

AN INTERVIEW WITH GUSTAVO SABERBEIN

By DAVID P. SAYBOLT

After 12 years of military rule, Peru returned to democracy in 1980 with the election of President Fernando Belaunde Terry. Seven years later, Peru faces political and economic crises that place it at the forefront of the debate on debt and democracy in Latin America.

Peru came to be seen as a maverick in the international banking community when President Alan Garcia, a social democrat elected in 1985, took office and announced that Peru would limit its public debt service to 10 percent of its export revenue. Peru pumped the resultant savings from debt service into domestic investment, prompting real growth to leap to 8.5 percent in 1986 from 1.6 percent in 1985.¹ But recently, as capital inflows have dried up in response to Peru's stance on debt service, Peru has had to resort to running down its reserves to finance investment. With the World Bank's announcement that it will cut off loan disbursements to Peru in December if the country does not renegotiate a stabilization package, Peru faces the possibility of being unable to finance its trade deficit and domestic growth when its reserves run out.

Garcia's dynamic personality and populist policies have sustained him at the pinnacle of a government that faces serious challenges from both the left and the right. A price freeze and the lowering of interest rates in 1985 seemed to have broken the cycle of inflationary expectations in Peru, but the lifting of the price regime in May 1986 has given way to an estimated inflation rate of well over 100 percent for 1987.

The nationalization of the remaining private banking sector on October 12, 1987 has strongly alienated the business community and may mark a major shift in middle-class support away from Garcia's policies, with some polls showing that the president's popularity has fallen from its peak by as much as 50 percent.

Political polarization has fueled speculation of a takeover by the military, though it may be the most reformist in South America. On the left, the Maoist Shining Path guerrillas are moving into cities, staging sabotage and political campaigns. Labor protests have escalated over the deterioration in real wages. Garcia has also faced increasing opposition, not only from political parties on the right and left, but from within his own party, APRA (American Popular Revolutionary Alliance). Some question the ability of the Garcia administration to muster the political capital and economic confidence necessary to implement successfully any new debt restructuring plan.

Fears of political destabilization may have increased the leverage Garcia needed to enter into unprecedented debt negotiations with the World Bank without first submitting to the IMF. Weakened commercial bank solidarity, the lack of real sanctions against a partial default on external debt, and the progressive erosion of the debt rescheduling

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1. The Economist Intelligence Unit: Country Report — Peru/Bolivia, 22 September 1987, p. 2.

process also may help explain the World Bank negotiations and other non-traditional deals that Peru has managed to close with some commercial banks. The most obvious source of leverage is Peru's sheer inability to meet its debt service obligations. While the results of the current negotiations have yet to be announced, Peru is likely to continue at the forefront of innovative debt rescheduling in Latin America.

FORUM: Looking at the world economy right now, it seems that the trend is toward increasing privatisation of state-controlled corporations. In October, Peru nationalized its banking sector. What is the objective of this move?

SABERBEIN: The objective of the nationalization of the remaining 30 percent of the Peruvian financial system in the private sector is to democratize credit. In other words, its aim is to help small- and medium-scale industries get credit, because in Peru the credit was becoming concentrated in the large monopolistic and oligopolistic enterprises associated with bank owners. Thus, the first objective has been to democratize the credit. Second, this measure seeks to decentralize the credit, that is to say, to take credit into the interior provinces of the country. The private bank enterprises had little desire to make credit accessible within the provinces since these loans were less profitable. Naturally, the greatest profitability was found among the largest enterprises located in the country's capital, Lima. We have nationalized (the banking sector) in response to the enormous need in the country to decentralize the economy and democratize the credit system.

We believe that the small- and medium-scale industries are called upon to play a major role in the growth of the country, and in the process of the consolidation of democracy. We also believe that if there is no economic growth and development within the interior of the country, it is practically impossible to overcome the great difficulties our economy and our society face.

Having said this, it is important to point out that the economic program we have implemented does not include an increase in the size of the state. That is, public expenditures as a fraction of GNP have remained constant. Also, we believe that in the public sector, there are some industries that have no reason to be there. We are going to transfer them into the private sector. For this reason, we can state clearly that we do not have a statist position, but rather a position which seeks growth and development, and overcomes the defects of a social and economic model which has not been successful for the last 150 years.

FORUM: While understanding your point about the public expenditure in relation to the size of the total economy, it is still clear that there remains a lot of resistance to the bank nationalizations in Peru. President Alan Garcia's use of the army is evidence of this resistance. Can the bank nationalizations and the democratization of credit be successful in the face of this opposition, and how does the Peruvian government plan to overcome this resistance?

SABERBEIN: The first thing I would like to point out is that my government has not used the army to take over the banks. Instead, we have used the police against a group of employees who were not complying with the law. In Peru this law was enacted by Congress after 60 days of debate. What action is necessary to maintain justice if someone opposes the mandate of the law? I, as Minister of the Economy (and Finance), have the obligation to comply with and to enforce whatever is approved by Congress, just as here in the United States the Secretary of State has an obligation when the Congress enacts a law. If we do not accept this principle, we destroy the lawful state.

FORUM: Addressing another issue now, when President Garcia came to power in 1985, he declared that Peru would pay no more than 10 percent of its export earnings for debt service. He has recently reaffirmed this commitment. Could you tell us the rationale for putting a limit on debt service?

SABERBEIN: This figure of 10 percent was not randomly chosen. This figure was the result of work carried out for two years prior to July 1985 by teams of economists using economic models and computers. We calculated that Peru was in no position to meet its obligations under the conditions which had been agreed upon. In July 1985, when President Alan Garcia took over the government, Peru was approximately \$2.7 billion in arrears. The first year we had to pay a debt service of more than \$2.5 billion. Consequently, during the first year of President Alan Garcia's administration, Peru had to pay over \$5.5 billion. This was impossible because exports amounted to \$3 billion at the merchandise level. We calculated the possibilities for debt payment — not for the first year of the administration, but for the five years the administration would remain in power. It turned out that to repay the debt it was necessary to use more than three quarters of total exports. This was impossible. For this reason we calculated a percentage for payment which embodied the fact that Peru recognized its debt but also recognized that it was in no condition to repay it. A higher percentage (of debt service to export earnings) would limit growth and deepen the current economic, social, and political crisis, the worst in the history of Peru.

In Peru, the recession caused the production per capita in July 1985 to fall to the level of 20 years ago. Second, only one in every three persons of working age had a stable job. Third, workers' purchasing power fell to half of their purchasing power in 1980. Fourth, the majority of private enterprises found themselves overly indebted, decapitalized and in a very precarious situation. In other words, there was a mixture of recession and inflation that had produced disenchantment in the population. The population, in turn, was starting to believe that the system was not functioning and that a very deep change was necessary.

FORUM: Let's take Peru's position in relation to the American banks. There are three groups involved: the Peruvian people, the stockholders of the American banks, and the American taxpayers. You have just explained the necessity

for the limit, but if Peru is to carry less of the debt burden, who must carry the rest?

SABERBEIN: When a company makes a bad investment, and I am referring to any industrial company, we recognize that the investment is bad and represents a loss. I think this principle should be applied to banking. This principle is part of the world of business. In the case of the loans made by American banks and banks from other parts of the world to Peru and other Latin American countries, many were made during the 1970s because there was a large supply of petrodollars in the hands of the banks. There was a lot of money burning in the hands of the banks, money which they loaned without completing the appropriate studies. One of the primary obligations of a bank is to study the potential for repayment of its loans; otherwise, it is making a bad investment. For this reason we state in Peru that there is a joint responsibility regarding the debt: on the part of those who borrow, and on the part of those who grant the loan.

FORUM: A tactical question: By setting a limit of 10 percent of export earnings on its public debt service, Peru has broken the rules of the international debt game. What if anything has happened to Peru as a result of this policy? And to the extent that sanctions by commercial banks or creditor governments have not occurred, why has this been the case?

SABERBEIN: I think that to be able to understand what is going on, we must look at the history of Peru and of other nations. Peru, as well as other countries in Latin America today, finds itself in a situation which it experienced several decades ago. In 1933, Peru, as well as all the other Latin American countries, with the exception of Argentina and Haiti, stopped repaying (their debt service) for 10 to 15 years. The problem was solved when the owners of the stock and debt papers suffered a nominal and real decrease on the (value of their) debt holdings. This was not the first time that Peru was in such a situation. In the nineteenth century, there were two times in which debt could not be repaid, which means that this will be the fourth time in 170 years that this has happened to Peru. And this (history) is not unique to Peru. This is something that economic historians are aware of. They know the problems of non-debt repayment cannot dissolve the economy of any nation, and that people always seek formulas to overcome such problems.

FORUM: Can you be more specific about sanctions during this round of Peruvian debt negotiation, and perhaps touch upon the issue of short-term trade credit and your negotiations with Midland Bank and First Interstate Bank (of California)?

SABERBEIN: The first thing that must be pointed out is that at the beginning of our administration Peru no longer had external credit from the banks.

We knew we had to rely upon our own resources before relying on our foreign or external resources.

Peru has suffered no specific sanctions. These days the banks, the governments, the creditors in general, have a better understanding of the debt problem. This (understanding) explains the conduct of banks, such as Midland Bank or First Interstate Bank of California, which have accepted the present Peruvian proposal of receiving partial debt repayment in products manufactured in Peru, including a purchase of exports equivalent to double the amount which Peru repays as part of its debt. This is evidently a difficult way to handle things, but it is a formula which is mutually convenient. On the one hand, the banks recover part of the debt, and on the other hand, we increase our exports. It is an alliance of mutual convenience.

FORUM: With all due respect for the increasing realism of the commercial banks, some skeptics in the United States would argue that the deterioration of solidarity among banks has given Peru an opportunity to exercise leverage in these negotiations. Would you discuss bank solidarity and the way it has affected your negotiating position vis a vis the commercial banks?

SABERBEIN: In the international economy there evidently is great competition among the banks. At the same time, banking is becoming more concentrated. Let me give an example. When Citibank made the decision to set aside reserves of \$3 billion, the move, more than anything, affected not the debtors, but rather the bank's competitors. In this way, Citibank was able to give the image which other banks could not project. Other banks wanted to do the same thing, but were not in as strong a position. We must look at the subject of the debt in conjunction with two other subjects which affect the banks on the international level: first, the competition among the banks, and second, the banking concentration.

FORUM: Would it be fair to say that this competition among the banks has enabled you to split, for example, Midland Bank and First Interstate Bank, off from other banks, and do you expect that in the Paris negotiations with European creditors you will have a negotiating posture toward the European banks different from the posture you had toward the American banks?

SABERBEIN: No, I don't think that Peru has split anybody. Peru told the banking community that it had no funds to repay the debt. Peru asked for non-traditional formulas to service the debt, and received over 40 proposals from different creditors including the banks. That is, Peru asked the banks themselves for suggestions, and the agreements which have been signed have been in part created by the banks themselves. But we don't want to draw any distinctions between American and European Banks. The first two banks (to conclude non-traditional agreements with Peru), one American and one European, each submitted their own criteria for negotiations. I would like to

take this opportunity to point out that there are many other banks which are now dealing with Peru and trying to find this same formula for settlement.

FORUM: I'd like to return to the issue of multilateral institutions. As recently as July 28 of this year, President Garcia reaffirmed his intention not to negotiate with the IMF. Now you are here in Washington negotiating with the World Bank. Has anything changed?

SABERBEIN: The President never stated that he would not negotiate with the World Bank. He did criticize the policies that were being recommended by the IMF, though. But we have seen in recent months a change in the thinking of the IMF. And we have even seen that many of the ideas we have been espousing for over two years have been stated recently in this same hotel (The Sheraton) where the general assembly of the IMF and World Bank was held. For example, Michel Camdessus, the new chairman of the IMF, spoke about the policies of the industrialized nations, particularly the U.S. policy, which had brought about a dislocation in the distribution of world savings with its high interest rates, and had brought about a great deal of uncertainty vis a vis the high fiscal deficit and high trade balance deficit. Because of uncertainties about (levels of) foreign exchange and interest rates, bankers have tried to find short-term investments rather than medium-term investments. Also, we have seen how adjustments must be made with growth. This is new thinking. Today we have seen (a general acceptance) of the principle of joint responsibility. Institutions are not forever unchanging. (Multilateral organizations) are institutions with people who constantly analyze national and international situations, and then permit changes.

FORUM: Certainly the multilateral institutions are having to learn new tricks. But a more skeptical observer might look at Peru and say that because Peru is running down its reserves, Peru is negotiating the inevitable, and has no choice but to come to the table at this time. How would you respond to that criticism?

SABERBEIN: I would like to say first that because of the recent policies, Peru has over \$1.6 billion in gross reserves. These reserves are sufficient for the next month or for the next six months. In other words, we do not have any great haste. What we do have is great caution.

FORUM: Traditionally, a debtor nation has had to get a stamp of approval from the IMF before commercial banks and the World Bank will negotiate. Clearly your negotiations here are setting a new precedent in going directly to the World Bank. What role do you see the IMF playing in the future of Latin American debt rescheduling, and do you see this precedent as having a large effect on the debt rescheduling process?

SABERBEIN: Peru is solving its own problems by taking progressive steps. The first step is the willingness of the Peruvian government to improve its relations with the World Bank and the (creditor) governments. There are common interests involved. Peru needs to increase exports, but to do that it is necessary to have not only a good economic program, but new financing. New financing is essential in importing the machinery required to increase (Peru's) export capacity. Countries like Peru can only repay part of their debt by increasing their exports. There is no other formula.

FORUM: Are you saying that Peru must be a capital-exporting nation now, or a capital-importing nation?

SABERBEIN: I think what Peru has to do is try to achieve a greater production for export. This must be achieved in two ways. First, Peruvian companies with export experience require medium-term credit lines to import that production equipment which cannot be produced locally. Second, it is necessary to arrive at clear and mutually convenient game rules for some foreign investment. For example, Peru has oil-exporting potential. It is important to note that foreign investment is necessary to extract this oil. Another example — recently we struck a major gas field which represents over \$20 billion. We do not have enough domestic savings to be able to extract that gas. To this end we need major foreign investment (in projects) which will ensure profitability for the stockholders. We have made a clear distinction between old debt and new debt; Peru is servicing its new debt. We think that the new foreign investors will (enjoy) clearer rules of the game. These rules will make it possible (for foreign investment) to benefit both the companies as well as the country.

FORUM: The debt crisis — is it a crisis within Peru or is it a crisis within the world economy?

SABERBEIN: The debt is evidence that the economic system which existed in Peru did not work. Just as our economy was accumulating debt, (we were suffering from) capital flight. If only we were able to achieve a reduction in capital flight, there would be no great need for loans. But how can we decrease capital flight, if the capital comes from Europe, Japan, and Latin America to here (the United States), where there are extremely high interest rates?

FORUM: Finally, let me ask you to look into your crystal ball for a minute. Six months from now, where would you like Peru to be, and what are the chances Peru will be able to get there?

SABERBEIN: We regularly perform this kind of exercise. For example, on December 15, we will approve the budgetary law for 1988, as well as the economic and social plans for 1988, and the three-year plan for 1990. These plans show that if Peru continues with its recent efforts in the external sector,

in public finances, and (toward) the increased efficiency of private and public enterprises, we will have created an economy capable of sustained growth, increasing decentralization, and strong exports. The improvement in raw material prices will aid exports. Several of the investments which we initiated over one and a half years ago will be maturing by 1988.

Peru started from a very difficult point. Despite this, we have made progress. There are difficulties which, we believe, will be overcome little by little, especially now that there exists a greater pragmatism on the part of the creditors. They have a better understanding of the subject of external debt.

What is important is that in Peru there is an awareness (of the need) to defend the democratic system, and to make the poorer people of the country and the city the major beneficiaries of the policies applied.