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The 'orthodox' road to a dope economy

William Engdahl describes how Harvard's Jeffrey Sachs used 'orthodox monetary shock' policies to turn Bolivia into a cocaine center. Now he wants to apply similar recipes to Poland.

Poland is in the most severe economic crisis of the postwar period and perhaps of its entire history. Within weeks, if present policy trends continue, and dramatic new assistance from outside is not made available, Poland will disintegrate into a Weimar-style hyperinflation crisis, far worse than the present inflation crisis.

With the value of the Polish currency, the zloty, dropping almost by the hour, many leading people in the new government are seriously considering a bold "monetary shock" program to change the eroding conditions. The man being most debated at present is Harvard University economics professor Jeffrey Sachs, who has just completed an extended series of discussions with leading members of Solidarnosc and others in and out of the Polish government.

The Sachs program has great appeal for many Polish patriots. He holds out promise that, if his policy is rigidly followed, it will give Poland "six months of chaos, improvement in one year, and full integration into the European economy within 10 years." Further, for a country which has had to endure almost 45 years of Stalinist bureaucracy and central planning inefficiencies, Sachs's program offers a means of sharply reducing the bureaucratic state-run sector.

If Poland should adopt the Sachs "orthodox monetary shock" program, Sachs and his sponsors will have accomplished what Soviet troops and 45 years of dictatorship have not been able to achieve—the destruction of the nation of Poland and of its will to fight.

Sachs has a cultivated public relations media image as the world's leading "anti-inflation expert." In reality, his "shock" policy is nothing but a computerized revival of the policy of German Reichsbank chief Hjalmar Schacht, who under Adolf Hitler imposed draconian austerity on Weimar Germany in 1923 on behalf of the Versailles debt collection policy of J.P. Morgan and the Bank of England.

According to published reports, Sachs insists that Poland must freeze its money supply, eliminate all state subsidies in the state-run economy, as well as price controls. Poland must relax foreign trade regulations to free exports and make the zloty fully convertible to Western currencies. What this means, we will see from the case of one of Sachs's previous victims.

The Bolivia experiment

The international credentials of Sachs, a 34-year-old product of the U.S. liberal establishment, all rest on his one "success" story. Professor Sachs boasts that he successfully designed the "stabilization program" which "reduced Bolivia's inflation rate from 40,000% per year to the current rate of 15% per year." Let us examine what lies behind this claim.

What Sachs's press releases do not mention, is the social cost of his "inflation cure." In 1985, Sachs became special economic consultant for the new government of socialist President Victor Paz Estenssoro. He designed Paz Estenssoro's "shock program," called the Plan Boliviano.

Bolivia is located in a landlocked area bordered by Brazil on the east, Chile and Peru on the west, and Argentina and Paraguay on the south. It is one of the poorest nations in the world, and has an economy which has been dependent for almost a century on foreign-owned mining and other raw material exploitation. Its fragile economy has depended on its being one of the world's largest suppliers of tin. In recent years this has been supplemented by large discoveries of oil and natural gas. Bolivia has one of the lowest literacy rates in the world, and official government estimates of 40% illiteracy are believed far too optimistic.

In 1978, the U.S. Carter administration pressured Bolivia to end a seven-year military rule under Gen. Hugo Banzer, and restore civilian rule. This opened up an extended period of political chaos. During the 1970s Bolivia, like many debtor nations, drew on the available international credit markets to finance its national economic investment as well as the externally imposed balance of payment deficits caused by the Anglo-American "oil shock" policies of the 1970s. That debt had been contracted, like most Third World debt, at interest rates which were "floating" at a fixed level above the London Inter-Bank Offered Rate (LIBOR). When U.S. Federal Reserve Chairman Paul Volcker imposed a version of the Sachs "orthodox monetary shock" in October 1979 on the U.S.

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money supply, world interest rates "floated" up to the highest levels of this century. This created staggering problems for Bolivia's $2.7 billion foreign debt, already then some 213% of annual export earnings. By the end of 1980, Bolivia had been cut off from all international access to private capital. By 1981 the International Monetary Fund and World Bank cut all funds as well.

To counteract the devastating cutoff of international credit, the Bolivian government, whose state sector dominated the economy, resorted to printing pesos to finance internal economic requirements. The post-1980 cutoff of international credit to Bolivia, as funds flowed instead into the United States under the Volcker monetary regime in the early 1980s, is the causal origin of the country's hyperinflation.

By early 1985 the government of Hernán Siles Zuazo had been forced to cease virtually all foreign debt servicing. The growing inflation since 1980 caused government tax collection to break down. The government was becoming increasingly discredited. Strikes and work stoppages, to protest inflation that soared above wage increases, became crippling, further aggravating the government's revenue crisis.

A "parallel foreign exchange market" was allowed, with an official fixed rate for the peso beside an "informal" or parallel black market rate for dollar exchange, in varying degrees until 1985, when the hyperinflation broke out to Weimar levels. The economy had become tied to the daily fluctuations of the available dollar supply on the black market. In the eyes of the population, the inflated peso became worthless. Bolivia became "dollarized."

What neither Professor Sachs nor other apologists for his "orthodox shock" monetarist policy will discuss, is the role of Bolivia's illegal narcotics economy in earning precious dollars. Wages were paid in worthless pesos, while private economic transactions were increasingly carried out in dollars. The prime source of dollars was the cocaine syndicates. The economy of Bolivia went "underground," and there was an enormous expansion of the black market already before Sachs's 1985 program was imposed.

On Aug. 29, 1985, under Victor Paz Estenssoro, the Sachs program, called the New Economic Policy, was unveiled. It specified the following:

The parallel "black market" and official peso exchange rates were "unified." The peso was simply linked to the dollar. The new rate of the peso was "stabilized" by an exceedingly tight government monetary policy and severe government budget deficit control. As part of the program to bring the state budget deficit to zero, wage indexation was abolished, and all markets for goods, credit, capital, and labor were "liberalized" to "free market" levels. The central bank set the daily peso rate according to a daily auction, where it bought dollars from sellers at the price of the previous day. This "unification" of the two exchange rates led to an immediate 93% devaluation of the peso against the dollar. The ensuing liquidity crisis forced the public to take their dollars out of hoarding, by selling them to the central bank.

With the central bank taking in the excess peso liquidity in the daily foreign exchange auctions, domestic interest rates were decontrolled from previous fixed low levels and allowed to "float" to the "market level." This immediately hit 35-40%, where it stays today. While strict credit cutoff to the large state sector took place, there was no parallel credit cutoff to the private sector.

Within two weeks, the hyperinflation cycle had been apparently broken. But then, in order to force the "stabilization" to continue beyond this initial shock, the government imposed drastic policies, looting the public sector and the general public to ensure continued supply of "stable" pesos. Prices for fuel, transportation, and other necessities were set at "market levels." Gasoline, which had been made available by the state-owned petroleum monopoly at subsidized prices before the shock program, was allowed to rise to the levels of the international petroleum markets. Food subsidies were ended. This enabled state revenue from these sources to revive. Further, a total freeze on all government spending projects ensured that the monies went to the central bank's peso stabilization.

None of Sachs's economic "shock austerity" would have been politically possible had the organized trade union movement not been completely discredited by the six previous years of runaway hyperinflation and strikes. This allowed Sachs to demand unrestricted layoffs of public sector workers in order to "balance" state budget spending. The important state-run tin-mining group, Comibol, slashed its workforce from 31,000 to 6,000 over the next two years. By 1987, the output of Comibol was at the lowest in 10 years.

Overall, some 10% of all state workers were fired or forced to "retire" in order to reduce the government deficit and restore "the external balance of payment equilibrium." Unemployment, according to unofficial estimates, rose as a result to 25% of the productive labor force by early 1988. More than 300 small and medium-sized companies were forced to close down, as deregulated interest rates soared to 35-40%.

The argument of Sachs is that the "shock" prepares the way for stabilization of monetary inflation so that, with resumed international credits and stable inflation, investment in the economy would resume. This has not happened. While Sachs treats Bolivia as an "autarky" economically, it is not. Collapse of international tin prices in late 1985 as Washington refused to support the tin producers cartel in the London Metals Exchange, dealt a devastating blow to Bolivian export revenues. In addition, with its own worsening economic problems caused by the same debt crisis, Argentina, the largest user of Bolivian natural gas, defaulted on its payments.

Scarcity of credit and Sachs's 35-40% interest rate levels increased domestic indebtedness. The Emergency Social

Fund, imposed in 1987 supposedly to mitigate the severe social effects of the shock program, actually did nothing to alleviate the problems of widespread unemployment in the state sector and mining. Between 1986 and 1987, because of growing economic depression in the physical economy and high unemployment, the state deficit again began to grow from 3.8% of GDP in 1986 to 10.5% in 1987.

The narcotics economy

There is one gaping hole in the Sachs "Bolivia success story," which the absent-minded Harvard professor omits from his published accounts of his experiment. He saw to it that there would be a "loophole" in Paz Estenssoro's Aug. 29, 1985 Supreme Decree. Article 142, in effect, permits laundering of illegally obtained dollars at the window of the central bank and private banks—with no questions asked. The availability of the laundered narco-dollars to the Bolivian banking system was the key to the entire stabilization of the peso!

With the peso now freely convertible into the dollar by the central bank, the dollar profits of the "hidden economy" of cocaine could now more easily enter normal money flows of Bolivia's economy. This is reflected in the fact that, after three years of the Sachs shock program, by the end of 1987, more than 80% of Bolivian domestic bank deposits were still in dollars. This forced continuation of high interest rates and the resulting scarce capital for industrial investment.

Sachs's Bolivia "success" is based, therefore, on a criminal fraud. He ignores mention of this illegal "black economy." In a March 1989 report on Bolivia, Dresdner Bank estimates that "drug trafficking alone is estimated to amount to some two-thirds of officially recorded GDP." None of this shows up in official government statistics. Sachs's "success" is based on statistics which deliberately ignore 66% of the economy!

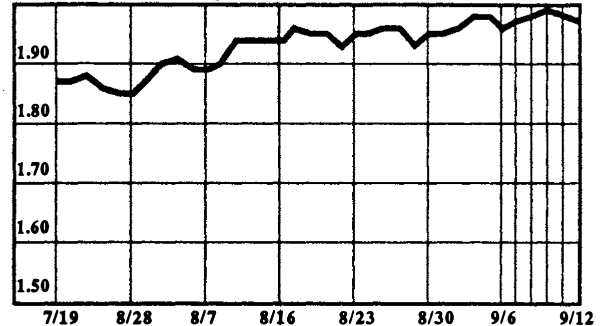
Because of Sachs's "free market" plan, "flight capital" did indeed began to return to Bolivia. But he chooses to ignore what those "hot money" flows were linked to. According to international law enforcement agencies, 40% of U.S. cocaine comes from the jungles of Bolivia. Under the Sachs plan, this cocaine money began to be legally traded in place of the peso. The returning narco-dollars did not go into productive investment in the economy.

By choking productive investment in the state sector and privately through astronomical interest rates, the Sachs plan enabled cocaine to become the focus of the economy. By 1988, more than 30% of the Bolivian labor force was linked to production or distribution of cocaine—double that of only a few years before the Sachs plan. By estimate of a former Bolivian finance minister, Roberto Jordan Pando, $3.6 billion of the small country's $4.5 billion Gross National Product now comes from cocaine. Between 1985, before the Sachs plan was imposed, and 1987, acreage devoted to coca bush rose from 198,000 acres to 372,000 acres.

Currency Rates

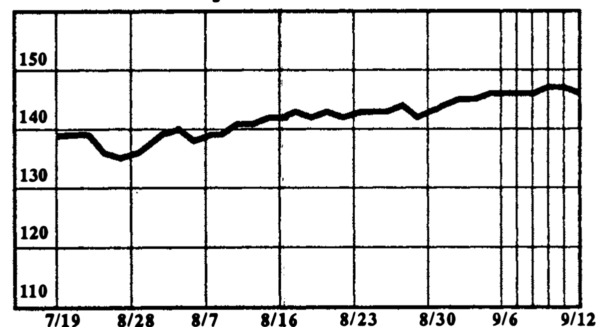
The dollar in deutschemarks

New York late afternoon fixing



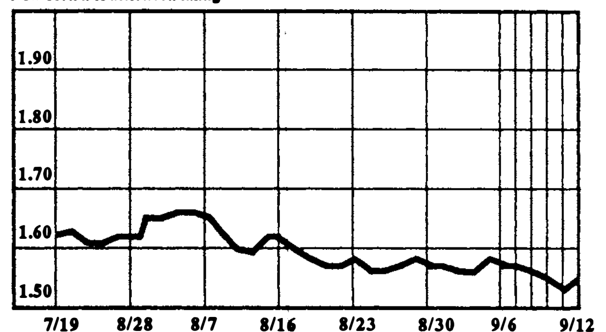
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing