



BRITISH EMBASSY

LIMA

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PERU : THE ECONOMY

1. Within the past 40 days major natural calamities have caused damage and destruction which, directly and indirectly, are estimated to have cost Peru US \$1 billion.
2. The least part of this is the cost of repelling the Ecuadorian incursion. An American Army Colonel attached to the Peruvian General Staff has estimated that the cost, over and above "standing charges" and the value of materiel lost (helicopters/planes), was US \$100 million made up of fuel charges, the cost of commandeering vessels and aircraft to transport troops and equipment plus the consequent loss of revenue resulting from their withdrawal from commercial service, the cost of the interrupted cross border trade and finally the ancillary costs which arose from maintaining troops in inaccessible locations.
3. The border incident was quickly followed by country-wide torrential rains which, whilst initially welcome in the North where they broke the five year drought, have severed road and rail communications, flooded farmland, and destroyed houses and bridges. (The rains will bring an almost certain 100% increase in agricultural production and the consequent reduction in imports in six to nine months' time.) The cost of repairing and replacing these communication links will be heavy and it will be many weeks before matters return to normal assuming that the necessary steel and materials are available in Peru.
4. On this side of the Andes some thirty kilometres of the Central Highway linking Lima with the Sierra and the Amazon have been destroyed. There is also damage to the road linking La Oroya to Cerro de Pasco and the road from Cerro de Pasco to the Amazon port of Pucallpa has been badly affected by landslides and at least one major bridge damaged.



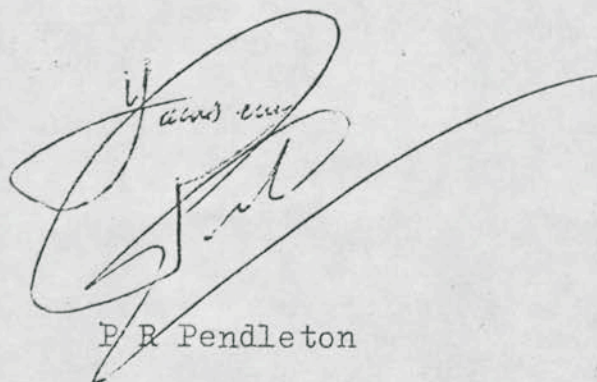
5. The Central Railway has not escaped. The line was first cut forty days ago and is unlikely to be repaired before May. Landslides and wash-outs have caused gaps up to 100 metres wide in the permanent way. These will have to be bridged, or filled where this is possible, but repair work is difficult or impossible whilst the rains continue.
6. In the North, flooding apart, the temporary closing of the Trans-Andean oil pipeline is a major economic disaster. It is not clear whether this is due to a landslide or mechanical breakdown but Occidental Petroleum say that they have been told that repairs could take up to 30 days. The pipeline transports oil to the value of US \$5.7 million plus per day. In the South two trains have collided killing over 30 people and injuring many more. The section of the system was already chronically short of rolling stock and the loss of coaches, wagons and locos is a heavy blow.
7. As we have already reported the fiscal strategy of the Government was to aim for a balanced budget with a marginally negative balance of payments at the end of 1981. This was to be balanced by capital inflows from foreign investment. The continuing fall in metal prices had already caused the authorities to revise their figures before these latest set backs. The boom in imports shows no signs of abating. The January fuel and food price rises were followed by further gasoline and diesel price increases on 12 March. Wage rises of an average 10% are to take place on 1 April, the second Government decreed rise this year, but will still not match inflation which is estimated to be running at nearly 10% per month.



8. On the labour front strikes for higher wages at Centromin and Southern Peru Copper mining installations and at Belco's offshore fields have caused losses. There is little publicity for these industrial actions but industry sources say that smaller labour disputes are widespread.

9. Speculation, and I stress that this is only speculation without any official basis, that the Government will be forced to change its economic strategy is rife. Doubtless this is mostly wishful thinking in the industrial sector but it does appear inevitable that the Government will be forced to take drastic action to correct the imbalance of imports over exports together with the flight from the Sol into the Dollar (the latter is in short supply as people hedge against inflation and devaluation).

10. The options open are few. To re-impose import controls, at least on cars consumer goods and textiles, would have little immediate effect now that demand has been satisfied and the stores are full. This accounted for only 1.2% of all imports in 1980 anyway. Legislation is in hand to rationalise the tax base but this will take many months to fulfill its designed expectations. The imposition of VAT or a similar consumer tax is under consideration. The argument will be between the monetarists and the pragmatists led by the Prime Minister and the President respectively. The outcome is difficult to predict. A lot will depend on the amount of aid forthcoming from international agencies and friendly countries. Ideally Peru should seek salvation in increased exports but this is equally difficult at a time when world trade is in recession. The only certainty is that a difficult economic patch lies ahead.



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