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Latin America

REGIONAL AND POLITICAL ANALYSIS

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LATIN AMERICA

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This publication is prepared for regional specialists in the Washington community by the Latin America Division, Office of Regional and Political Analysis, with occasional contributions from other offices within the Directorate of Intelligence and from other agencies within the Intelligence Community. Comments and queries are welcome. They should be directed to the authors of the individual articles.

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Lima police disperse demonstrators protesting austerity measures last month.

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Peru: Strike Increases Pressures on Government

The Peruvian government's deliberations on economic policy took on a greater note of urgency this week as a leftist-led general strike brought commercial life in Lima to a standstill. This signal victory for the left, coupled with the violent disturbances it has orchestrated throughout the country in recent weeks, places the government under additional pressure to modify substantially the severe austerity program announced last month. The cabinet continues to disagree, however, over what changes are needed, casting doubt on the government's ability to cope with the situation.

The strike on Tuesday, organized by the Communist-supported General Confederation of Peruvian Workers, closed most shops and factories and completely disrupted

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transportation in the capital. A breakdown in communications made it difficult to determine how effective the strike had been in other cities.

1 Regular army troops and tanks were patrolling the streets of Lima to prevent any recurrence of violent incidents that claimed six lives in the industrial suburbs, where demonstrators clashed with marines and security forces. The government also reportedly ordered the arrest of scores of labor leaders.

3, 1 The success of the strike undoubtedly surprised government leaders, who had questioned the left's ability to mount such an effective walkout. The strike was supported by the Christian National Workers Confederation, the ultra-left National Agrarian Confederation, and even the government-financed labor organization. It was the first time that a strike had been supported by such ideologically divergent labor organizations, some of which have been in constant conflict.

3 All of this spells additional trouble for the government. It reportedly was already concerned about leftist-instigated student and worker protests over food and fuel price increases that had spread to 15 urban centers and resulted in 20 deaths. The cabinet is now considering new economic guidelines that were submitted on Tuesday by Finance Minister Saenz. Although no public announcement has been made, the new proposals reportedly include a rollback of petroleum, transportation, and food prices and a relaxation of restrictions on public spending.

President Morales Bermudez now finds himself caught between the exigencies of the present situation and Peru's need for economic stabilization measures to qualify for essential foreign balance-of-payments credits. [redacted] 25X1
3 [redacted] 25X1
2 [redacted] He faces strong opposition, however, from a cabinet group, led by Industry Minister Gaston Ibanez O'Brien, that apparently is less interested in long-term stability than in finding more immediate palliatives. 25X1

3 The disagreement promises no early solution to the problem. Should the civil unrest continue, it could threaten not only Morales Bermudez' position, but also his commitment to return Peru to civilian rule in 1980.

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Belize: The Pressures on a Bystander

Amid continuing speculation that Guatemala and the UK are making progress on a possible territorial cession to pave the way for Belizean independence, Belize is cast in the role of suspicious bystander. Chief British negotiator Rowlands will visit Guatemala next week to pursue the territorial question. This next stage of talks will probably determine whether the negotiations will continue or be derailed, leading to a resumption of border tensions.

Premier Price

Premier Price of Belize participated as an observer in the July 6-7 talks in Washington.

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Price and his ruling Peoples United Party have adamantly opposed ceding any territory to Guatemala, believing that time and international opinion are in their favor. Price would prefer to continue efforts to internationalize the question and capitalize on overwhelming support for Belize's cause in the UN.

One of Price's concerns is that preliminary studies indicate possible deposits of oil in southern Belize, the territory most likely to go to Guatemala in a compromise settlement. Belize is poor, and loss of any territory, particularly with potentially valuable natural resources, would cause Price serious politicial injury.

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Price is also facing increasing political challenges at home. Opposition party leaders accompanied him to the Washington talks and presented a facade of cooperation on independence without territorial cession. In the two weeks since the conclusion of the talks, however, the opposition press has lambasted Price, and the United Democratic Party (UDP) chose the sensitive period of border tension to stage a protest demonstration in Belize City. The UDP insists that Price submit any independence move to a national referendum. UDP leaders declare that Belize must not rush into independence without assurance of protection from Guatemala--in reality, they would like to see no independence before the general elections two years hence, which they expect to win.

Guatemala banks on the UK's ability to pressure Price to cooperate in a territorial cession. The leading opposition party in Guatemala has now raised the Belize matter as an issue in the current presidential campaign, thereby limiting the government's options in negotiating a settlement before the election next March. The Guatemalans continue to believe that Cuba is offering military and technical assistance to Belize [redacted] 25X1

25X1 [redacted] Price publicly denies having close relations with Cuba, but has implied that he would accept Cuban support in the event of a clash with Guatemala. This may be simply a tactic to scare the Guatemalans out of their intransigence, since Price probably realizes that close relations with Cuba would jeopardize essential British support. Guatemala is more likely to overreact than to come to terms in the face of a real Cuban connection. [redacted] 25X1

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Panama: Keeping the Lid on at Home

As the treaty negotiations in Washington enter their final phase, Chief of Government Torrijos is so far maintaining his mastery at home. Recent government efforts make plain that General Torrijos, especially at this point in the negotiations, has no intention of allowing domestic events to dictate any of his treaty tactics. Over the last several weeks, the government has been working to extend its control over students, has decreed relatively low level media attention for the negotiations, and is holding down emerging rightist, ultranationalist criticism of a new treaty.

On the student front, the government is making a significant effort to ensure that activities are coordinated or at least closely controlled. Students, no strangers to the government's carrot-and-stick approach, have recently been the recipients of both.

The administration has stepped up efforts to make the largest student group, the Panamanian student federation (FEP) more responsive. The government has established an unofficial commission to assist the leftist pro-Torrijos political organization, Fraccion, that controls the FEP.

1,2,3 [redacted] 25X1

At the same time, the Guard has shown it will crack down on unsanctioned activities by the ultra-left. [redacted] 25X1

25X1 1,5 [redacted] Torrijos recently stated he was willing to use whatever force was necessary to prevent students from disrupting the negotiations. On

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June 27, when youths from an ultra-leftist group decided to make an apparently unplanned return to the US embassy following a peaceful demonstration by a larger group, Guard units used rubber hoses to disperse them.

Torrijos appears equally unwilling to be pressured by ultra-nationalistic critics on the right. Responding to charges this month by the Independent Lawyers Movement that the government has conducted "closed door diplomacy" with regard to the treaty talks, Torrijos' foreign minister rebutted the argument and attacked the "ulterior personal objectives" of persons "whose political ideas do not coincide with ours." Officials have effectively employed such implicit charges of disloyalty to the Torrijos Revolution and, combined with control of the media to follow up on such leads, they should be able to keep the lid on the right.

The government appears to have decreed generally low-key media coverage of treaty-related matters. The most closely controlled papers, when they lack clear guidelines, have sometimes totally ignored major developments. Even those papers subject to less control have been very sparing in their editorial comment. [redacted] 25X1

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Venezuela: New Cabinet Ministers Appointed

2 President Carlos Andres Perez named seven new ministers to his administration last week. Although there had been rumors of imminent cabinet changes for some time, Perez caught some people by surprise by announcing the new appointments just two days prior to the Democratic Action (AD) party's selection of Luis Pineura Ordaz as its presidential candidate for the December 1978 election.

/ The most important of the seven changes was the naming of Alberto Consalvi as minister of foreign affairs, Major General Paredes Bello as defense minister, and Lauria Lesseur as minister of the presidential secretariat. The other incumbents are Luis Jose Silva Luongo, minister of finance; Gustavo Pinto Cohen, minister of agriculture; Hector Hurtado, minister of state and president of the Investment Fund; and Jose Luis Salcedo Bastardo, minister of state for culture, science, and technology.

2 The replacements afford Perez the opportunity to provide an answer to critics of his political and economic policies as well as to ensure that his most trusted people are in key positions. Perhaps more important, the new appointments probably represent the beginning of a series of carefully calculated moves to maximize Perez' authority in the government and to prolong his influence within the AD party.

2 The announcement of the cabinet changes on the eve of the primary served to distract public attention from Pineura's center spot on the political stage. Pineura's selection as the AD standard bearer marks the first time the party has chosen a presidential candidate by direct primary. Perez, who perhaps would have been in a stronger position under the former convention delegate system to influence selection of an AD candidate, was known to favor the other party hopeful--congressional whip Jaime Lusinchi.

2 From this point on, the relationship between Perez, his party, and the other major political institutions will

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undergo significant changes as public attention shifts to Pineura and power begins to slip inexorably from the President's grasp. Such a diminution of attention and authority will be in direct contrast to Perez' role as a strong chief executive who over the past three years has become the dominant political figure of the nation.

The appointments of Consalvi and Bello in particular--each trusted confidants and close personal friends of the President--are intended to arrest the decay of Perez' political power. Consalvi is expected to be a staunch defender of Perez' numerous foreign policy interests, while Bello, renowned as a "political general," is expected to employ his strong connections in the AD party to the President's benefit.

Jockeying for political power is vitally important to a man like Perez who envisions himself as a hemispheric leader and a spokesman for the third world. Furthermore, by feathering his political nest now, Perez may still be in a position to run for the presidency in 1988 when he will again be constitutionally eligible.

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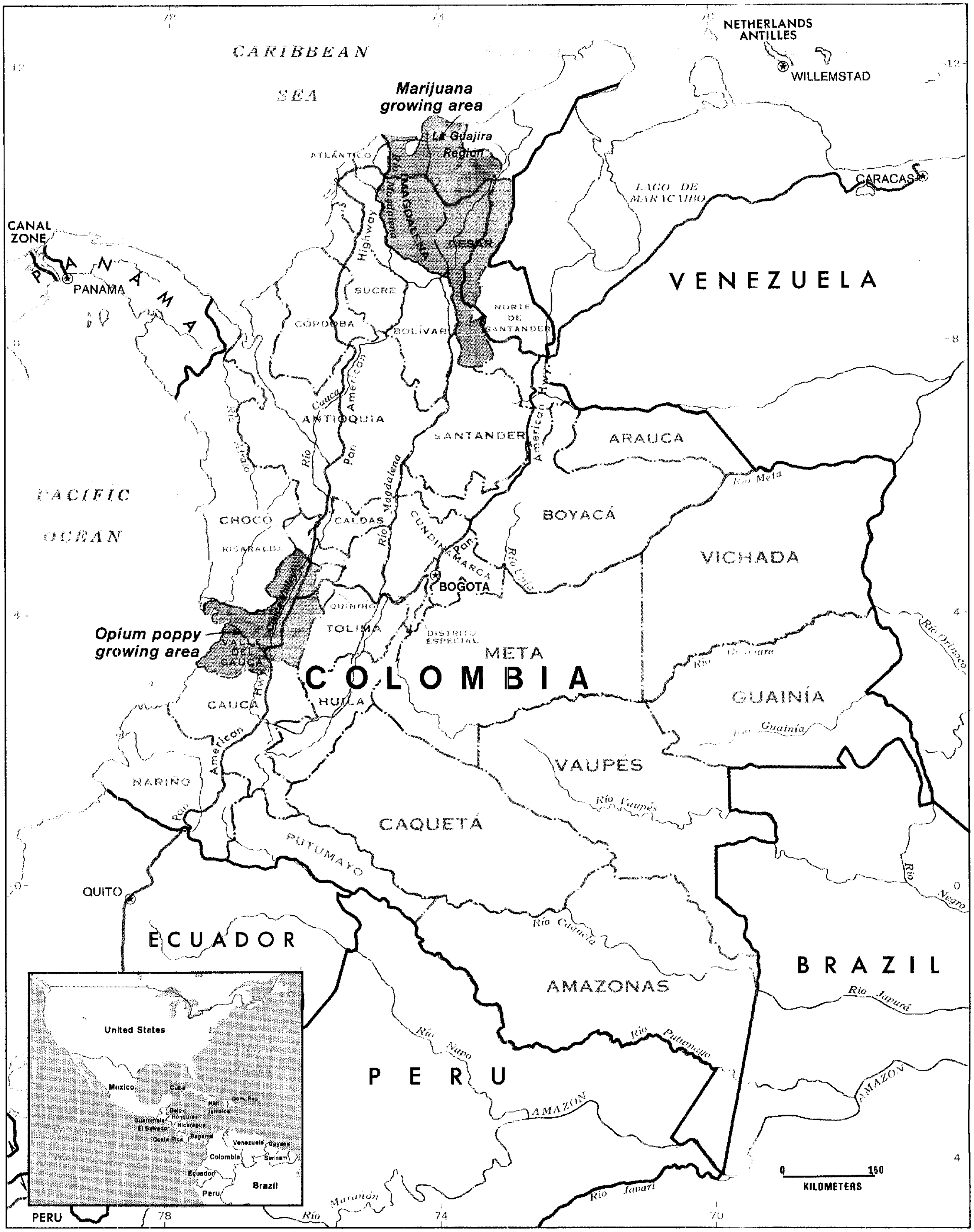
COLOMBIA: Major Drug Producing Areas



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Colombia: Strengthening Narcotics Control Efforts

Relations between Washington and Bogota appear to have been strengthened--at least with regard to joint drug control efforts--as a result of last month's meet-
2 ing between First Lady Rosalynn Carter and President Lopez. Since then, Lopez has met with other US envoys and drug experts to discuss the narcotics problem in Colombia. A number of positive developments have already begun to unfold.

At Lopez' urging, the US has agreed to give the Colombians $3.7 million worth of equipment, including
2 three helicopters, to try to curb the flow of cocaine and other drugs to North America.

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The emphasis in all of the narcotics dialogues has centered primarily on the cocaine problem. But in the wake of recent widespread media coverage in Colombia on the extensive cultivation of marijuana in the Guajira region, Lopez has specifically requested US technical assistance for a herbicide spray program similar to the one currently under way in Mexico.

Colombian police officials estimate that as many as 30,000 hectares of marijuana may be under cultivation. Preliminary reports from a US drug control expert indicate that 90 percent of the crop would be susceptible to aerial spraying without danger to humans or legitimate agricultural crops. A pioneer in aerial spraying, Colombia has the necessary equipment, chemicals, and personnel to launch its own eradication campaign. It is likely, however, that the initial request for technical assistance from the US will be followed by a request for financial and material support as well.

Although marijuana eradication is a low priority for the US, it is a major concern to the government of

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Colombia in terms of domestic abuse, political embarrassment, and as a major contributing factor to the lawlessness of the Guajira region. In view of the growing evidence of opium cultivation in Colombia, there is a possibility that at some later date the US may find it desirable to encourage the Colombians to initiate aerial spraying against the poppy fields and coca bushes in other parts of the country.

While coca is not grown extensively in Colombia, local traffickers might decide to increase cultivation--particularly if crop substitution programs and more stringent enforcement measures in Peru and Bolivia re-
2 sult in a reduction of coca leaves. At the same time, Mexican traffickers, whose heroin operations have been disrupted by the poppy eradication program there, are reportedly collaborating with Colombians to establish a new source of opium gum. An eradication campaign in Colombia against marijuana would not only set a precedent, but also allay suspicions and fears of both the official and the public sectors about the possible deleterious effects of a larger scale herbicide spray program.

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Brazil: Outlook for the Balance of Payments, Inflation, and Economic Growth

Brazil's military government has been enforcing austere economic policies to cope with a huge foreign financial gap* and severe inflation. Prospects are good for a return to a more comfortable payments position and strong economic growth in the next year or so.

Although the government reacted slowly to signs of growing economic imbalance in 1973-75, rapidly rising foreign debt and accelerating inflation finally forced it to adopt stringent monetary, fiscal, and wage policies in early 1976. Continuation of tight policies and strong export growth should preserve Brazil's foreign creditworthiness and allow a faster economic pace in 1978-80. Progress against inflation is likely--with some hope that the current annual rate of nearly 50 percent may be halved over the next 12 months--but careful management of domestic expenditure will be required to keep it under control.

Dimensions of Economic Imbalance

In 1968-73, Brazil achieved one of the world's highest economic growth rates while containing inflation and holding the current account deficit to readily financeable levels. This era faded in 1973, when growth of domestic demand became excessive, boosting both the price level and demand for imports. Soaring oil and other import prices added to inflationary pressures the following year and accelerated the rise in the import bill; at the same time the world recession began to slow export growth. A quadrupling in the current account deficit pushed the foreign financial gap to $9 billion in 1974, while inflation jumped from 16 percent to 35 percent.

**Financial gap is defined as the current account deficit plus amortization of medium- and long-term debt; shifts in short-term capital are not included.*

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Brazil: Foreign Financial Gap

	1973	1974	1975	1976	1977[1]
	Million US $				
Exports, f.o.b.	6,199	7,951	8,670	10,130	13,500
Imports, f.o.b.	6,192	12,641	12,169	12,277	12,300
Net services	-1,695	-2,432	-3,213	-3,915	-4,500
Current account deficit	-1,688	-7,122	-6,712	-6,062	-3,300
Debt amortization	-2,063	-1,920	-2,120	-2,888	-3,800
Financial gap	**-3,751**	**-9,042**	**-8,832**	**-8,950**	**-7,100**
Medium- and long-term capital inflows	5,435	7,778	7,564	8,931	7,400
Direct private investment	940	887	895	1,010	1,100
Official lending agencies	528	979	907	768	700
Private foreign credit	3,967	5,912	5,762	7,153	5,600
Net short-term capital and errors and omissions	549	117	39	2,526	-300
Change in reserves	**2,233**	**-1,147**	**-1,229**	**2,507**	**0**
Other financial items:					
External debt at yearend (including short-term)	14,023	19,998	25,521	34,090	37,390
	Percent				
Debt service ratio	44	35	39	44	44

[1] Estimated.

Since then, import controls and a marked pickup in export earnings held the financial gap roughly constant through 1976 despite the climb in debt service payments. Inflation worsened, however, reaching 46 percent last year.

Because Brazil has had to cover its tremendous financial gap mainly by borrowing abroad, total foreign debt rose from $14 billion at yearend 1973 to $34 billion at yearend 1976. Debt service payments climbed even faster than export earnings; the debt service ratio rose in 1975 and 1976 after declining in the previous two years.

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The rapid accumulation of foreign debt, higher debt service ratios, lower foreign reserves relative to imports, and resurgent domestic inflation combined to dampen Brazil's credit rating. Both the government and private Brazilian borrowers are paying a greater premium over London interbank rates than a few years ago. Brazil nontheless retains adequate access to foreign financing, largely because of its outstanding economic growth record and long-term growth prospects. During first half 1977, Brazil remained the largest LDC borrower on the Eurodollar market.

The Effort To Restore Equilibrium

Brazilian policymakers, reluctant to admit that growth rates of the "economic miracle" years could not be sustained, were slow to react to the signs of growing economic dislocation. Not until late 1974 were direct controls imposed to check rapidly rising imports. In 1975 these controls were broadened and strengthened; the government also launched an extensive program to accelerate domestic output of the fuels, raw materials, intermediate goods, and capital equipment that make up 90 percent of imports. For more than 30 months imports have remained stable at annual rates just over $12 billion, despite the rise in import prices over the period and annual GDP growth averaging 6 percent.

Brasilia's success in restraining imports has heightened inflation. The step-up in inflation in 1973 occurred primarily because of accelerating investment spending. While direct controls restrained price increases for a time, they were relaxed early in 1974 and prices rose abruptly. By midyear, prices came under better control as soaring foreign payments cut effective demand for domestic goods. The current account deficit rose from 2.5 percent of GDP in 1973 to more than 8 percent in 1974. Inflation then remained at lower rates through the early months of 1975, after which it again gained momentum as the investment rate combined to rise while the current account deficit abated.

It was not until the beginning of 1976 that Brasilia made a concerted effort to contain inflation. Since then, monetary policy has been tightened, and consumer

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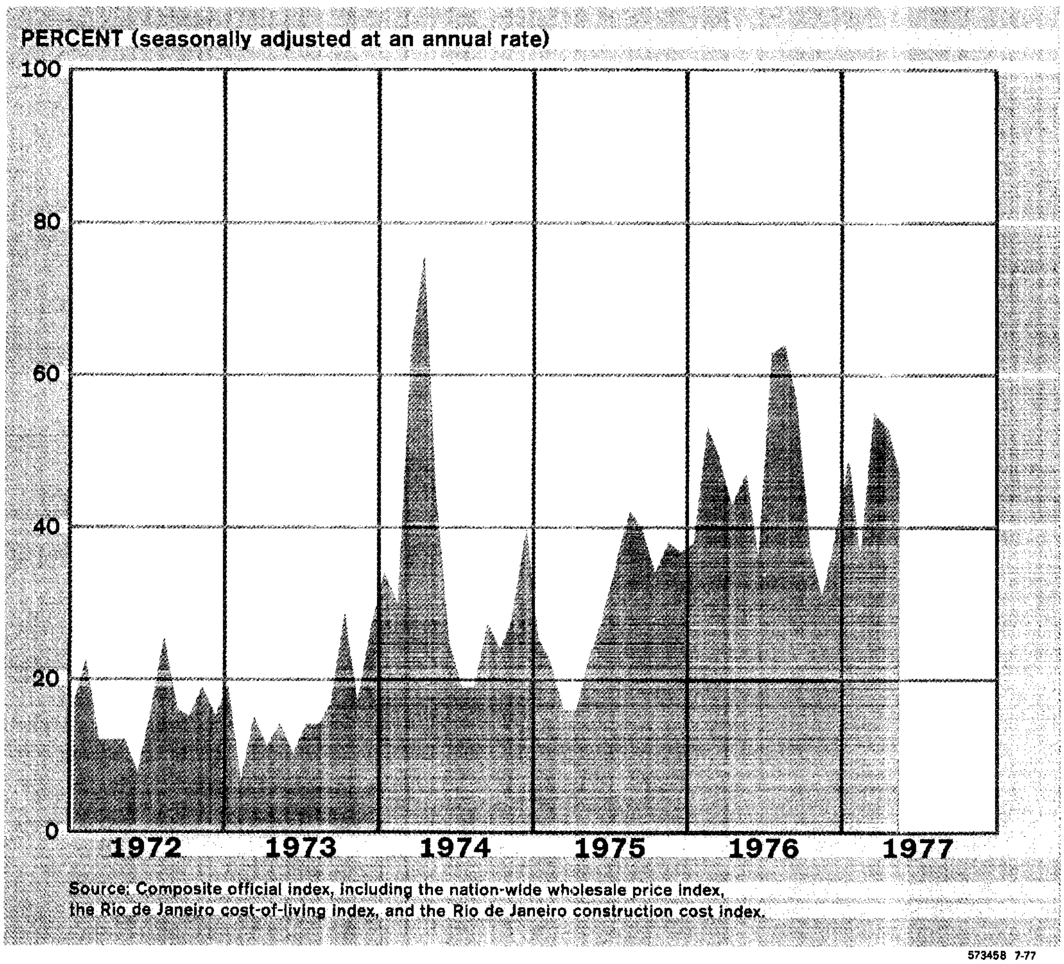
BRAZIL: Inflation Rates



credit has been restricted. About midyear, wage guidelines were firmed up, and real wages now appear to be declining. Late in 1976, public sector investment targets were cut sharply.

The Painful Adjustment in 1977

As a result of these measures, the domestic economy is experiencing its most difficult year in more than a decade. Retail sales are down from a year ago, unemployment is rising, and business failures are on the increase. Even so, substitution of domestic products for

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imports, strong export demand, good crops, and moderately higher investment will permit a 4 to 5 percent growth in real GDP, compared with 8.7 percent in 1976. If GDP simply held at the estimated fourth quarter 1976 level, year-over-year growth would measure roughly 4 percent.

Despite the economic slowdown, inflation has continued unabated and is becoming the focus of growing public discontent. The price rise probably will average 40 percent this year, down but little from last year. Last year's price increases, reinforced by Brazil's indexing system, continue to push up costs. Price pressures also stem from the continuing introduction of high-cost domestic substitutes for imported goods. Finally some foodstuffs are in short supply following the second poor year for several basic crops.

While direct controls and weak demand continue to limit imports, export receipts are soaring. Brazil probably will achieve a trade surplus of at least $1 billion this year, the highest recorded in the past 30 years. Propelled chiefly by high coffee prices, exports may increase by as much as 40 percent in 1977. Soybean and cocoa prices also are up considerably from last year, and manufactured exports are doing well as Brazilian firms turn to foreign markets to compensate for sluggish domestic sales.

The trade surplus will cut Brazil's current account deficit nearly in half in 1977, and the financial gap should narrow by almost $2 billion. Net borrowing requirements (somewhat more than $2 billion) will be the lowest since 1973. Rising interest and amortization payments nevertheless will hold the debt service ratio near the 44-percent level of 1976.

The Longer Outlook

Brazilian policymakers can be expected to shift toward expansionary measures as quickly as inflation and the financial gap are reduced to acceptable levels. The current inflation target appears to be a 25-percent annual rate, a goal that could be reached by early 1978. Brasilia will then step up public sector investment and tone down austerity measures, particularly if strong

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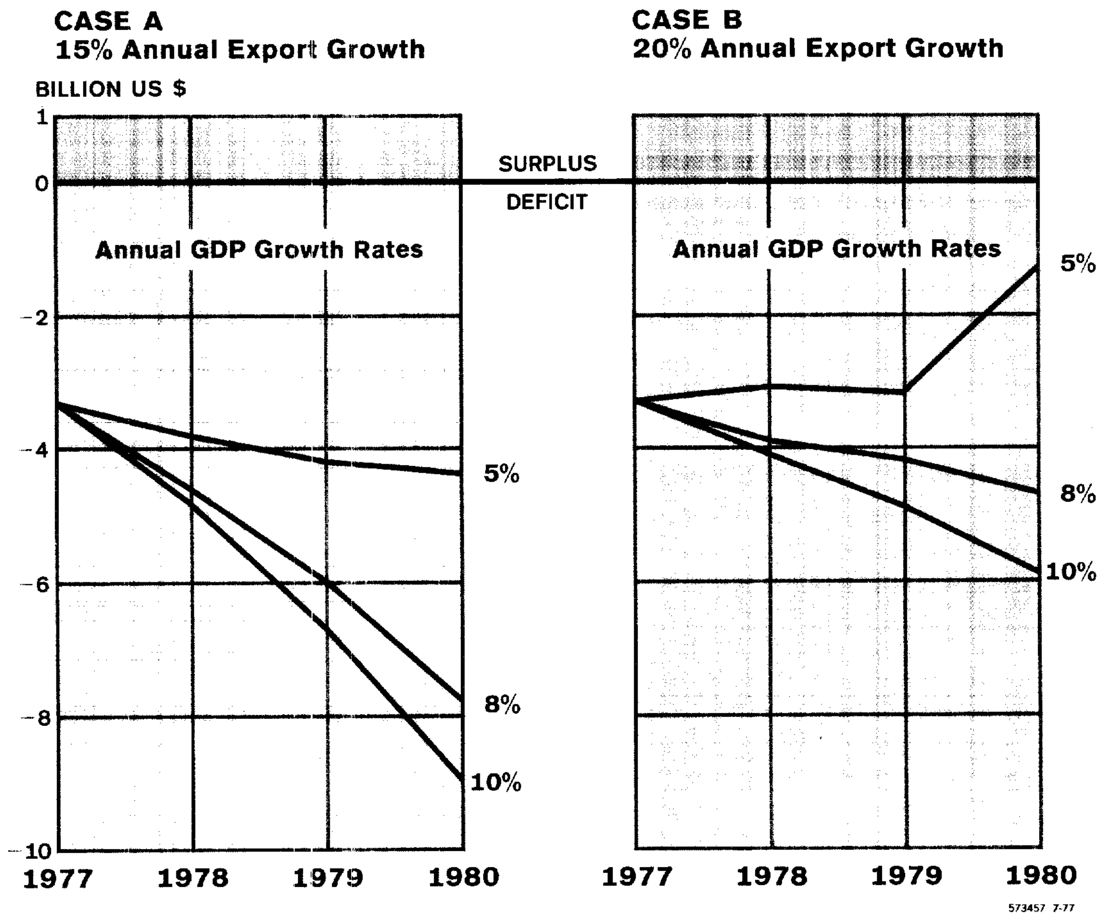
export growth continues. A softening world coffee market may delay Brasilia's ability to boost imports, however, requiring the retention of anti-inflation measures. The Geisel government's weakening political base and its desire to return to more rapid economic growth will remain strong arguments for easing restrictive policies.

BRAZIL: Current Account Balances at Various GDP Growth Rates



Despite an uncertain outlook for exports next year, a reasonable annual growth rate for the whole period through 1980 would fall in the 15- to 20-percent range. The current retreat of coffee prices from recent peak levels will be moderated by continued tightness in world coffee supplies; another Brazilian frost would send the

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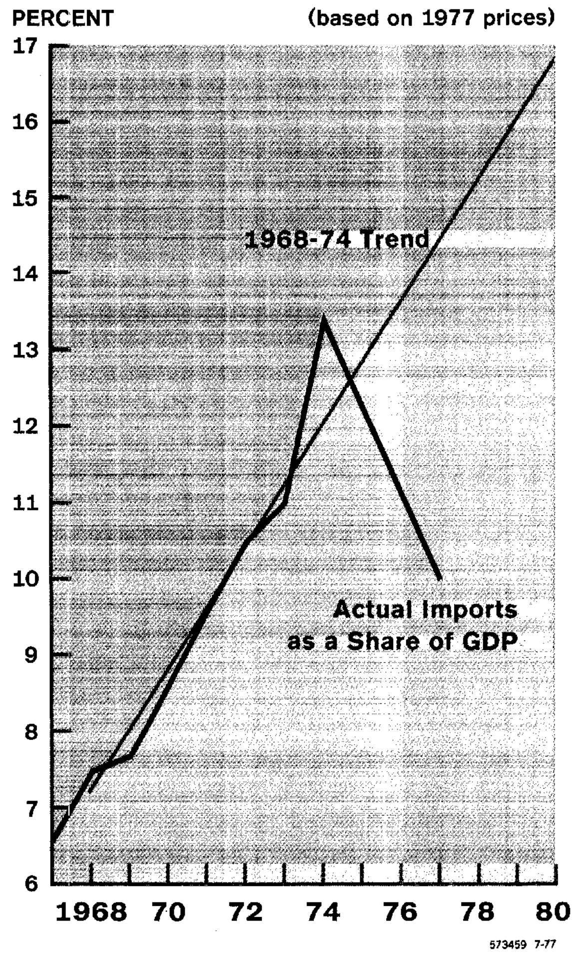
market into a new period of strong price advance. While Brazil's reserve coffee stocks are now badly depleted, existing stocks probably could cover one more bad harvest with only a moderate reduction in export volume.

BRAZIL: Imports as a Share of GDP



Once controls are relaxed, imports probably will pick up markedly over the next few years because of a renewal of rapid economic growth and the need to rebuild working inventories, badly depleted since 1974. Even with continued import substitution, imports are again likely to rise somewhat faster than GDP for a few years at least. In the 1968-73 boom years, imports grew nearly twice as fast as the economy, rising from about 7 percent of GDP in 1967 to 11 percent in 1973. The import to GDP ratio increased sharply in 1974, to 13.4 percent, as surplus stocks accumulated; the subsequent drop to 11 percent by 1976 was partly due to the working off of these excess inventories. The import ratio now appears to be excessively depressed both in terms of its trend over the past decade and by the standards of almost all other countries. We estimate that the import to GDP ratio will edge back up to 12 percent by 1980.

Debt service payments should increase more slowly than exports over the next few years. The growth of interest payments will be fairly moderate because an improved trade balance should slow the growth of total debt. While amortization payments are accelerating because of the shorter average term of recent loans and the expiration of grace periods, the amortization schedule indicates that debt repayments will rise somewhat more slowly than exports. The debt service bruden would worsen considerably, however, if interest rates increase.

Three-fourths of Brazil's debt has been borrowed at variable interest rates; Brazilian bankers have estimated that, at current debt levels, an increase of 2 percentage points in money market rates would add about $500 million to annual interest payments abroad.

Given the above projections, we estimate that the current account deficit will return to the $6 billion to $7 billion level by 1980, while the financial gap will reach $10 billion to $12 billion. Nevertheless, Brazil's creditworthiness should improve over the next three years. Debt service payments will be moderately lower and net borrowing requirements much lower relative to exports than in 1976. Partly offsetting this improvement, however, is an implied drop in foreign reserves as a share of annual imports, from one-half at the close of 1976 to one-fourth in 1980.

The expected export growth and net borrowing abroad in 1978-80 should provide enough imports to support annual real economic growth in the 7- to 10-percent range. Given the rising trend of Brazil's investment rate during the 1970s and the heavy investments needed to carry out large, capital-intensive import substitution programs, economic growth at the lower end of this range would require an investment rate at least equal to the present 26 percent of GDP. If Brasilia tries to push growth toward the 10-percent level, the required investment rate would mount. Meanwhile, the expected current account deficits through 1980 imply a declining inflow of foreign funds relative to GDP. To finance an adequate investment rate without increased inflationary pressures, Brasilia will need to increase domestic savings through firm wage, consumer credit, and fiscal policies over the next few years.

Brazil's military regime is capable of meeting this challenge, even though its power to sustain unpopular economic policies has lessened. The regime is aging. Recent economic problems--inflation in particular--have eroded its prestige. Moreover, the regime must choose a successor to President Geisel within the next 18 months, a process that could further weaken its ability to cope with economic problems. [redacted] 25X1

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