PERU'S BANKING NATIONALIZATION COURTS ECONOMIC DISASTER

Peru's President Alan Garcia last month announced that he would nationalize his country's ten remaining privately owned domestic banks, along with six financial corporations and sixteen insurance companies. Garcia's action is certain to undermine Peru's already shaky economy and handicap seriously its chances for economic growth. Rather than recognizing that government failures have caused many of Peru's economic problems, Garcia is seeking even greater government control. The Reagan Administration, which frequently declares its determination to foster economic growth in the Third World, should send a clear message of disapproval to Lima. The White House immediately should withdraw its request to Congress for $56.5 million in U.S. Agency for International Development (AID) funds for Peru. This assistance, according to AID, is designed to promote the "expansion and strengthening of private sector institutions"--something made extremely difficult by Garcia's bank nationalization. The Administration should explain to Garcia that it is such policies as nationalization that cause underdeveloped countries to remain underdeveloped.

Quarter-Century of Poverty. Until recently, the pattern in less developed countries (LDCs) was for governments to control economic activity tightly. Wages, prices, banking, credit, production, distribution, and trade were directed by powerful bureaucrats, politicians, and vested interest groups with close government ties. Private property often was nationalized and expropriated, and economic freedom denied to individuals and businesses. The result of more than a quarter-century of these policies has become clear to almost all Third World leaders: poverty, economic stagnation, poor health care, and pessimism. The failures of centralized, command economies has prompted a number of Third World states to try a more free market strategy. Led by such Asian countries as Sri Lanka, Singapore, and Thailand, many LDCs are prospering. Countries in Latin America and Africa also are recognizing the failures of economic statism and exploring such growth oriented policies as privatization of state-owned enterprises, trade and foreign investment liberalization and tax reform.

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Peru's Garcia seems oblivious of this trend. The Garcia government virtually has suspended interest payments on its foreign debts and placed tight controls on foreign currency transactions. As a result, the International Monetary Fund and and the World Bank have cut off all financial aid. Bank nationalization compounds Peru's problems. Now all decisions on who obtains remaining scarce credit facilities will be in the hands of government officials. Such decisions will be based on a mixture of political expendiency, bribery, and cronyism, not on sound economic judgments. No doubt inefficient government enterprises and activities will have preferential access to funds while potentially profitable private firms will be starved of credit.

The nationalization shows that the Garcia government will not protect private property. Such threats to private property rights may be the single factor most responsible for continuing Third World poverty. The results of the 1982 bank nationalization by Mexico indicates what Peru can expect. Capital flight from Mexico reached panic proportions as Mexicans saw that their money and property were not safe in their own country. Some $5 billion fled the country in the months following nationalization. In 1986 Mexico required a $12 billion international financial bailout in part to compensate for the capital outflow.

Tightening the Stranglehold. The folly of Peru's current economic policies and the solution to its economic difficulties are explained in a recent study by Peruvian economist Hernando de Soto, of the Institute for Liberty and Democracy in Lima. De Soto finds that approximately one-third of Peru's economic activity now takes place in the black market, what he calls the "informal sector." Entrepreneurial individuals can provide extensive retail services, public transportation, small-scale manufacturing, construction and many other services, only by ignoring government regulations, permits, and taxes. What is holding back the entrepreneurial and creative efforts of the people of Peru is the dead hand of the state. The answer to this, says De Soto, is to eliminate suffocating red tape. But rather than cutting back radically the role of the state in the economy, freeing the people to produce and profit from their own efforts, the Peruvian government is nationalizing the banks and is tightening even further its stranglehold on the economy.

The Reagan Administration correctly has maintained that only encouraging growth in the less developed countries will solve the international debt crisis. Prosperity will come only when governments allow markets to function. The Administration therefore should condemn Lima's recent bank nationalization as an example of what not to do, and withdraw from Congress its request for $56.5 million in AID funds for Peru.

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George Melloan, "A New Latin Hero Has a Message for Capitalists," *The Wall Street Journal*, March 17, 1987, p. 33.