Andean Report by Manuel Hidalgo

Coca sets exchange rate in Peru

The private sector is denouncing the narco-economy, but the Fujimori government would legalize it.

With the consent, and even support, of the government of President Alberto Fujimori, Peru has turned into a narco-economy, and it is the drug trade, not the central bank, which is now setting the price of the dollar in that country. The value of coca exports from Peru has nearly surpassed the total value of legal exports. Dollars brought in to pay for coca leaf and basic cocaine paste—Peru provides 60% of the world's raw material for cocaine— equal somewhere between $1.5-2.5 billion a year, and growing.

The quantity of narco-dollars is so great, in fact, that the dollar's parity with the Peruvian currency has *fallen* in recent weeks. The resulting revaluation of the sol has triggered protests from portions of the country's business community, which are demanding government intervention against this fictitious revaluation.

But the government has announced it will continue to permit the narco-financiers to set the parity. Central Reserve Bank (BCR) president Jorge Chávez told the daily *Expreso* on Jan. 25 that the BCR "is not planning any change in its policy of non-intervention in the fluctuations of the exchange rate, because it firmly believes this will rise in accordance with market forces," the result of "a reduction in cocaine processing, which in turn will permit the substantial reduction of the flow of narco-dollars from the parallel market."

The way the price of coca is now setting the sol/dollar parity rate works as follows. An oversupply of narco-dollars, which freely enter the banking system (since there is complete exchange and financial deregulation), combined with the fierce recession caused by the austerity demands of the International Monetary Fund (IMF), has caused the price of the dollar to fall. Since there is no exchange difference between the dollar that comes from the sale of Peruvian copper, for example, and that from sale of coca leaves or paste, the coca-dollars inundate the market, lowering the value of the dollar overall and consequently shrinking the income of Peruvian exporters.

The situation is aggravated by the monetarist policies of the BCR, which maintains only one-fourth of normal liquidity in the economy, supposedly to avoid a resurgence of inflation. Thus, the surfeit of dollars and deficit of Peruvian sols has shrunk the dollar to one-third of its real value, according to unofficial BCR sources.

Things have gotten so bad that important layers of the private sector are now denouncing the situation as untenable: "The government cannot place its confidence . . . in the free play of market forces . . . when it is risking the very survival of the majority of industrial companies," warned the National Society of Industries, in a statement published Jan. 27 in the daily *El Comercio*. The statement added: "The backward exchange rate not only strips our export sector of international competitiveness, but artificially cheapens imported products, to the detriment of national production. If one adds to this a restrictive monetary policy, the recession will deepen."

On Jan. 29, in an article in the business daily *Gestión*, prominent Peruvian industrialist Gian Flavio Gerbolini charged that businesses were on the verge of bankruptcy, since "an exchange rate is established on the basis of the low parity of coca, and the legal [economy] is being told to operate on the basis of the resulting [dollar] price."

Some within the business community have not yet seen the handwriting on the wall, and are blindly convinced that one cannot have too many dollars—no matter the cost. Thus, the National Society of Exporters invited former Chilean Economics Minister Hernán Buchi to Lima, where on Jan. 29 he proposed that Peru dollarize its economy completely, as Panama has done, in order to achieve a "real parity." He urged that all contracts be redrawn in dollars and, of course, that wages be still further gouged to facilitate "competitiveness."

Although Buchi took care not to say so explicitly, his proposal implicitly calls for full and open legalization of the narco-dollar.

What Peru's business community has yet to come to grips with is the fact that their exports are falling because of the world depression, not because of an overvaluation of the sol, and that revaluing the dollar will accomplish little as long as there is no serious program to rebuild Peru's shattered physical economy—an approach which necessarily demands a break with the IMF.

In his article cited above, Gerbolini acknowledges that recession and neo-liberalism go hand in hand, and that the situation in the country will only worsen, "unless and until we free ourselves of an economic theory that subjects decision-making to an erroneous strategy."