several reasons beyond just keeping Morales Bermúdez afloat. First, Peru was important both in itself and in symbolic terms. Its debt--$3.7 billion at that point--was one of the largest in the Third World. Half of it was owed to private banks, including $1.5 billion to U.S. banks alone. Second, a Peruvian default might trigger a chain reaction among other Third World countries in trouble with their foreign debts. Third, default would create animosity among the smaller U.S. banks and the international banks that had been involved in the syndicates for Peruvian loans arranged by major U.S. institutions in the past. These smaller banks might then refuse to participate in future Third World loan syndications, having been badly burned in Peru.

On the other hand, the banks had no intention of making it easy for the Peruvians. For one thing, they had to save face and to keep from getting the reputation of being a "soft touch." Thus they needed to construct a set of requirements that would provide their pound of flesh. This was especially the case since Peruvian officials had paraded around the world denouncing imperialism and capitalism for the last seven years. Also, some formula had to be devised to mollify the banks' clients who were at that very minute being threatened by the Peruvian government. These included Marcona Mining Company (still negotiating compensation for the nationalization of its iron mines in mid-1975), and Southern Peru Copper Corporation (which faced problems over depreciation allowances and tax delinquency). Finally, a way had to be found to make sure Peru generated sufficient foreign exchange to be able to pay the service on its past loans without resorting to further international credits for this purpose in the future.

The resulting deal between Peru and the banks was a three-part program that dealt with all of the banks' problems. It included: (a) an orthodox stabilization program, though of a milder sort than the IMF would have imposed, involving a 44 percent devaluation, price increases, and minor budget cuts; (2) more favorable treatment of foreign investment, including reopening the jungle coastline to private oil companies, agreeing with Marcona on a price to be paid for its iron mine, and agreeing with Southern Peru on payments due; (3) partial withdrawal of the state in favor of local private enterprise, which began with the sale of Pescaperú's anchovy fleet to private interests and changes in labor legislation to attract more private investment.[36]

All of the loan conditions, of course, were described by the bankers as essential for guaranteeing Peru's economic future. They argued, for example, that Southern Peru's immediate repayment of the $50 million in back taxes, depreciation allowances, and penalties would have meant postponement of completion of the Cuajone mine--and thus Peru's loss of an estimated yearly output of $250 million of copper, a key foreign-exchange earner. In the Marcona case, they rationalized that if the company were not compensated, the Hickenlooper amendment could be invoked, cutting off essential U.S. aid and other funds. Finally, the bankers expected more favorable treatment of the private sector to increase private investment so that the government would not have to run up huge deficits and borrow abroad to finance its projects.[37]

The most controversial aspect of the program, however, was the provision that the banks were to monitor the Peruvian economy to make sure that the agreed-upon inflation, budget, and other targets were met. Not since the 1920's had private banks become so involved in the domestic affairs of a Latin American government. The loan was divided into two equal tranches; the first was released immediately, the second was withheld for several months. Authorization to draw the second tranche was to be contingent on agreement of 75 percent of the lenders (by dollar participation) that Peru was making satisfactory economic progress. Even the bankers admitted the weakness of this arrangement in comparison to the more detailed IMF monitoring. As one stated: "We won't be seeing any major changes. This second drawdown is just something to keep <u>some</u> sort of control."[38]

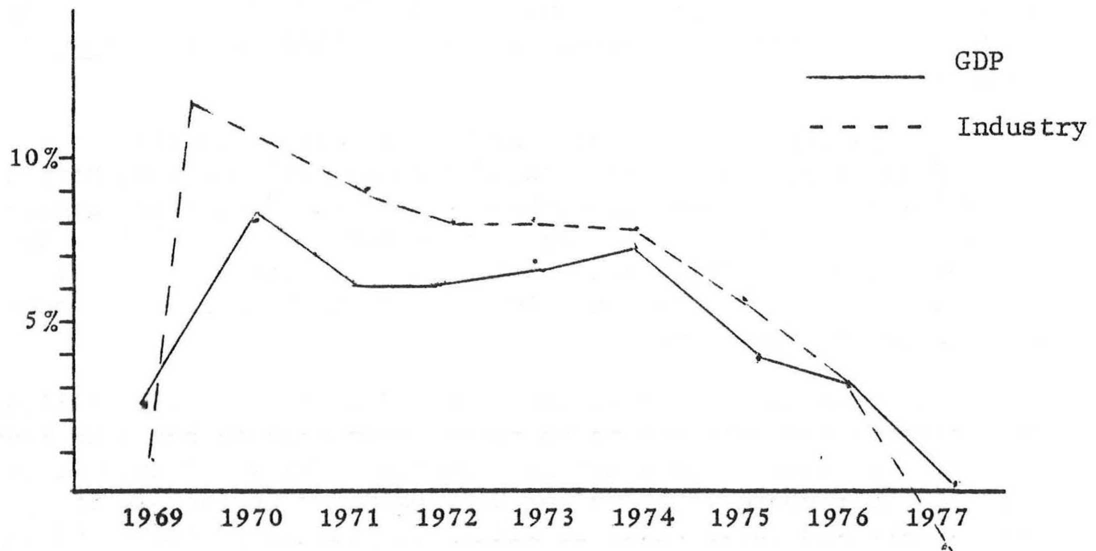
The package was put together by Citibank, with the participation of Bank of America, Chase Manhattan, Manufacturers' Hanover, Morgan Guaranty, and Wells Fargo. These six banks composed the "steering commitee" for the loan, since no bank was willing to take total responsibility as lead manager. Bankers' Trust and Continental Illinois were also invited to join but refused because they disagreed with the notion of banks assuming the monitoring function.

The steering committee banks agreed to provide $200 million, contingent on a further $200 million to be raised from private banks in Western Europe, Canada, and Japan. The steering commitee banks would themselves place half of their share with smaller U.S. banks, with the aim of spreading Peru's debt and their risks as widely as possible. Above and beyond the special conditions described above, the terms of the loan were quite stiff. The interest rate was 2.25 percent above LIBOR, and the maturity was only five years. Completing the negotiations proved difficult. The original announcement was made on July 26, but the final signing did not take place until nearly the end of the year. The European and Japanese shares were not arranged until the first half of 1977.[39]

The effects of these policies on the Peruvian economy were dramatic and negative, but determining who was responsible for them becomes complicated. The banks imposed a set of conditions, but Morales and his top economic officials wanted to move in this direction in any case. They definitely favored private enterprise and foreign capital more than the Velasco regime had. Furthermore, they had announced stabilization measures

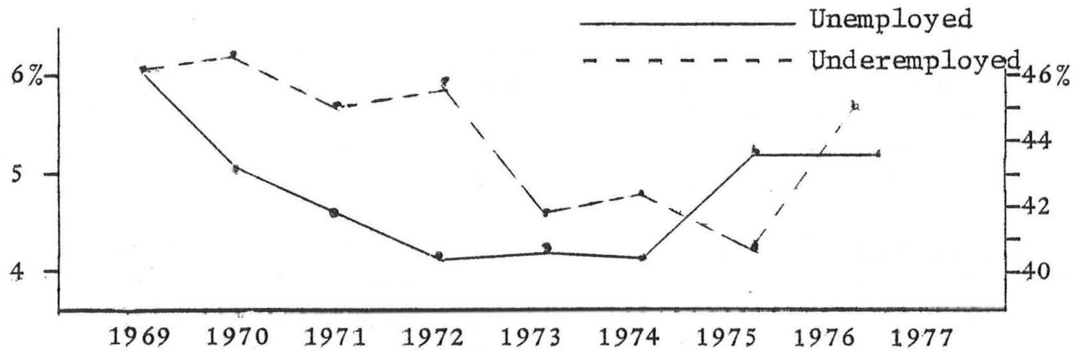
before the loan negotiations were even begun (in January 1976), and it must be remembered that Morales was de facto head of government when the first such measures were intorduced in June 1975. Thus it seems likely that many of the changes would have been made with or without the banks' intervention, although the latter was certainly useful in helping overcome internal opposition to austerity measures. Some of the blame could be shifted to the bankers, who also provided access to extra funds that somewhat softened the austerity program.[40]

One result of the banks' policies was a drop in production (see Table 3). This drop had already begun in 1975, in part owing to extremely poor performance in the fishing and mining sectors. There were also important declines in industry and services as a result of the 1975 emergency measures. Thus the GDP growth rate fell from an average of 6.3 percent in 1972-74 to only 3.5 percent in 1975. The bank measures further depressed the economy, pushing growth down to 2.8 percent in 1976, despite a strong recovery in fishing, mining, and agriculture (sectors essentially unrelated to government demand policy). Sharp declines in 1976 occurred in those sectors most susceptible to changes in internal demand--industry, construction, and services.



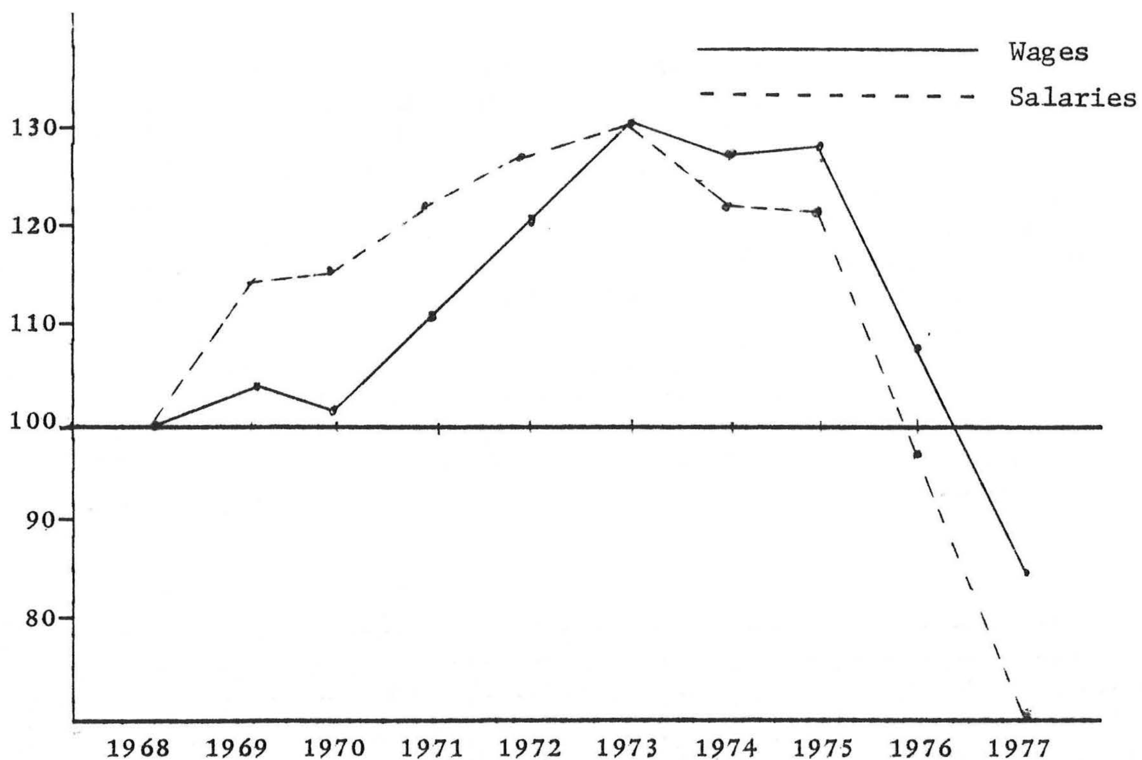

Graph 1. Growth rates of GDP and industry in Peru, 1969-76.
SOURCE: Table 3.

The employment situation also suffered reverses (see Table 5). In a pattern similar to that of production, open unemployment had already increased in 1975, going up from an average of 4.1 percent during 1972-74 to 5.2 percent in 1975. This figure increased only very slightly to 5.3 percent in 1976. On the other hand, underemployment increased from 41 percent to 45 percent between 1975 and 1976.




Graph 2. Unemployment and underemployment rates in Peru, 1969-76.
SOURCE: Table 5.

The biggest effect of the 1976 measures was on wages and salaries (see Table 6). According to an OAS study, real wages and salaries for the Lima area reached a peak in 1973, 33 percent above their 1968 level. They then fell in 1974 and remained at the same level in 1975. During 1976, the drop was so serious that average remunerations were back to about their 1968 level. The World Bank, for instance, calls attention to mid-1976 as a watershed in incomes policies. Before that point, the policy had been "to maintain and even increase real wages"; afterwards a drop was accepted.[41]




Graph 3. Variations in wage and salary index, Peru, 1968-76.
SOURCE: Table 6.

In addition to these negative effects in terms of growth, employment, and remuneration, structural changes also resulted from the banks' conditions. Specifically, private enterprise in general, and foreign capital in particular, began to regain much of the economic and political power it had lost during the Velasco years.

Enter the IMF: 1977-78.--The Peruvian drama repeated itself in 1977, but with an important change in the cast of characters. Though the balance of payments was expected to improve, a huge trade deficit still threatened, and service payments on the debt remained oppressive. Thus Peru had to look for foreign financing once more. This time, however, the banks refused to negotiate without IMF participation. Why did the bankers change their minds? The reasons for their switch are easier to understand than the explanation for their original decision to monitor the situation themselves. Many factors were at work, yet all pushed in the same direction.

The first set of factors was negative from the banks' point of view and concerned problems arising from the direct intervention. Most important was the opposition to the new monitoring role. Opposition from the left had been expected, both within Peru and internationally. A typical example was the commentary by the editors of Monthly Review, one of the leading leftist journals in the United States. Calling the new agreement "an intensification of the debt peonage of [Peru]," the editors then went on to say:

> To a significant degree this development is hardly new, but it does bring into the open what is usually hidden in the relations between bankers and weak borrowers: influence over the affairs of client states by tacit agreement, secret covenants, or "financial discipline" imposed by a supposedly disinterested international agency such as the IMF. What is new in the Peruvian case is the unabashed announcement of direct and overt control by private bankers in an era that is supposed to be characterized by growing sensitivity to the devices of imperialism and by a strengthening of the nationalist spirit among ruling classes in underdeveloped countries. While we might speculate on what the various explanatory factors might be, this new wrinkle at the very least reflects a deepening of dependency on the financial centers of imperialism by many Third World countries.[42]

The banks, however, were probably unprepared for the opposition from within their own ranks. As mentioned earlier, both Bankers' Trust and Continental Illinois, two major U.S. institutions with heavy involvements in Peru, refused to join the steering committee or to participate in the new loans, objecting to the damage to the banks' image that might result. As Alfred Miossi, Executive Vice-President of Continental Illinois, put it: "For a private bank to police the actions of a sovereign government puts it into a difficult position. International agencies have a more neutral role and are better suited for this.[43] Another banker,

whose institution was a steering committee member, said, "I don't think the banks can play the role of appearing to intervene in the affairs of a country. Whether they like it or not, it could be considered Wall Street imperialism."[44] European bankers expressed similar concerns, speaking of the "politicization" of the deal. They pointed out that banks identified with the stabilization program ran the risk of becoming scapegoats for the unpleasant results.[45]

Bankers also expressed doubt that they would have as much clout as the IMF because of their commercial ties to Peru. As one critic suggested, "The banks have a vested interest in Peru, and they've got to think of their commercial lending relations in the country. What are the Peruvians going to think if they start snooping around and delving into the books?" Considering the problem of checking on the figures Peru would provide, another banker argued that the last thing the banks wanted to do was to send their Lima branch managers over to the Peruvian Central Bank to verify the data.[46] Presumably G. A. Costanzo, Citicorp's Vice-Chairman, spoke for the other banks when he said: "The reaction to this loan was a signal to me that I want no part in deals with this kind of discipline in the future."[47]

The second set of factors explaining the banks' decision focused on the advantages of working more closely with the IMF. First, bringing in the Fund would end the criticisms leveled at the steering committee banks and would reunify the banking community, since those bankers who had opposed the 1976 operation had all advocated closer relations with the IMF. It would provide a more "neutral" façade for imposing conditions on Peru--although appearances were not the only advantage. The banks would also be able to profit from the Fund's experience in dealing with Third World governments, from its access to data on Third World economies, and from its capacity to set up and implement a monitoring procedure.

Closer cooperation with the IMF would also square with the wishes of the Federal Reserve, the U.S. government agency charged with regulating the banks' overseas operations. Arthur Burns, then chairman of the Federal Reserve, had been advocating such increased cooperation for some time, pressuring the banks to stop acting independently with respect to the debt problem. In a Febraury 1977 speech he made this position public, declaring "We need to develop the rule of law in this field, and the only instrument for this is the IMF. Unless we have the rule of law, we will have chaos."[48] The exact nature and extent of bank-IMF cooperation was undetermined. Proposals varied from greater sharing of information to joint loans.

The third factor behind the reversal of the banks' position was what enabled them to work more closely with the Fund. They knew that the IMF economists would demand more stringent conditions than they themselves had imposed the previous year, but such conditions now seemed more viable. In 1976, the banks had been fearful of forcing the government to the wall; now intervening events had made them more confident that the outcome would produce a shift to the right rather than to the left. The most important confirmation of this belief was the July 1976 ouster of the leftist-leaning cabinet ministers--Jorge Fernández Maldonado,

Miguel Angel de la Flor, and Enrique Gallegos. No public protest resulted. In addition, the government's ability to disperse the demonstrations and break the strikes protesting the mid-1976 stabilization measures was comforting to the bankers. They drew the conclusion (soon to be severely challenged) that the Peruvian political climate was not as explosive as they had believed it to be the previous year.

Given the banks' insistence on involving the IMF, the Peruvian government acquiesced and a Fund mission arrived in Lima in March 1977. The mission decided that Peru should hold its 1977 inflation rate to 15 percent, should reduce its budget deficit to no more than 20 billion soles,[49] and should achieve equilibrium in its balance of payments with no new loans. In a typical set of demands, the IMF "suggested" that Peru (1) cut all subsidies to public enterprises, leaving them to acquire necessary financial resources through price increases; (2) raise gasoline and other fuel prices enough to both eliminate the Petroperú deficit (16 billion soles) and provide a surplus for the central government; (3) cut another 10-20 billion soles from the deficit by eliminating the purchase of capital goods for public sector investment and selling off firms to the private sector; (4) tighten up the tax system by eliminating all tax exemptions (including those on traditional exports), creating an emergency "wealth tax," and indexing tax payments; (5) eliminate noneconomic restrictions on imports (e.g., quotas); (6) devalue the sol by 30 percent (i.e., to 90 soles/dollar); and (7) limit wage and salary increases to 10-15 percent.[50]

The political implications of this program were intolerable even to Peru's conservative financial officials. Central Bank President Carlos Santistevan and several Central Bank directors sent a letter to Finance Minster Barúa, threatening to resign if the IMF program were accepted. The letter stated that the Fund was "seeking to balance the economy in an extremely short term, and its measures would have excessive and unnecessarily depressive effects which can, and should, be avoided."[51]

Santistevan and the Central Bank countered the IMF with a more flexible set of proposals, but at the same time other members of the government (especially Industry Minister General Gastón Ibañez) proposed measures to _expand_ the economy by increasing government spending, pegging the exchange rate, reinstating food subsidies, and cutting the price of gasoline. Caught between these opposing pressures, Morales Bermúdez made no decision, and in May, Finance Minister Luis Barúa resigned in frustration.

The new minister, Walter Piazza, was the first private businessman appointed to a cabinet post by the military government. His proposals resembled those of the IMF, the main differences being a higher budget deficit and a higher expected inflation rate. On the basis of this program, Piazza managed to negotiate a deal with the Fund, but it was rejected by the cabinet and he too resigned.[52]

Nevertheless, certain elements of his program--mainly price rises--were put into effect and aroused strong popular opposition, including the first strike since 1919. The government response was two-edged. On the one hand, it imposed a curfew and sent in police and army troops. Hundreds

of workers were arrested, and at least nine people were killed. Laws were subsequently suspended to allow factory owners to fire strike participants, and some 6,000 workers lost their jobs. On the other hand, the government also tried to mollify the strikers by raising wages and salaries. The increases, however, were not enough to cover increases in food and transportation costs.[53]

Three months later, the Peruvian government signed an agreement with the IMF that was very similar to the Piazza proposals. According to the agreement, the real crunch would come in 1978, when the government was to cut the budget deficit to a third the 1977 total and inflation by half. This implied a further increase in unemployment and a further reduction in the purchasing power of wage earners. In return, Peru was to receive $100 million, to be disbursed in bimonthly installments over two years.

The first installment of the IMF loan was released in December, but in February the Fund's mission returned and declared Peru in massive violation of the agreement. In refusing the second and all further drawdowns, it focused special attention on the budget deficit (reportedly already over the yearly total agreed upon), the pegging of the sol at 130 to the dollar, and some dubious accounting procedures designed to help cover up the shortfalls.[54] When the banks heard the report, they called off a $260 million loan then under negotiation; the U.S. government also refused further assistance. This meant that Peru's only debt relief still on line was the Soviet Union's agreement to postpone 80 percent ($100 million per year) of the payments for arms purchases between 1978 and 1980.

The dilemma of the Morales Bermúdez government at this point was dramatic. The Peruvian public sector foreign debt was $4.8 billion (private debt added another $3.4 billion), and Peru was scheduled to pay over $1 billion in interest and amortization during 1978 alone. This sum would constitute some 55 percent of export revenues, a figure the government estimated could rise to 708 percent by 1980 (see Table 10). The Central Bank had virtually no foreign exchange, and lines of credit were shut off.[55] In practical terms, this meant that without quick action Peru's imports would have to be cut drastically, throwing tens of thousands of people out of work and cutting the food supply.

The banks and the IMF nevertheless insisted on further austerity measures as the <u>sine qua non</u> to extending any relief. Some officials in the Carter Administration were slightly more hesitant (although they did nothing) because they recognized the obvious contradiction between the need for repression implied in further austerity measures and the Morales Bermúdez plan to return the government to civilizan control. Although some people in Peru--including members of the local bourgeoisie as well as the left--suggested a moratorium on debt payments rather than further austerity, there is no indication that Morales Bermúdez or any of his top economic officials seriously entertained this idea. Their own inclinations, and the overwhelming financial power of the banks and the Fund, pushed in the same direction. Thus on May 15 prices were doubled on fuel, public transportation, and basic foodstuffs as government subsidies were eliminated in order to cut the budget deficit.

Coming after workers had already lost a fourth of their purchasing power to inflation in the first quarter of the year, the measures quickly produced clashes in the streets of Lima and strikes in provincial cities. After more than a dozen persons were killed, the government placed the country under martial law, jailed hundreds of leftist labor leaders, and announced a two-week postponement of elections to choose a Constituent Assembly. This did not stop a two-day general strike on May 22-23. The strike was almost total in many parts of the country, but the power of the workers was simply not sufficient to outweight that of the financial community. This was especially true since the government was at most mildly against the austerity measures and possibly wholeheartedly in favor of them.[56]

What did Morales Bermúdez gain from the price increases and the heightened enmity of the vast majority of the population? Apparently he gained the support of the IMF, the banks, and the U.S. government in his search for debt relief. Within days of the new austerity measures, and with the sound of strokes and rioting still echoing in the streets, the international banks tentatively agreed to roll over some $200 million in amortization owed them during the rest of 1978. Interest was still to be paid, however, and the deal was tied to the signing of a new agreement with the IMF by September.[57] In addition, such an IMF agreement held out the prospect of a complete rescheduling of the foreign debt, as the Peruvians have requested. The U.S. government also promised minor aid in the aftermath of the May events in the form of a $15 million agricultural credit.[58]

But the relief is only temporary and partial; the basic question still remains. Can the Morales Bermúdez government implement an austerity program that calls for further cuts in workers' incomes, plus a drop in military imports and input for local industry? The task may be even more difficult this time around, since opposition has been institutionalized in the Constituent Assembly elected in 1978 to prepare for Peru's return to civilian rule. The left won 28 percent of the 100 seats, and even the right-wing Popular Christian Party (27 percent of seats) has said it will oppose the military government.[58] Thus the only way an austerity program is likely to be implemented is by greatly stepping up the existing level of repression and probably closing the Assembly. The process will provide an exceptionally clear test of the Carter human rights policy. Are human rights in Peru more important than support for the IMF?

## Conclusions

The Peruvian case is important in itself, but it also sheds light on a number of more general problems of private bank financing in Latin America and the rest of the Third World. These problems can best be seen by returning to the three characteristics of the privatization of finance mentioned at the beginning of the paper.

We will recall that the first characteristic was the role of privatization in helping to sustain the growth of bank profits. In the early 1970's, the banks' U.S. and European loan demand began to falter; in response, the banks began to look upon a group of Third World countries as desirable clients. Although adequate published data are lacking to verify the importance of these new Third World loans, it is suggestive that the

international share of the profits of the top dozen U.S. banks rose from 17 percent in 1970 to 49 percent in 1977. In the case of Citibank, South American profits went from less than two percent of total profits in 1971 to 27 percent of total profits in 1977--with Brazil alone accounting for 20 of that 27 percent. Brazil similarly accounted for 13 percent of Chase's profits in 1977.[60]

Peru was an early participant in the new loan market, entering in 1972. A year later, it represented eight percent of all loans to Third World countries, surpassed only by Mexico and Algeria.[61] The importance the banks attributed to the Peruvian loans can be deduced from the fact that they broke the informal blockade the U.S. government and the miltilateral agencies had established against the Velasco government to make them. The prospect of profits--both immediate and long-term--outweight political factors. In fact, descriptions of the situation in Peru in the early 1970's are reminiscent of Latin America in the 1920's. One top officer in a big private Lima bank (who opposes the military government) said "The foreign bankers came down here lending money as if there were no tomorrow. Or course the government took their money. How would it refuse. Why should it?"[62]

When problems arose with the Peruvian loans, the banks initially intervened directly; but the strong negative reaction has probably eliminated direct intervention as a future option. The criticism that arose--especially inside the financial world--was decisive. The banks do not want the publicity and controversy that come with setting macroeconomic conditions for loans and monitoring their implementation. They are still inexperienced in dealing with countries as clients. Not only do such clients differ from individuals and private corporations in size, source of income, and political considerations, but the setting is different as well. Rather than behind-the scenes negotiations where no outsiders know the details, the new style negotiations became front-page news when the press and political opponents dig for information. After the Peruvian experience, it seems clear that in the future some official agency will have to be brought in from the outset; the IMF remaining the obvious candidate.

The second characteristic of the privatization process of the 1970's was precisely that it led to a new role for the public institusions. Rather than being the key actors themselves, as they had been during the 1950's and 1960's, they began to put more emphasis on supporting the private banks. An especially close collaboration developed between the banks and the IMF--although they have not always been in agreement, and the simplistic view that the latter is the "tool" of the former is incorrect. The Fund has its own ideas about how an economy should be run and does not need any coaching from the banks. In fact, one of the continuing disagreements between the two seems to center on the banks' view that the Fund is <u>too</u> rigid in its prescriptions.[63] The new supportive relationship is also evidenced by co-financing of loans by the Export-Import Bank, the World Bank, or the Inter-American Development Bank.

In general, opinion within the U.S. government also favors privatization. Thus the Eximbank went into co-financing, and AID funds

fell dramatically in favor of private finance. Treasury officials also support this trend. As C. Fred Bergsten (now Assistant Secretary of the Treasury for International Affairs) said at the time of the banks' Peru operation: "I think it is better in international political terms that a Morgan Guaranty--or hopefully a consortium of international banks--makes that loan. It's better for them to put tight controls on than to have a national government have to do that. It can then be portrayed as coming through market pressures, and judgments on the economic merit of the country's position, rather than being laden with political overtones."[64]

On the other hand, some members of Congress are intent on imposing controls to prevent the government from "bailing out the banks." In the Peruvian case, the government gave less help than the banks and Peruvian officials advocated. Both the State Department and Treasury stressed, however, that if the situation became critical they would reevalutate.[65] A major question, now that Peru wants to reschedule its debt, is who will have first claim on the available resources--the public lenders or the private banks?

Support for the private banks also implies support for the international financial system as a whole One of the key issues by the raised subject of private loans to Third World countries has revolved around the question of stability, with some arguing that sooner or later an important country will default on its debts, and that others may then follow (a new version of the domino theory). But even if the dominos did not fall, a single default may bankrupt some of the weaker banks and trigger a chain reaction, throughout the banking system. In historical terms, the analogy goes back to the heavy Latin American borrowing during the 1930's and fears of defaults similar to those of the 1930's.

Short of a recession much more serious than that of 1974-75, however such a scenarios does not seem likely. First the institutional changes brought about partially because of the upheaval of the 1930's--the creation of the IMF and the World Bank, as well as the greatly increased economic role of capitalist governments--militate against a repeat of the chain defaults. Second, the bankers themselves are aware of the potential problems and are taking steps to avoid them. Specifically, they refuse to accept a default. Rescheduling has replaced default as the worst possible secnario for the banks' point of view, with both banks and governments (for different reasons, to be sure) wanting to avoid even rescheduling in order to maintain the countries' creditworthiness. Refinancing loans provides one alternative.[66] Another alternative is increased assistance from the U.S. government, and this is where the foreign policy implications of the debt problem arise. Will the U.S. government sit by and watch some of the major U.S. banks endanger themselves--and thus the stystem as a whole--because of repayments problems or loans? Or will it come to their rescue, either positively (by making public loans to Third World governments so they can repay their private loans) or negatively by forcing the governments to pay, through a credit blockade or other means)?

The third characteristic of the privatization process has had to do with the price paid by Third World countries. The most concrete change has involved the worsening terms on the money they have borrowed. Even leaving aside grants and soft loans, there has been deterioration of two kinds. Hard loans from multilateral agencies usually matured in about 20 years, whereas the new Euroloans average 8-10 years. Also, the new loans carry floating interest rates that create planning problems and probably make overall payments more costly than they were under the old fixed-rate system. In addition, the profit-making character of the banks makes them less patient with repayment problems than were AID, the World Bank, and the IDB.

Ultimately, both public and private loans have tended to lead to IMF austerity programs. Just as the IMF "seal of approval" was the lynchpin of the system of public development finance in the 1950's and 1960's, so it has come to be under the privatized system of the 1970's. In both cases, the political and economic costs imposed on the beleaguered countries are tremendous, as the Peruvian case illustrates very well.

In economic terms, stabilization programs wreak utter havoc on domestic economies. A few groups profit--those connected with the banking and primary-export sectors--while the vast majority suffers the consequences. Those who suffer most are workers, who see their wages cut or lose their jobs. In Peru, even official statistics admit that average incomes in real terms are now only 60 percent of their 1973 level and that less than half the work force has "adequate employment."[67] In structural terms, the industrial sector as a whole seems to be in danger. On the one hand, credit and demand have fallen as a result of stabilization measures. On the other hand, if imports are cut to provide foreign exchange to service the debt, those cuts must fall heavily on capital goods and inputs for domestic industry. In any case, growth will have to be much slower than in the past, as increasing proportions of export earnings go for debt service.

The political consequences of stabilization programs are equally dramatic. Such programs have proved impossible to implement in Third World countries without highly authoritarian regimes. The growing repression in Peru since 1976--curfews, arrests, deportations, deaths, suppression of strikes and demonstratiions, dissolution of workers' organizations--it is not mere coincidence. It is an integral part of stabilization--is not mere coincidence. It is an integral part of stabilization, as workers refuse to passively accept the burden of maintaining the banks' profits. Under these circumstances, many doubt that Morales Bermúdez's plan to return Peru to democratic rule by 1980 will prove feasible.

A couple of years ago, some hoped and others feared that private loans would give Third World government increased leverage in dealing with the banks because the threat of default could be used to gain concessions. Peru provides dramatic evidence of the naivete of such a notion: the government has now accepted all of the IMF-bank demands. Available evidence indicates that new leverage exists only under very specific conditions. First, of course, the government must be united

against the stabilization policies--which the Morales Bermúdez government certainly was not, with some factions opposed to austerity and the President and his top officials not. Second, leverage exists only if the country in question is of key importance in political and economic terms and is under clear and immediate danger from a crdible leftist force.

In the Latin American context, there are probably only two countries of sufficient economic importance to threaten the banks--Brazil and Mexico. In neither case, however, is there any immediate leftist threat or any apprent desire on the part of the governments to use their potential power, so the question remains moot. Looking further afield, two European cases are instructive. In Italy, the IMF and the banks failed to gain any major concessions in terms of economic policies because of Italy's importance to the EEC and NATO, and because the Communist Party has a real chance to take control of the government. In Britain, on the other hand, the IMF did manage to wring major concessions, despite the U.K.'s international importance, because the government was divided and no serious threat existed.[68]

In summary, the Peruvian case (and other more general evidence) indicates that the banks have been the primary beneficiaries of the privatization of development finance in the 1970's. In direct terms, they have protected and expanded their profits, and in indirect terms, they have obtained increased support from public sector institutions. The Third World countries--and especially their working classes--have borne the brunt of the banks' successes, as living standards have decreased and repression increased so that available resources can go to service the foreign debt. Those of us who find such a situation unacceptable must turn our attention to looking for alternative solutions, not just for the immediate crisis but for the long run as well. Many of us doubt that such a solution can be found within a capitalist framework, but this is the subject of another paper.

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[28]Shane Hunt, "Direct Foreign Investment in Peru," in Lowenthal, ed. Two years later, Chase returned the favor by agreeing to head an international syndicate to find funds for the Cuajone copper mine--a key project whose financing had been stalled for two years.

[29]OECD, Development Cooperation, 1976.

[30]Calculated from Banco Central de Reserva, Memoria Anual, 1975.

[31]The Greene Agreement was an agreement between the United States and Peru, negotiated by James Greene, former official of Manufacturers' Hanover. In a feat of economic diplomacy, it resolved the long-standing disagreement between the two countries over compensation for Standard Oil's subsidiary International Petroleum Company. A lump sum was agreed on as compensation for all companies nationalized by Peru, with separate lists of recipients presented by the United States and Peru. See discussion in Latin America Economic Report 2, no. 9 (Mar. 1., 1974).

[32]See accounts in Latin America Economic Report, 3, no. 27 (July 11, 1975).

[33]Andean Report, January 1977.

[34]Another interpretation of the pipeline decision, however, says that it was not made on economic but on military grounds. That is, for reasons of national defense, the military decided to build the pipeline rather than use the cheaper means of shipping the oil by way of Brazil.

[35]Washington Post, Mar. 14, 1978.

[36]Accounts of the package can be found in various places. See, among others, The Andean Report, August 1976; Latin America Economic Report, 4, 30 (July 30, 1976); New York Times, July 24, 1976, and August 4, 1976; Financial Times, July 27, 1976; and Nancy Belliveau, "What the Peruvian Experiment Means," Institutional Investor, October 1976.

REFERENCES

[37]Belliveau.

[38]Ibid.

[39]One of the complications was the disclosure in mid-August that the Peruvians had bought a large number of Soviet aircraft worth approximately the same amount as the U.S. loans. Rumors that the loans would therefore be cancelled proved groundless, but the bankers were not pleased. See Financial Times, Aug. 1, 1976.

[40]The relationship between the banks and the Peruvian government was similar to that which often exists between the IMF and governments seeking loans. Like the banks, the Fund has its views of how an economy should be run, and this often coincides with the views of one faction of the government. This faction, however, may not have sufficient power to impose its policies without outside help.

[41]World Bank, "Peru: Informe socioeconómico" (January 1978), p. 13.

[42]"The Editors' Comment," Monthly Review, Sept. 1976, p. 20.

[43]Belliveau, p. 34.

[44]Harvey D. Shapiro, "Monitoring: Are the Banks Biting Off More than They Can Chew?," Institutional Investor, Oct. 1976, p. 2.

[45]Belliveau, p. 34.

[46]Ibid.

[47]Ibid.

[48]Business Week, Mar. 21, 1977.

[49]The sol in 1976 was valued at 65 per dollar.

[50]Details are presented in the Lima weekly Caretas, Apr. 5, 1977, pp. 11-15.

[51]Latin America Economic Report, 5 no. 15 (Apr. 22, 1977).

[52]For a more extensive account of the contradictory sequence of events surrounding the IMF negotiations, see Nicholas Asheshov, "Peru's Flirtation with Disaster," Institutional Investor, Oct. 1977.

[53]Bill Bollinger, "Workers' Militancy Grows in Peru," The Guardian, Apr. 26, 1978.

[54]Latin American Economic Report.6, no. 10 (Mar. 10, 1978).

[55]Information comes from television speeches by Morales Bermúdez and Finance Minister Javier Silva Ruete. See Wall Street Journal, May 22, 1978, for the former, and Latin America Economic Report 6, no. 24 (June 23, 1978), for the latter.

[56]Bill Bollinger, "Peruvian Workers Stage General Strike," The Guardian, May 31, 1978.

[57]Financial Times, June 1, 1978, and New York Times, June 10, 1978. The one major bank holding out on this latest agreement was Chase Manhattan, lead bank for the huge Cuajone copper project. Chase sent a telex to the Peruvian government demanding that a law be approved immediately guaranteeing continuation of the current practice of setting aside money from copper sales to service the Cuajone loans. Retaliation, in the form of interfering with new loans, was threatened if such a law were not forthcoming. (See Financial Times, May 24 and June 1, 1978).

[58]Wall Street Journal, June 2, 1978.

[59]Latin America Political Report 12, no. 24 (June 23, 1978).

[60]Information is from the annual reports of the banks.

[61]OECD, Development Cooperation, 1976.

[62]Asheshov, p. 38. See similar documents in Business Week, Sept. 5, 1977, pp. 31-34.

[63]For an analysis of differences of opinion between the banks and the Fund, see Cary Reich, "Why the IMF Shuns a 'Super' Role," Institutional Investor, Sept. 1977.

[64]Shapiro.

[65]Interviews with State Department, Treasury Department, and private bank officials.

[66]The difference between rescheduling and refinancing has both economic and psychological aspects--although both mean that a country cannot pay its debts. A rescheduling involves a lengthening of the period during which the country will repay its loans, and usually a grace period as well. Refinancing, on the other hand, means that a new loan is given to enable the old one(s) to be repaid. Because interest may be increased and commissions will be earned by the banks, under this method, it is the preferred one from the banks' point of view. In psychological terms, a rescheduling is considered more damaging to a country's creditworthiness.

[67]Television speech of Finance Minister Javier. See Latin America Economic Report 6, no. 24 (Jun. 23, 1978).

[68]On the Italian and British experiences with the IMF, see Cheryl Payer, "The Italian Crisis," mimeo, 1978, and Barbara Stallings, "The IMF in Europe: Inflation Fighting in Britain, Italy, Spain, and Portugal," mimeo, 1978.