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Intelligence Memorandum

Peru: Thirty Months of Revolution

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
4 May 1971

INTELLIGENCE MEMORANDUM

Peru: Thirty Months of Revolution

Summary

In October 1968 the Peruvian armed forces pledged themselves to produce a thorough national revolution. In the succeeding 30 months, they have promoted a strong sense of aggressive nationalism and have begun to restructure the country's basic institutions. Their objectives, extensive and sometimes conflicting, include destroying the hegemony of the native oligarchy; promoting agricultural development and rapid industrialization; limiting foreign (basically US) economic and political influence; and diversifying political and economic contacts in the non-Western world. They condemn both capitalism and Communism and have adopted measures that do not fit into any firm ideological outline. In some instances, their measures follow those previously instituted on a piecemeal basis by other Latin American countries. Despite some current problems, military leaders still appear convinced that they can promote a genuine revolution and that their methods are basically valid. They intend to stay in power until they have made significant progress in solving the country's ills and until they are sure that a successor regime will continue the general direction of their policies.

Note: This memorandum was prepared by the Office of Current Intelligence and coordinated within CIA.

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Beginning a Revolution

1. During its 30 months in control, the military government has concentrated on restructuring the economy, but the changes instituted have also laid the groundwork for an eventual major redistribution of political power. Close government involvement in the economy has been adopted as a basic principle. Some industries have been reserved for government development: petroleum refining, steel, cement, non-ferrous metals, basic chemicals, fertilizers, and paper. The government will control all new investments in these areas and eventually buy out existing private companies.

2. Six days after gaining power the military expropriated the properties and facilities of the US-owned International Petroleum Company (IPC). Since then, it has nationalized the largest private telephone system, expropriated the large sugar plantations, and announced that it plans to nationalize all remaining private communications systems and the electric system. It has bought out several large private commercial banks, taken control of all foreign exchange transactions, assumed charge of export marketing of minerals and fishmeal, taken possession of the largest private railroad company, and is considering nationalizing the major Peruvian international airline, which is already partially state-owned. The regime has agreed to pay cocompensation for all properties taken, but its offers to IPC and W.R. Grace are considered inadequate.

3. Firm limits have been placed on foreign participation in industry. All manufacturing companies with a yearly gross income of \$23,000 or more, whether in existence or to be established, must be at least 51 percent Peruvian owned. Foreign ownership in excess of this amount will be transferred to the government or private Peruvians. The regulations permit the company to regain its original investment and make an undefined "reasonable profit." Similar regulations applicable to the large fishmeal industry were included in regulations issued in March 1971.

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4. Regulations governing the ownership and operation of producing mines have not yet been issued. Restrictions have been placed, however, on future foreign participation in the development of new mines. The government established a firm schedule of dates for the submission of proposals for mine development, evidence of assured financing, and the initiation of mineral production. Some of these regulations require a specified percentage of government financial and administrative participation. The US-owned Anaconda Company, for example, lost its Cerro Verde copper concession because it refused to agree to 51 percent government control of the operation. Other US mining companies have lost their undeveloped concessions because of problems in meeting the deadline to begin development, government allegations that their concessions did not have proven ore deposits, or inability to provide evidence of assured financing by the required date. The major copper concession still being developed by a foreign firm is the Cuajone deposit of the US-owned Southern Peru Copper Company (SPCC). This mine will require a total investment of approximately \$355 million. In late January, President Juan Velasco Alvarado warned SPCC that it would lose the Cuajone concession unless the mine is developed according to the contract schedule.

5. For other industries, the government has established a broad set of incentives to encourage the expansion or establishment of priority sectors and is urging new firms to locate outside areas already developed. The government has also granted incentives to encourage the formation of mixed public/private companies.

6. The most radical of the government's economic measures is the decree, new to Latin America, that grants industrial employees eventual 50 percent ownership and management of their companies. All industrial firms are required to contribute 15 percent of pre-tax profits to an entity called the "industrial community," which represents all the company's employees. The industrial community will use this money to buy shares in the company until it owns 50

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percent. Despite the strong objections of businessmen, the same regulation was included in this year's decree on the fishing industry and is likely to be included in the forthcoming general regulations for the mining industry. The contribution to the industrial community is in addition to a cash donation of 10 percent of pre-tax profits paid directly to the firm's employees. The same benefit, in a modified form, has been extended to employees of the fishing industry and will probably be established for mine workers when the general mining law is released.

7. The concept of worker participation in ownership and management was embodied in the original agrarian reform law of June 1969. The law, which provides for government compensation, calls for the government to nationalize the large sugar estates and agro-industrial enterprises and convert them into cooperatives as well as to nationalize smaller plantations and distribute the land to individual farmers. Approximately 65,000 farm families have already received land or are members of newly established cooperative farms. The basic problem facing the agrarian reform program is that there is not enough arable land to permit individual distribution to all eligible recipients. To make a start at resolving the problem, the government canceled the original distribution of one large estate and turned it into a cooperative, as more recipients could be benefitted by this arrangement. President Velasco's recent statements imply that many large estates will be converted to cooperatives, rather than distributed to individuals.

Political Effects

8. Some of the government's measures, as well as its well-publicized posture as the defender of the "little man," have won it significant popular support among Peru's long-neglected urban and rural low-income groups. This has resulted in some erosion in the political strength of the American Popular Revolutionary Alliance (APRA), the country's largest political party, long anathema to the Peruvian military. Partly because organized opposition has been

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subdued, the government has made little serious effort to form political groups to support its policies. In addition, the military does not intend to withdraw from power in the near future and feels it can afford to postpone forming the political base for a successor regime. There are some indications, however, that President Velasco hopes eventually to mold an organized base of support for the government, possibly by building a controlled labor confederation or by establishing the committees of "social mobilization" that he has been discussing recently.

9. Other political measures were motivated by the desire to eliminate actual or potential opponents. Such actions included the almost total reconstitution of the Supreme Court, the revision of local judiciary bodies, and the appointment of new municipal officials. Restrictions on the press resulted in the moderation of the editorial position of an anti-government Lima daily and the forcible subordinations of two Lima newspapers to progovernment journalists' federations.

International Relations

10. In order to promote nationalism and to reduce foreign influence, the government took deliberate steps to confront private US companies and the US Government; fewer such moves have been made in 1971. The first major act was the seizure of IPC's oil fields and facilities. This move was very popular, because the Peruvian public had long been convinced that the company's concessions and operations were in violation of Peruvian law and common justice. By artificially setting the company's alleged debts far in excess of the proposed compensation, Peru challenged directly the US policy requiring compensation for expropriated properties. The US Government has delayed application of economic sanctions because the question of compensation is theoretically still under discussion. President Velasco, however, has made it clear that he considers the matter closed. This demonstration of the government's ability to stand up to the United States

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made significant political capital for the new regime and indicated that the military intended to carry out its announced revolutionary goals.

11. The question of compensation for the nationalized agricultural holdings of the W. R. Grace Company is still under negotiation. Grace has refused to accept the proposed compensation because it considers it inadequate. This problem, now almost two years old, is of immediate concern because of pressure by Grace and some US congressmen to reduce or tax Peru's sugar quota in the US market to obtain what they consider a just compensation. Peru has not, as yet, begun a major propaganda offensive against the company or the US Government over this issue.

12. Peru has also conducted an energetic campaign in support of its claim to 200 miles of territorial waters. In 1969, when relations with the US were strained because of the IPC problem, Peru seized a number of unlicensed US fishing boats within the 200-mile limit. This action led to the temporary suspension of US military aid to Peru. The Velasco government retaliated by asking the US military mission to leave, although it permitted a seven-man Military Advisory Group to remain. In 1970, two US fishing boats were seized and fined; so far in 1971, only one has been captured. Peru reportedly has overlooked the less flagrant violations of other US fishing vessels this year, and it appears that the government is deliberately trying to avoid creating a new incident over this issue.

13. Over the past year Peruvian officials appear to have muted other situations that could lead to new incidents and have given some indications that they desire a closer relationship with the US. US earthquake relief after the May 1970 disaster was widely publicized, and the personal visit of Mrs. Nixon was uniformly lauded by Peruvian officials, including President Velasco. The Peruvian foreign minister reportedly did not attend last month's OAS meeting in Costa Rica because his statements in favor of the re-admission of Cuba to the OAS went beyond President Velasco's position. The government may have believed

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that a reiteration of this proposal would have created another point of friction with the US. Recently a Peruvian official said that his government intends to advise the US of its planned moves in the international sphere so they will not be misunderstood; the US was informed in advance of the arrival of a Chinese Communist trade group in Lima in late April.

14. Part of this softening attitude apparently is derived from the presence of the Allende regime in Chile. Several Peruvian officials have expressed concern that Chile may adopt classical Communist forms. In addition, Peruvians have always feared Chilean military might; apparently this disquietude was the basis of the government's reported plans to request an increase in US military aid and the reassignment of a US military mission to Peru.

15. To complement its reduced dependence on the US, Peru has established diplomatic relations with all the countries of Eastern Europe except Albania and East Germany; Cuba and the Asian Communist countries have not been recognized, however. The visit of a Chinese Communist trade delegation in April resulted in the establishment of formal commercial relations but there is no evidence that diplomatic ties are imminent.

16. In its relations with the USSR, Peru has made wide political and cultural contacts, but progress in the economic field has been limited. In August 1970 Peru accepted a Soviet credit agreement for \$30 million (\$28.3 million after downpayments) for the purchase of machinery and equipment. There is no indication, however, that it will be used in the near future. The ministers of agriculture and fisheries have concluded independently that Soviet machinery would not be appropriate for their needs. President Velasco recently commented that the announced Soviet interest in aiding a Peruvian irrigation project was limited to inspecting the area.

17. The Soviets seem most interested in fostering the reduction of US influence in Peru and improving

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their own relative position but want to do it without significant financial commitment. The largest Soviet assistance to date is the \$2.5 million in earthquake relief aid. The USSR purchased some Peruvian cotton in 1970, but the total value of Soviet bloc trade was less than two percent of Peru's total trade last year.

18. In recent months Peru has become increasingly suspicious of Soviet motives and activities. The Peruvians probably hold the Soviets at least morally responsible for this year's costly series of mine strikes by the pro-Soviet General Confederation of Peruvian Workers. In addition, the activities that led to the expulsion of five Soviet diplomats in Mexico recently, evidently made an impression on the government.

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the foreign minister has suggested that his government might protest formally the alleged involvement of Soviet diplomatic representatives in the country's internal affairs. The presence of Soviet diplomats in Lima is one way for Peru to demonstrate an independent foreign policy, however, and the Velasco government probably still has some hopes of significant commercial sales. As a result, it seems unlikely that Peru will make strong moves against the Soviets without some specific proof of their intervention in internal affairs.

19. Peru has not pressed for closer relations with Cuba, nor has it given any firm indications that it plans to resume commercial relations with Havana. Peru has publicly expressed its willingness to support the readmission of Cuba to the OAS, although it has said it does not intend to sponsor the proposal and will not take unilateral action to recognize the Cuban regime. Although Castro originally derided the revolutionary credentials of the military government, by mid-1969 he was viewing events in Peru more sympathetically. He now considers Peru to have the type of "revolutionary government" he would be pleased to see established in other Latin American countries.

20. Peru has developed contacts with the non-aligned nations in order to promote support for its position on territorial waters and to strengthen demands for more trade and aid from the developed countries.

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Problems

21. The growing number of strong government measures has produced a series of problems, primarily of the economic sort but with political implications. It does not appear likely, however, that these problems will result in a basic change in the orientation or implementation of government policies. The major problem is a continuing hesitancy on the part of foreign investors to finance development projects. Government spokesmen, including President Velasco, have tried to convince them that their assistance is welcomed and in fact required, but investors are generally waiting to see if these verbal appeals are backed up by a comparable revision in the government's investment laws.

22. The situation in the mining industry illustrates this problem. The government took over several large US-owned copper concessions when the companies failed to meet the imposed deadlines for mining the deposits. With one possible exception, no foreign group has yet provided any financing to exploit this copper. In February 1971, a \$41 million credit was opened by a Belgian firm and a European-based financial consortium. This was the first major development credit from Western Europe since the new government took power. Under its terms, at least half the money is to be used for the development of a large copper concession; the credit may be increased to build a state-owned copper refinery. Final agreement, however, has not been reached, and Peru is apparently trying to get better terms from other sources.

23. Problems could also arise over the Southern Peru Copper Company's plans to continue development of its Cuajone deposit. The company must present proof by June that it will find financing for the remainder of its proposed \$355-million investment or accept the burden of paying for it itself. It has not yet secured firm financial commitments from Western European or Japanese investors. In addition, SPCC's infrastructure and development costs may be increased by the government take-over of the neighboring Quellaveco concession.

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24. There is, however, some foreign investment. A Yugoslav firm has just signed what is described as a "skeleton contract" for the construction of an \$80-million hydroelectric and irrigation project in northern Peru; technical details of the project are yet to be arranged. As far as American private investment is concerned, a US petroleum firm has continued to fund its off-shore oil drilling, and another company has agreed to sink approximately \$25 million into the expansion of its iron ore mining and treatment facilities; this investment, however, actually began late in 1968.

25. On the domestic side, the government has attempted to stimulate interest with a series of tax incentives. Although there are indications that domestic investment has risen a little from its previous low levels, it is still far below the levels called for in the 1971-72 development budget.

26. Foreign investors may be waiting for indications of a more favorable US attitude toward Peruvian development projects and for signs that Washington is willing to be more responsive to Peruvian requests to international lending agencies. The US voted last November to approve a Peruvian request to the Inter-American Development Bank (IDB) for a loan totaling \$23.3 million for an irrigation project. Additional indications of US policy will be seen in the US response to a Peruvian request to the IDB for an \$11.8-million loan for road construction.

27. The agrarian reform program also is running into financial and administrative problems. These will probably increase if the government attempts to keep to its schedule of distributing land to 65,000 peasant families a year through 1975. President Velasco admitted that one reason for the removal of the minister of agriculture in April had been his ineffectiveness in implementing the program. In any event, a temporary decrease in agricultural products available on the market is likely to result as the program is extended; perhaps because of improved weather conditions, it has not been noted so far.

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In addition, the small farmers will probably be less satisfied as members of cooperatives than they would be as private land owners. Because the agrarian reform is so basic to the government's program and will eventually affect large numbers of poor Peruvians, its success or failure will to a large extent determine the attitude of the rural lower classes toward the government and its entire revolutionary program.

28. Problems are also arising over the activities of the pro-Soviet labor confederation, CGTP. Since the military government gained power, it has deliberately promoted the CGTP in order to weaken the rival labor group that is controlled by APRA. In return for government support of CGTP wage demands, the group provided useful political backing. The government finally granted it legal recognition in January, but the CGTP chose the same period to begin a lengthy series of costly strikes in the critical mining industry that eventually shut down the country's major mines. In March, the government arrested and temporarily held nine Communist labor leaders, demanding that they discontinue their strike activities. Since then, several other moves have been taken against Communists in the government, and the head of the powerful Advisory Committee to the Presidency is reportedly intent on removing all Communists from the government. Although the government probably will not terminate its mutually advantageous relationship with the CGTP, Velasco apparently intends to keep a closer watch on its activities and may try to limit its growing strength and militancy.

29. There are some indications of dissatisfactions within the armed forces. Some military officials, including Foreign Minister Mercado, are eager to terminate their government service and return to purely military functions. Other officers have presented formal requests to President Velasco that the military withdraw from the government within a year. The reason is probably that described recently by an official of the war college. He expressed serious disagreement with the scope and effect of some of the government's major revolutionary activities, charging that such policies have hampered the massive inflow

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of foreign investment and technology required for Peru's development.

30. Despite these criticisms, the armed forces basically appear to support the government's revolutionary objectives and the measures that have been adopted. President Velasco seems convinced of the correctness of his government's program, and there is no indication that he is facing significant opposition from the cabinet or the military leadership. It is probable that the economic or internal political situation would have to deteriorate substantially before military objections would provide a major deterrent to continuing the government's program.

Prospects

31. The Peruvian revolutionary government probably will continue its present policies for the foreseeable future, although there may be some changes in their implementation. Nevertheless, the failure to attract significant new private investment makes it likely that there will be some relaxation of restrictions on business. The removal of the controversial minister of industry in late April may portend some modifications in current policy. At a minimum, his departure may reassure businessmen that government policy is not basically anti-business.

32. Peru has given some indications that it is willing to have a better relationship with the US, but the degree of cordiality probably depends on US actions. Two issues in which the military government will see an indication of US policy are the current loan request to the IDB and the question of the Peruvian sugar quota. If these should be resolved to Peru's satisfaction, the government would probably continue its apparent policy of giving verbal support to its basic policies while trying to reduce the possibility of direct confrontations with the US. Peru's failure to achieve satisfaction on these two issues, however, would be interpreted as a punitive action of the US, and the Peruvian Government would probably react as strongly as it has in the past. There will still be irritants in the

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relations with the US, and Peru is likely to continue exploiting them when it seems expedient.

33. Official Soviet representatives as well as local Communists are likely to enjoy a less receptive climate than formerly. There probably will not be strong government actions against either group, but their activities may be circumscribed and placed under surveillance. This will reduce their potential to cause problems while maintaining the Peruvian Government's general desire to use both groups for its own purposes.

34. It does not appear likely that the military will withdraw from the government in the near future. Internal political opposition is not sufficiently organized to force its removal, and there is no indication of widespread support for this proposal within the armed forces. Nevertheless, there may be additional changes within the military leadership of the government, especially if economic prospects do not improve. The armed forces probably will continue to govern until they are convinced that their revolutionary measures are firmly established and are having definite results, and until they are sure that the next regime will not significantly alter the general orientation of policies now in effect.

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