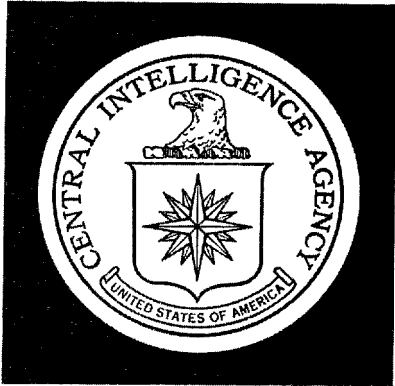


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DIRECTORATE OF
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WEEKLY SUMMARY

Special Report

Problems Facing Peruvian President Belaunde

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Secret

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PROBLEMS FACING PERUVIAN PRESIDENT BELAUNDE

With one year remaining in his six-year term, President Fernando Belaunde Terry is faced with increasing economic and political problems. His Popular Action party is moving to the left and has nominated a leader of the "hothead" faction for the presidential election next June. Although some of the fiscal measures needed to promote financial stabilization are at last being adopted under an extraordinary-powers law passed by Congress in a rare instance of cooperation with the executive, prospects are not good for an early restoration of Peru's once-enviable record of economic accomplishment. As politicians seem less and less capable of governing effectively, military leaders are again working on contingency plans--a routine procedure when they believe they may ultimately have to assume political power.

Belaunde's Style

Some of President Belaunde's problems arise directly from his style of governing. He has not been a strong leader, particularly over the past year which has seen a steady deterioration in Peru's economy and the President's relations with Congress. The President has increasingly given the impression that he is interested only in finishing out his term, allowing events to drift in the hope that problems would somehow resolve themselves.

Belaunde's ideology is a vaguely defined adherence to "social justice." His specific programs are heavily oriented toward public works projects, probably as an outgrowth of his architectural background. His

primary goal is to complete the trans-Andean highway system that will connect Peru's coastal region with the fertile Amazon basin to the east. He also has advocated agrarian and urban reform programs.

He has always, however, been vague about the financing of the specific programs. His suggestions for solving Peru's present difficulties are no more definite. Recently even his own cabinet members have openly tended to view his programs as excessively unrealistic in view of Peru's economic problems.

Problems with the Popular Action Party

Although Belaunde founded the Popular Action Party (AP)

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after his defeat in the 1956 presidential election, his alienation from its leaders is becoming increasingly evident. Not long ago the party expelled and censured several of Belaunde's supporters because of policy differences. Although Belaunde fought their ouster and has advocated their reinstatement, the party leadership has refused to accommodate him.

At the party's convention in June, Edgardo Seoane, the first vice president of Peru and leader of the leftist "hothead" faction of the AP, was chosen as the party's presidential candidate in the election next June. In his acceptance speech, which probably reflected political oratory more than true conviction, Seoane called for sweeping reforms, including state regulation of the economy and investment, and legalization of the Communist Party. He also criticized rich nations for imposing unfavorable terms of trade on developing countries--an obvious slap at the US.

The AP convention adopted a number of leftist resolutions, including a condemnation of "imperialist aggression against North Vietnam." The resolutions also call for commercial ties with Communist countries and a general amnesty for Peruvian political prisoners, presumably including captured guerrillas.

Other Political Parties

Belaunde received the support of the Christian Democratic

Party (PDC) in the election campaign of 1963 and in his government until last fall. By November 1967, however, policy differences between his party and the generally more leftist PDC had become irreconcilable. In addition, the PDC blamed the government's policies for electoral setbacks that both it and the AP had suffered. Since leaving the government the PDC has given Belaunde's program only selective support.

PDC leaders are becoming increasingly strident in their criticism of the United States. Their presidential nominee has called for suspending payments of Peru's debt to the US and for studying means of canceling US mining concessions.

The PDC lost an important moderating influence in December 1966 when the popular mayor of Lima, Luis Bedoya Reyes, left the party to form the Popular Christian Party (PPC). Bedoya and the other PPC leaders have supported the government, but they never formally entered the alliance with AP. Leftists within the PDC are being encouraged by the Marxist-front Unity of the Left, which has proposed an electoral pact that could be an important force in the elections next year, especially if it also were joined by leftists from the AP.

The major opposition party is still the American Popular Revolutionary Alliance (APRA), led by 73-year-old Victor Raul Haya de la Torre. APRA has supported very few of Belaunde's

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programs, and has stood firmly against raising taxes without first exploiting all other sources of revenue. Apristas have generally supported positive programs, however, when the country was in serious difficulty. This was demonstrated recently when APRA supported a bill giving the executive special powers to deal with the faltering economy, even to include raising taxes.

Some rapprochement apparently is developing between APRA and the military, which have been at loggerheads since the 1932 clashes between APRA militants and armed forces personnel that led to deaths on both sides. The military took over the government in 1962 to prevent Haya from obtaining the presidency, but military spokesmen have recently hinted that he might be permitted to conduct an unobstructed political campaign next year and take office if elected.

Congressional-Executive
Relations

The congressional elections in 1963 gave control of Congress to a coalition of the APRA and the National Odrista Union (UNO), the personal political vehicle of former dictator General Manuel Odría. In April and May 1968, however, the UNO split because of a dispute over the blind obedience required by Odría. The dissidents have formed a new party called the Independent Parliamentary Action Group, which at times cooperates informally with APRA and with what is left of the UNO. This division increases the number of groups to be placated by Belaunde if he is to receive legislative support for his policies.

Opposition to Belaunde's program in Congress has not been blindly obstructionist. His strained relations with his own party have prevented him from



FERNANDO BELAUNDE



EDGARDO SEOANE



HOYA DE LA TORRE

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No Foreign Dissem

presenting a strong government position to the opposition legislators. In addition Belaunde has not used his presidential prerogatives forcefully and has permitted Congress to delay and dilute his legislative proposals.

Belaunde's problems with the legislature are exemplified by the large number of cabinet ministers who have resigned because they were unable to secure congressional approval for their programs or were threatened with censure. The Finance Ministry, for example, has changed leadership so often that no one man has had time to develop a coherent policy. In May, Belaunde was forced to reorganize the cabinet almost completely as a result of deteriorating public confidence in his government's ability to deal with serious economic problems.

The present prime minister is Oswaldo Herculles, a physician who at one time served as minister of public health. So far, at least, his cabinet has received more support from Congress than has been usual in Peru. Under the 60-day special powers provision Finance Minister Manuel Ulloa has promulgated a sweeping financial stabilization program, most of which Congress is expected to approve when it reconvenes later this summer.

Strains between the executive and the legislature also occurred as a result of a congressional investigation this

year into the contraband activities of several government officials, AP party members, and the military. This investigation, which even involved a few members of Congress, caused a further decline of public confidence in the political and governmental machinery that runs the country.

The Peruvian Military

The Peruvian armed forces consider themselves the arbiters of Peruvian politics. They have played an important but behind-the-scenes role since Belaunde's inauguration in 1963. Although there are sporadic rumors of coup plotting, there is little indication that the military is interested in taking a more active hand in government unless there should be a real paralysis of both the legislative and executive branches.

The extent of the armed forces' influence is indicated by the fact that the air force completed purchase of a squadron of French Mirage supersonic jet fighters at a time of budgetary problems. Belaunde must consider military reaction to all his policies and is reluctant to take action that he knows will offend the military establishment.

Foreign Relations

Peru's relations with the US have been plagued by a number of disagreements in recent years. The most serious concerned the

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purchase of the Mirages, which raised the question of the applicability of US legislation that would limit or suspend aid to countries that buy sophisticated military equipment. Rumors that aid had already been suspended caused a rash of anti-American sentiment in May. Most Peruvians believe the US legislation is an unwarranted interference in their internal affairs. Belaunde has tried to restrain military purchases, but he is forced to keep the military satisfied or face a move against his government by the armed forces.

An additional problem with the US has developed over fishing rights within the 200-mile territorial limit claimed by Peru. Like Ecuador, Peru has seized US fishing boats that were within its claimed territorial waters, provoking protests from members of the US Congress.

The Peruvian military seems to consider Chile a serious threat, and most of its contingency planning is directed there. Hostility to Chile dates from the nineteenth century War of the Pacific, when Chile captured the Bolivian littoral and part of southern Peru. The prospect of the election of a Communist-supported president in Chile in 1970 adds urgency to the plans of the Peruvian military.

Although Peruvian trade with Communist countries expanded in 1967 and a Peruvian trade mission

visited Eastern Europe and the Soviet Union this summer, the Peruvian Government has been reluctant to discuss diplomatic relations. Many politicians advocate expanded contacts with the USSR, and businessmen have also shown a great deal of interest. Public reaction has been favorable to the development of economic and cultural relations, but formal diplomatic arrangements probably will take some time to mature.

Economic Problems

During its first several years in office, the Belaunde government sustained the high growth rate that began in 1960. The rise of Gross National Product from 1960 to 1966 averaged 6.3 percent annually--the highest rate in South America and one of the highest in Latin America. Growth dropped to 4.0 percent in 1967, however, and to an annual rate of 3.5 percent in the first quarter of 1968--or barely more than the growth of population.

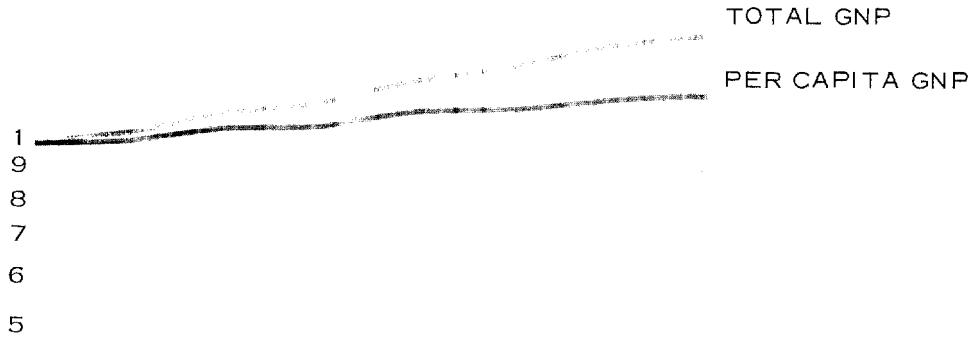
The chief cause of the slowdown was bad weather that cut deeply into agricultural production. Reduced public and private investment slowed construction, and a combination of higher tariffs and devaluation reduced supplies of imported materials needed to expand mining and manufacturing. This year, the slowdown has been accentuated by new quantitative restrictions on some imports and by further declines in investment as the business community

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Economic Trends in Peru 1960-1967

GROSS NATIONAL PRODUCT



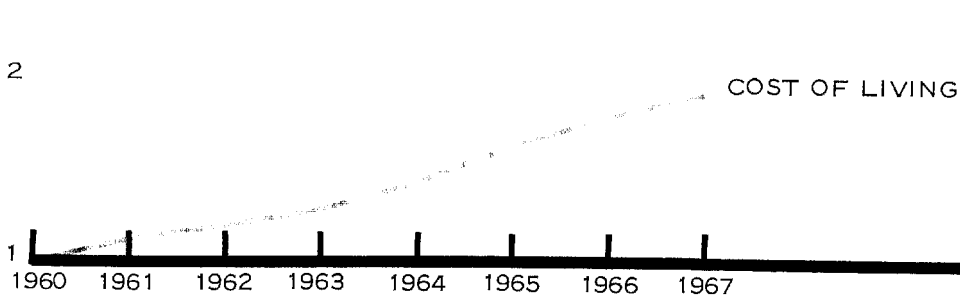
SECTOR BREAKDOWN OF PRODUCTION



TRADE (in Millions of US Dollars)



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lost confidence in the Belaunde government's ability to cope with its fiscal problems.

Balance of Payments Difficulties

The substantial growth in export earnings had been an important aid to economic expansion. In 1967, however, fish-meal prices dropped and cotton exports declined. At the same time, imports rose in anticipation of an increase in import duties. A trade deficit accumulated, and short-term capital began to flow out of the country because of an expected devaluation.

Following the 40-percent devaluation of the sol in September, exports grew and imports were curtailed. By the end of the year, a small export surplus was achieved. This surplus has increased this year because of the devaluation's restrictive effect on imports, reinforced by the imposition of a surcharge on most imports and a temporary prohibition on others. Peru's balance of payments, however, has continued to deteriorate, apparently because of a continuing flight of short-term capital.

Budgetary Problems

Budgetary deficits have been a persistent problem for Belaunde. During his administration the rise in government spending has more or less paralleled the rise in GNP. Most of the increase in expenditure has been devoted to public investment, wage increases to compensate for the rapidly rising cost

of living, and--in 1967--the purchase of military equipment. Central government revenues, including foreign aid, have lagged increasingly behind expenditures. Belaunde's extensive use of exemptions from import duties and profit taxes to encourage industrial expansion is partly responsible for the gap. The major cause, however, was congressional refusal to adopt his proposals for new taxes. Because of this impasse, the government deficit increased rapidly. In 1967, it was equal to 20 percent of total expenditures in spite of a curtailment of investment spending. Recourse to loans from the central bank to finance the deficit contributed greatly to inflationary pressures.

In preparing for the budget for fiscal 1968 that began on 1 April under Peru's new budget system, the Belaunde administration again pressed for the extensive new revenue measures. The emasculation of these proposals by Congress led to the resignation of two successive finance ministers and was a major factor in the resignation of the entire cabinet on 28 May. Although further cuts in investment spending were made, the prospective 1968 budget deficit was equal to 20 percent of planned expenditures.

On 19 June, however, Congress granted the government a 60-day period of extraordinary powers to carry out a new fiscal program by decree to reduce the prospective deficit. Major elements of the program include

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No Foreign Dissem

large increases in taxes on gasoline, the adoption of several new taxes, and cuts in military and other spending. These measures will reduce the deficit to about 14 percent of expenditures. The government hopes that this display of responsibility will pave the way for refinancing its foreign debt and a consequent further reduction in the deficit.

US Private Investment and Foreign Aid

The inflow of direct private investment funds dropped sharply in 1966 and continued its downward trend in 1967. Important factors behind this trend were growing doubts about Peru's financial stability, and frequent demands by Congress for the nationalization of such foreign firms as the US-owned International Petroleum Company. The decline in private foreign investment may be reversed as a result of the Belaunde government's new fiscal program.

Apparently influenced by the program, the US-owned Southern Peru Copper Company announced on 24 June its willingness to proceed with an investment of \$280 million to develop newly discovered copper deposits. There is also press speculation that the other two large US-owned copper companies in Peru may follow suit, with investments totaling as much

as \$500 million for the three companies over the next few years. Expansion of copper exports as a result of these investments would not take effect for three or four years.

Belaunde's public investment program has been financed in part by US economic aid. The Symington and Conte-Long amendments to the US Foreign Economic Assistance Act of 1967, however, recently prompted restrictions on aid to Peru because of its military expenditures. This problem may be eased by the government's new fiscal program which calls for a cut in military expenditures.

Outlook

The new climate of cooperation between Congress and the executive may alleviate some of Belaunde's most pressing problems but the prospect for any long-range solutions is dim. Belaunde's estrangement from his own party will undoubtedly continue and it is highly unlikely that his over-all relations with Congress will improve significantly. Belaunde will probably serve out the remainder of his term unless there is a large-scale breakdown in public order as a result of the current fiscal problems. The military is now conducting studies of Peru's major problems on the possibility that events will necessitate a military intervention in the

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government. It is still too early to determine the military's attitude toward next year's elections, but there have been indications that its opposition to APRA may be softening.

In spite of the improved prospects for a lower government deficit and some recovery of business confidence this year, a continued slow rate of economic growth is likely. Sluggish export performance over the next year or two,

caused in part by a continuing decline in copper prices, will require continued import restrictions and possibly another devaluation. In turn, shortages of imports will restrain the expansion of investment and production and will contribute to continuing inflationary pressures. Finally, crop forecasts indicate that because of continued bad weather, agricultural output for the full year 1968 may well be below the 1967 level. (SECRET NO FOREIGN DISSEM)

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