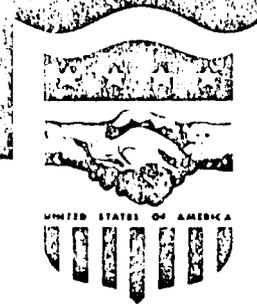


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AGENCY FOR
INTERNATIONAL
DEVELOPMENT



COUNTRY DEVELOPMENT STRATEGY STATEMENT

FY 1981

PERU

DEPARTMENT
OF
STATE

January 1979



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USAID/PERU

COUNTRY DEVELOPMENT STRATEGY STATEMENT

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TABLE OF CONTENTS

	<u>Page</u>
A. Analytical Description of the Poor	1
1. The Magnitude of Poverty in Peru	1
2. The Geographic Distribution of Poverty	2
3. Nutrition and Health Status	3
4. Education and Cultural Status	7
5. Role of Women	8
6. Target Sub-Groups	9
B. Progress, Commitment and the Persistence of Poverty	13
1. The Peruvian Revolutionary Experiment	13
2. Causes of Poverty	20
3. Prospects for Future Economic Growth with Equity	23
C. Host Country Development Plan and Budget	28
D. Absorptive Capacity	31
E. Other Donors	33
F. AID Assistance Strategy	34
G. Project Assistance Planning Level	50

11

A. Analytical Description of the Poor

1. The Magnitude of Poverty in Peru

Behind the facade of modern Peru there exists a second nation of at least eight million sierra and urban slum inhabitants. This group is larger than many single nations, and its inhabitants live in conditions of poverty more often seen in Africa and South Asia than in Latin America. These are not "pockets of poverty"; they are vast regions where the majority of families exist on per capita incomes of less than \$150 per year, entire cities in which more people live in slums than in acceptable housing. Increasingly large numbers of people have been falling into this poverty group as a result of the country's current economic crisis.

A recent World Bank Study, based on 1971 consumption data, has concluded that, using the most conservative definition of poverty*, 28% of Peru's population, or 4.5 million people, cannot satisfy the most minimal food and non-food requirements to adequately sustain life needs. Broken down by the country's three principal regions, 59 percent, some 2.64 million, live in the Andean highlands (sierra); 12% on the coast, and 29% from the eastern slopes of the Andes (high jungle) to the low jungle (selva). In the southern sierra, almost 47% of the population is living in poverty, and the proportion of population who fall below the minimum poverty threshold for the entire rural sierra is 41%. The severity of the poverty problem is indicated by the fact that the income of the average poor person in Peru would have to be more than doubled to reach the minimum

* The poverty threshold is defined as a diet that just allows minimum nutritional requirements plus an allowance, for all other consumption, of just under a third of the cost of this diet.

minimum poverty threshold. In the southern sierra, income is 1 1/2 times lower than the national median income of the poor. Moreover, the World Bank report cautions against the use of the 28% poverty figure as a definitive index of poverty in Peru. By not including a measure of access to basic public goods and services, whose availability is acutely deficient in broad areas of the country, the extent of poverty, especially in the rural areas, is significantly understated. Moreover, declines in real income over the past two years have driven up urban malnutrition levels. Given the unavailability of public services and declines in real income, we estimate that about 50% of the Peruvian population --eight million people-- live in conditions of absolute poverty, in the sense of basic human needs deprivation.

2. The Geographic Distribution of Poverty

Poverty in Peru, while not exclusively confined to the rural areas, can nevertheless be considered a phenomenon of rural origin. Urban poverty is caused principally by high rates of rural outmigration (5.9% per year) as a result of a limited agricultural land base, inadequate mobility channels in rural areas, and the poor performance of the traditional agricultural sector. Geographic income distribution patterns, based on a GOP national food consumption survey (1971-72), indicate an extremely skewed distribution in favor of the coastal region where Peru's principal cities are located. While metropolitan Lima comprised only 20.1% of the country's total population, its residents earned 46.2% of the national income. The entire coastal region accounted for 40.6% of total population and 69.1% of total income. The sierra, with over half the country's population, received less than a fifth of family income (13.9%), while the distribution of population and income in

the selva was nearly equal (8.6% and 7.0% respectively). There is also a direct linear relationship between income and level of urbanization. Rural areas account for 54.4% of all families, but receive only 23.5% of all family income. Income per family becomes greater as one moves up the urban scale. To illustrate income disparities even more dramatically, the GOP study shows that the average family in metropolitan Lima receives an income 9.5 times greater than the average family in the country's poorest region, the southern sierra. By the same measure, families of the coast, selva and sierra (the entire region) have incomes 7.1, 3.4 and 2.0 times higher than that of the poorest southern group.

A Geographical Profile of the Peruvian Poor, prepared by the Mission in 1976 confirms regional imbalances in income and access to public services. Using data gathered for twelve social, economic and cultural indicators to compare 23 departments and ten indicators to compare 150 provinces, it was found that the majority of poor reside in the sierra and the largest concentration of poor are located in: (1) the "mancha india", consisting of the continuous southern sierra departments of Ayacucho, Apurimac, Huancavelica, Cuzco, and Puno, and (2) in a northern sierra region consisting of Cajamarca, Ancash and San Martín. Highly significant disparities in access to services were found between the cities and modern agricultural enclaves of the coast, and the rest of the country. Although the large urban regions are found among the least-poor areas, there still exist important differences in living conditions both within each urban area and among the various cities.

3. Nutrition and Health Status

Peru's nutritional status manifests major deficiencies; primarily, the diet is unbalanced and characterized by a low caloric intake. Yet, while

the nutritional situation is poor for the country as a whole, it is even worse in rural areas. The areas suffering from the most severe nutritional deficiencies are the southern sierra, the lower selva and the rural part of the central sierra, with a combined population of over 4.5 million. The cause of the severely unbalanced diet of the rural population is insufficient consumption of foodstuffs -- especially cereals, vegetables, milk, eggs, and fats -- which has been aggravated in the past few years as the result of stagnant agriculture production, continued high population growth increases and the decline of real incomes. GOP studies indicate that approximately one-half of all Peruvian children are malnourished, with the largest proportion of malnourished children found in the sierra and selva. Seventy percent of all rural families are calcium-deficient; 56% register deficiencies in riboflavin and carotene, and 54% do not satisfy acceptable caloric intake levels.

Nutritional inadequacies, however, are not limited to the rural areas. One-half of the national population with caloric deficiencies lives in Lima. In 1972, before the onset of the current economic crisis, fully 19% of Lima's child population was malnourished. Urban diets have deteriorated considerably since then. Government information reveals substantial decreases in the amount of both calories and proteins consumed by the middle and lower socio-economic strata of metropolitan Lima since 1972, due to decreased real incomes which have been translated into a lower consumption of all meats, cereals, sugar, milk and fats. In 1978, the caloric intake for the lowest socio-economic stratum in Lima was only 62% of daily requirements. Hunger is a current reality for an estimated 400,000 living in the Lima slums (pueblos jóvenes).

Peru, like other developing countries, is characterized by high fertility, moderate mortality and significant rural-urban migration. The national population was estimated in 1977 at 16.6 million with an additional 461,000 in 1978. The birth rate is estimated at 39.5 per thousand, mortality at 11.6 per thousand, and the annual growth rate at 2.9%. The fertility rate averages 5.71 nationally -- 4.6 in the urban areas and a very high 8.5 births per woman in the rural areas. The high rate of population growth results in a relatively young population. 43% of the population is now under 15 years of age, while only 4% are 65 or older. A demographic study done by the GOP presents alarming results; if present high fertility rates are kept constant, the population will more than double by the end of this century. These high growth rates mean that each year Peru adds several hundred thousand persons to the group living in absolute poverty.

Peru's health problems are more severe than the Latin American average; child and infant mortality are high and result from a high incidence of malnutrition in the country's poorer regions. Nearly half (48.4%) of all deaths occurred in children under 5 years of age and sixty percent of these are due to malnutrition-related diseases. Average infant mortality is 142 deaths per thousand live births, rising to an appalling 200 per thousand in the southern sierra. Nationwide, 172 children out of every 1,000 die before the age of two. In the most deprived regions of the sierra that figure rises to 300/1000. Life expectancy is age 52. In 83 of Peru's 150 provinces it is less than 50 and, in 14, less than 40.

A rural population of 6.2 million lies largely outside the reach of medical care. While there are 5.9 doctors per thousand inhabitants

nationally, metropolitan Lima accounts for over 70% of all medical personnel. The remaining 30% is distributed elsewhere, primarily in departmental or the provincial capitals. The availability of hospital beds shows the same unequal distribution. While there are only 2.12 hospital beds per thousand nationally, metropolitan Lima accounts for over half the amount, with the remainder in the departmental capitals. In Lima, there are 4.4 beds per 1000 residents, while in Apurimac and Puno, two of the most marginal departments, there are only 0.6 beds per thousand inhabitants. Although the Ministry of Health has some health infrastructure in the rural areas, providing paramedical attention, these facilities are ill-equipped and do not cover even one-half of all rural health districts.

Access to potable water and sewerage systems manifests the same urban/rural disparities, although the inaccessibility of these services also characterizes the large and rapidly-growing urban slums. In 1972, 64.9% of the total population lacked access to potable water systems and 73.2% has no drainage or plumbing. In rural areas, only 6% of the population had access to potable water systems and a scant 1% had plumbing facilities. Eighty percent of all rural households use either river water or underground springs, with some degree of contamination. Only slightly more than half (55%) of all urban households have piped water or wells. The extent of electrification in rural areas is also minimal. Less than 3% of all rural homes have access to electrical lighting, while 81% utilize kerosene lamps and 14% use only candles. This compares with 57.2% of urban homes with access to electricity.

Lack of access to health-related public services imposes a double penalty on the poor, since alternatives are often even more costly. To cite

some examples, the unit cost of a cylinder of water in a Lima pueblo joven is 16.7 times more than that of an equivalent unit of running water. Similarly, the cost of a candle is three times higher than an equivalent unit of electricity, and kerosene is still higher. Thus, the lack of access to public goods and services works to drive significant numbers of the Peruvian population more deeply into poverty.

4. Educational and Cultural Status

While 85% of school age children in Peru have some access to basic education --an impressive achievement-- again, highly significant disparities in access to and quality of education exist between the urban and rural areas. The literacy rate of the national population over 14 years old, is 72.4%, 84% in the urban areas and 48.1% in the rural areas. The illiteracy rate among rural women (67%) is much higher than that of rural men (42%). In absolute terms, the numbers of illiterates in Peru is growing. Only 55% of the total population has had more than four years of schooling --61% of the urban population and only 22% of rural inhabitants. To the extent that the rural population has access to educational services, the education provided is almost exclusively primary, with secondary and technical schools virtually non-existent in all but a few district capitals in the rural regions. Although minimal education infrastructure exists in the rural areas, there tend to be strong geographic disparities in both the distribution of qualified teachers and in coverage of non-formal education programs.

Over three million Peruvians do not speak Spanish; most of these are Quechua-speakers with a smaller number speaking Aymara. This groups constitutes a sizeable minority of citizens who live almost exclusively

in the rural sierra in conditions of absolute poverty. Numerous differences exist between these linguistic groups. In educational attainment, fewer Quechua-speaking children continue after the first year or complete primary school. This is due to both the initial language barrier and to the greater absence of schools in the remote mountainous areas where Quechua-speaking children live.

The linguistic cleavage reflects, to a large extent, the coast/sierra dichotomy of Peruvian society. The Spanish monolingual population (68.6% of all Peruvians) is concentrated in the coastal and urban areas. The Quechua and Aymara monolingual population is concentrated in the rural sierra, especially in the central and southern region of the "mancha india". Thus, the marginality of the rural poor in terms of income, lack of access to education and health facilities, etc., is reinforced by a real, although covert, ethnic order which has historically determined the political and social position of ethnic groups.

5. Role of Women

Peruvian women are more disadvantaged than men according to most poverty indicators. A woman is more likely to be illiterate, less likely to be economically active (by 45% to 12% in terms of the non-agricultural labor force), paid less if employed, and vulnerable to abandonment while responsible for child-raising (especially prevalent in urban slums).

Problems which women face differ according to social class, and rural vs. urban location. Results of a Mission-financed study indicate that rural women perform domestic chores --care and maintenance of the home and children-- as well as sharing in the responsibility for family

productive efforts. Especially in subsistence farming, where the male head of household frequently works away from home, women perform at certain times virtually all agricultural tasks from plowing and planting through harvest and marketing. The rural woman also engages in commercial and artesian activities --selling produce, making chicha (a drink) for sale, or weaving for local trade. Within the family, rural women play an important decision-making role -- handling domestic finances and often making agricultural decisions on the sale of produce and purchase of farm inputs.

Urban Peru appears to be a more restrictive context for the woman as a decision maker within the family --machismo tends to dominate family finances, for example. However, opportunities for personal advancement outside the home are much greater than in the countryside. Women are represented in the major urban professions. Thousands of working class girls and women are enrolled in a variety of formal and non-formal education programs, which the government strongly supports. Thus, the agenda for urban women --both the poor and the middle class-- includes greater attention to expanding legal rights (divorce, employment) than would typically be the concern of rural women. However, both rural and urban women share many of the same interests as well -- for example, the Mission study indicates an equally strong desire to greater access to information about family planning.

6. Target Sub-Groups

The Mission has attempted to define Peruvian poverty in terms of geography; health, nutrition and educational status; income distribution,

and the role of women. Each of these perspectives is a useful guide to AID programming. But each also lacks an important dimension --the connection between the poor and their means of making a living. The following categorization attempts to breakdown the poverty group, especially the rural group, according to assets held and forms of rural organization. The five target groups, which also include the urban poor, follows:

-- Independent market-oriented farmers. These are farmers who, in addition to producing foodstuffs for their own household, produce or have the capacity to produce a reasonable surplus for sale in the domestic market. Viable farm size differs, of course, by region and use of irrigation water. The IBRD cites two hectares and above. The Mission believes that in some areas of intensively cultivated land only two hectares may be viable. Using a somewhat higher cut-off of 5 hectares, the Mission estimates that the independent farmer group totals 263,000 families nationwide, with 172,000 (65%) in the sierra and 53,000 in the selva.

-- Agrarian Reform Group Beneficiaries. This group is comprised nation-wide of 170,000 families who belong to group farming entities set up during the Agrarian Reform. Most of these associative enterprises (AE's) cultivate common land (the old hacienda lands) which produces crops and livestock for sale. Within most units (especially in the sierra), at least part of the family continues to individually possess and farm a relatively small (generally under 5 has.) plot for their own consumption. In terms of productivity and income, the associative enterprises are not homogeneous. In the sierra, most AE's are neither productive nor profitable, and living conditions are generally poor for the approximately

60,000 member families. Poverty has been reinforced by the insufficiency of technical assistance, agriculture inputs and unfavorable price policies. Moreover, many AE's in the sierra have too many members to assure adequate income. In contrast to the sierra AE's, the enterprises on the coast are significantly more productive, and the GOP has allocated more resources in the coastal sector. When compared to members of campesino communities and groups, and to the smaller of the small independent farmers, families residing in agrarian reform units --even those in the sierra-- are relatively better endowed with arable land.

-- Campesino Community and Group Members (Comuneros). CC's are the remnants of pre-Columbian villages which continue to possess an area of land and exploit it as their own. In most cases, pastureland is communally owned, while cropland is subdivided for use by individual members. Although there are more than a thousand CC's with over 420,000 families or 2.4 million people, only 415 CC's became legally recognized under the Agrarian Reform. Only 2% of total CC holdings is cultivated land as opposed to pasture, and only one half of all comunero families have agricultural land for their own use. For those with land, subsistence plots tend to be smaller than 0.5 hectare per family. Most of the CC's are in the sierra, and some in the high jungle.

Campesino Groups are composed of small subsistence plot holders, who were renters prior to the agrarian reform. Families continue to operate these minifundios and may individually own livestock pastured on group land. There are currently 798 groups, totalling 44,761 sierra families. The often-used figure of 325,000 agrarian reform beneficiary

families combines the membership of associative enterprises, campesino groups, and legally-registered campesino communities.

-- Landless and Near Landless. This is the residual group of families relying partially on agriculture for their livelihood. There are an estimated 438,000 such families with 79% living in the sierra. Many of these do hold small plots of land, but are not considered statistically as farmers since their holdings are too small to provide even a subsistence living. Most must rely on casual labor opportunities or cottage industry. In addition, due to the rapid growth of their numbers, labor supply far outstrips demand for their services.

These families constitute the majority of the rural labor force, approximately 2.5 million people who live in conditions of absolute poverty. Together with members of CC's, this group has the most tenuous position of all rural target groups, and we suspect that it provides the bulk of the population flooding the coastal cities, swelling the ranks of the urban poor.

-- Urban Migrants. Coastal cities are experiencing extremely high growth rates that far surpass the government's capability to provide basic services. Substandard housing and limited employment opportunities for ill-prepared migrants have resulted in continued poverty for a conservatively-estimated 2.5 million people.

To sum up, poor target groups are identified as follows:

	<u>Millions</u>
Independent, market-oriented farmers (sierra and high jungle)	1.1
Agrarian reform beneficiaries (sierra)	.3
Campesino Communities and groups (sierra)	2.6
Landless and near landless (sierra)	2.0
Urban poor	<u>2.5</u>
	8.5

Virtually all these groups, with the exception of some of the independent farmers, fall within the definition of absolute poverty used earlier in this section.

B. Progress, Commitment and the Persistence of Poverty

1. The Peruvian Revolutionary Experiment

a. Background

A basic tenet of the Revolutionary experiment was that structural changes in the land tenure system, in education, and worker participation in the industrial, mining, and fishing sectors would lead to increased incomes for the poor and a more just society. The Velasco, or Phase I government (October 3, 1968 - August 29, 1975) undertook the most sweeping reform in Peruvian history to restructure the ownership of national wealth. One U.S. scholar described the 1968 scenario for the military as follows: "Their way was relatively unimpeded at the start. Peru's still relatively low level of social mobilization and participation, the weak and dependent nature of Lima's industrial bourgeoisie,

the dwindling economic base of Peru's rural elite, and especially the general disrepute which civilian politicians had achieved, all left Peru's officers virtually unchallenged."

Expropriation

The new government's first major act was the now-famous expropriation of IPC. In June 1969, the Agrarian Reform Law was decreed followed shortly by the expropriation of the large and prosperous coastal sugar estates. By 1975 virtually all large private landholdings had been expropriated. In the minerals sector, the Phase I government attempted to induce foreign companies to undertake rapid development of undeveloped concessions; success in this venture was only partial. Agreement was reached with Southern Peru Copper Company (SPCC) for expansion, and later a number of foreign petroleum companies were contracted to explore for oil. Mineroperú, the state mining enterprises, was established in late 1970 and given the task of managing the expropriated assets of foreign companies. A series of additional foreign firms were expropriated or bought out; the larger include ITT in 1969, Chase Manhattan's local bank subsidiary in 1970, the Peruvian Corporation (railway), the Conchan oil refinery in 1972, Cerro Corporation (minerals) in 1974, and Marcona (iron ore) in 1975. In March 1971 the General Fishing Law established state control over the marketing of fisheries exports, and in 1973 with the disappearance of anchovy the entire fishmeal industry was taken over by the government. By 1973 the State had assumed the role previously held by foreign capital in electricity, telephones, and railways, had taken over much of the mining

sector and banking system, virtually all export marketing, and the entire fishing sector.

Reform

The agrarian reform, decreed in 1969, established a large number of diverse types of enterprises owned and administered by the campesinos themselves and the GOP mounted a campaign to train campesinos in management techniques. In July 1970, the General Industries Law decreed the establishment of Industrial Communities within modern sector manufacturing enterprises by which workers would receive a progressively increasing share of ownership, profits, and management (up to 50%). In March 1972 the General Education Law appeared with the declared objective of extending educational opportunities to all Peruvians. This reform created 650 school districts (NECs) to promote local level participation, providing an opportunity for mobilization of community participation around specific issues. The revolutionary government introduced important policy changes towards the squatter settlements which surround Peruvian coastal cities. It organized these low-income communities as pueblos jóvenes (new towns), granted residents the legal title to their land, assisted them in building and strengthening their political and organizational structure, and promoted housing cooperatives and sites and services projects. Municipal and block committees in the pueblos jóvenes provided the urban poor with new channels of participation. During 1973 public debate began on perhaps the most unique of the proposed new reforms - social property. The Social Property Law was promulgated on May 2, 1974, establishing social property enterprises as worker-managed,

market-oriented firms, with ownership vested in and the bulk of profits destined to the "social" or public sector for further reinvestment.

Managing the Revolution

By 1972, the initial reforms of the Phase I government had been enacted into law and the government felt itself under increasing pressure to find additional sources of funding to sustain economic growth. It began to contract for the exploration of jungle oil and this exploration proceeded at an intensive pace until 1975. By late 1975, despite two successful oil strikes, the total reserves located amounted to only 550 million barrels (about 3-4 months of Venezuelan production). This left mining, and specifically copper, as the most immediate source of export expansion. The two key projects in this area, Cuajone (SFCC) and Cerro Verde (MineroPerú), came on stream in 1976 and 1977 respectively -- the onset of a cyclical low of world copper prices. Export earnings began to drop. Domestic private investment also declined rapidly.

One Phase I supposition was that the attack on large-scale capital, foreign and domestic, would open the way for a new stratum of dynamic local enterprises of medium scale. However, on the whole private investment fell off in the period 1969-1973. Many potential investors left Peru, and most of those who stayed adopted a "wait and see" attitude.

The period from the fall of Velasco in August 1975, to mid-1976 was marked by a struggle between "moderates" and "leftists" within the military. Subsequently, the "Phase II" government has adopted an ideology which can be described as "doctrinal insurance" of the basic reforms of the Revolution combined with recognition of the private sector's

legitimacy. The Phase II government applied certain new policies to the greatly-expanded state enterprise sector --reprivatization of the fishing fleet and adoption of measures to maintain the profitability of state enterprises. The Industrial Communities were restructured into what is fundamentally a profit-sharing scheme with maximum ownership by workers set at one-third of share equity. Foreign exchange controls were eliminated, and social property enterprises deemphasized (relatively few were actually ever established). Food and petroleum subsidies have been largely eliminated. The heavy emphasis of Phase I on state ownership was significantly modified, and several major mining and oil ventures in the past few years have been undertaken with an enhanced role for private companies. Although the private sector has not obtained everything it desired, its fear of imminent expropriation has receded.

b. Economic Deterioration and Crisis

Estimated GDP for 1978 is 17% less than GDP which would have resulted from a 5% annual growth rate from 1970. GDP per capita for 1978 is at about the same level as in 1972, i.e. between \$530-580. Real personal income has declined substantially particularly since 1975. Banking system net international reserves have declined by \$1,748 million since the end of 1974, and at the end of 1977 total external debt amounted to \$8.3 billion. From mid-1976 to mid-1978 economic policy was marked by unsuccessful attempts to restore fiscal and balance of payments equilibriums. By mid-1978, the GOP had to confront a balance of payments situation entailing grave consequences, e.g. cessation of imports due to the unavailability of foreign exchange to service short term commercial

debt. Subsequently, the GOP has obtained an IMF standby arrangement (to run through 1980) and has renegotiated public sector external debt for 1979 and 1980, which totals about \$2 billion.

Economic deterioration from 1975 to the present was due partly, but not principally, to the unavoidable costs of structural reform. Obvious costs were evident, e.g. the start-up costs of various state enterprises, losses due to decapitalization of physical and human capital in the foreign enterprise and agricultural sectors, and the loss of potential investment of wealthy emigrants. Apart from these costs, some of which will be offset by future benefits, we believe that the most powerful causes of recent economic deterioration have been the following:

-- Living Beyond Means. From 1971 on, and apart from 1974, Peru's B/P has not been strong. Public and private external debt increased rapidly. Expansion of domestic credit was too rapid to assure price stability and the efficient operation of a fixed exchange rate. Tax revenues declined as a proportion of GDP. By 1976 the erosion of international reserves brought increasing doubts concerning Peru's external creditworthiness. Unfortunately, the government delayed undertaking appropriate macroeconomic corrections.

-- Waste of Capital. Presently available data indicate that Gross Domestic Investment, which had averaged 20.9% of resource utilization (the sum of Consumption plus Gross Domestic Investment) during the nine-year period 1960-1969, fell to 15.6% of total resource utilization during the nine-year period 1969-1977. Thus Peru failed to capture significant domestic resources for productive purposes. Also, the public

sector's share of Gross Fixed Investment averaged 46.6% during the five year period 1972-1976 as compared with 27.3% during the period 1962-1966. Unfortunately, not all public spending proved to be economically productive. For example, Peru's present Minister of Economy and Finance stated publicly on June 14, 1978, that military expenditures had been excessive. Excessive military expenditures, certain public sector projects of low productivity, capital flight, and "protective" private sector investment of low productivity (e.g. urban real estate) all resulted in a large waste of resources, which had a negative impact on the pace of economic growth and led to a lowering of living standards.

-- Bad Luck. World market conditions for Peru's exports have weakened markedly since 1974. In the mid-1970's some analysts were projecting that Peru's commodity exports would reach nearly \$4 billion in 1978. Earnings in 1978 were actually \$1.9 billion. The difference arises principally from lower-than-forecast volumes of fishmeal and petroleum exports and from low copper and sugar prices. The impact of these sizeable short-falls in export earnings on Peru's \$10-12 billion economy has been severe.

c. Impact of the Revolution

Though it is too early to attempt a definitive summary, we feel that the strength of the Peruvian revolution to date lies in its reduction of the power of the oligarchy. The ability of this narrow, but economically powerful, group to block reforms needed for expanded participation of the poor in national economic development has been sharply reduced. The reforms implemented by the revolutionary government increase the possibility

that the benefits of future growth in Peru will be more equitably distributed. Moreover, Peru has accomplished these reforms while demonstrating respect for human rights. On the other hand, income redistribution has yet been minimal -- limited principally to shifts within the top quarter of the income distribution -- and economic growth has lagged.

2. Causes of Poverty

Rural Poverty. The persistence and gravity of poverty in the rural sierra region derive from a combination of high fertility rates a limited natural resource base, and isolation of various types -- physical, economic, and institutional. Peru's poor are poor partly because the region of the country they inhabit is poor. They are kept from becoming productive more from the fact they are not given needed public sector assistance than from high taxes, high rents, political repression, and various other forms of direct exploitation. Although one can not rule out persistently unfavorable terms of trade vis-a-vis domestic urban or foreign markets, it is doubtful that this, by itself, can explain fully the substantially lower incomes of the sierra rural poor.

Several Peruvian analysts identified the following factors in response to the question, "Why are they poor?": (1) small amounts of arable land; (2) use of traditional technologies; (3) isolation from large markets which is related to (4) non-existent or precarious condition of roads; (5) farm production oriented principally to family consumption (with a corresponding loss in output as compared with that which would exist with greater specialization); (6) lack of adequate public sector services of most types normal to Peru's principal urban areas, in particular, health and educational services; (7) differentially poor public services

related to sierra agriculture, e.g. credit, availability of improved seed, and agricultural extension services. To this list we would add (8) constrained mobility arising from linguistic and ethnic differences, i.e. in the sierra region there is a high correlation between poverty and indigenous Indian culture.

Economic Dualism. The Agrarian Reform transferred rural assets, and the industrial and mining reforms increased worker participation in profits. These measures increase the chance that future growth in Peru will be more equitably distributed. But the fact is that the reforms have not yet resulted in significant shifts of income to the lower half of the income distribution. Moreover, the transfers which have occurred have been vertical rather than horizontal, i.e. income was redistributed within each economic sector rather than, for example, from the rich sector (urban modern) to the poor sector (agriculture). Though horizontal transfers would have been greater had the government not entered a period of economic crisis, the inability of a government as determinedly reformist as this one to effect such transfers points to the deep-rootedness and persistence of dualism in the Peruvian economy.

Dualism is manifested in the fact that the bulk of Peruvian production comes from a small number of firms. These firms are able to employ relatively few workers who receive higher pay than those in smaller-scale industry. In Peru, some 850 firms (about 6% of all businesses) account for about two-thirds of Gross Domestic Product. Approximately 150 of these firms account for 50 percent of imports. Concentration of economic activity in the modern sector is reinforced by the fact that most of it occurs in and

around Lima. Dualism in Peru has both a sectoral and a geographic basis. Therefore, there is a clear need to broaden the basis of Peruvian economic production both in sectoral and in locational terms.

Inappropriate Factor Pricing. Departures from price-directed resource allocation have tended to strengthen Peru's economic dualism. In the manufacturing sector, labor stability and Industrial Community laws coupled with cheap capital goods policies (low tariffs, tax exoneration for reinvestment, and negative interest rates) significantly reduced the pace of expansion of modern-sector employment. Based on data for manufacturing firms with 20 or more workers during the period 1972-1975, one study indicates that the cost of creating 4,803 permanent jobs amounted to S/.29.5 billion --approximately \$110,000 per job. Even if allowance is made for capital flight and an overvalued exchange rate, this figure is about three times the norm for other developing countries. It is even high compared to capital-rich developed countries. Because of the impact of inappropriate factor pricing, the modern sector is more isolated from the rest of the economy than it need be, particularly in regard to employment creation.

Government price policy has traditionally worked to the disadvantage of the agriculture sector. Though the government has recently removed subsidies on imported foodstuffs -- freeing budget resources for development purposes, including agriculture -- the internal terms of trade still present a problem to the farmer. Some prices of domestically produced food commodities have been permitted to rise, but further movement toward a market-oriented price system would provide an important stimulus to farm output.

Interest rate policy in general is moving in the right direction, with the government hopeful of achieving positive rates this year.

3. Prospects for Future Economic Growth with Equity

The Morales Bermúdez government plans a return to civilian rule by late 1979 or 1980. The new government will have the task of constructing its own strategy for long-run economic growth and for reduction of poverty. We assume that the new government will maintain the principal structural reforms of the Revolution, assign a predominant, or at least important, role to the private sector, utilize a price-directed resource allocation system, and pursue recent GOP economic policy initiatives to increase non-traditional exports, implement a progressive population policy, encourage regionalization of government spending and decentralization of administration, and improve tax administration

a. Past Performance as a Guide to 1980's Growth Prospects

Table I indicates rates of growth in output of Peru's basic productive sectors during the period from 1950 to 1975. (Data for all periods are not wholly comparable; for 1950-1970, GNP-based data are utilized and for 1971-1975, GDP-based data are utilized). During the period 1951-1975, Peru's GNP (or GDP) grew by 250% and the output of its basic productive sectors grew by 245%. This sustained economic growth outstripped a population growth of approximately 92% and produced an average annual increase in GNP per capita of about 2.5%.

Growth rates for each of the basic productive sectors responded to a variety of forces. Growth of output of domestic manufacturing was generated principally via import-substitution industrialization. The

manufacturing sector was encouraged by sharply increased levels of protection (two general import tariff increases in the 1960's), outright import prohibitions (beginning in 1968), import duty exceptions for capital goods, and various tax incentives for reinvested profits.

Agricultural production did not grow as fast as population over the past three decades, which placed an additional burden on Peru's balance of payments. Decline in agriculture is a major concern due to the fact that a large portion of the labor force (43%) is still employed in this sector. As recently as 1950 agriculture produced more than half of total exports. By 1961 the share of agricultural exports had declined to 35% of total exports, and by 1967 Peru's exports of agricultural products were less than its imports of foodstuffs and animal feeds.

Peru has long exemplified a classic export economy. Historically, the growth of exports has depended upon the exploitation of some new natural resource base in high foreign demand. By the 1960's, Peru had acquired a diversified export base including fishmeal, copper, silver, lead, zinc, cotton, sugar and coffee. The boom period for Peruvian exports was 1958-62, when volume increase by 82 percent. This increase was somewhat unique, since it was caused by the onetime, combined effect of the opening of the large-scale Toquepala mine in 1959 and by the rapid growth of the fishmeal industry.

Looking at past growth experience, it is difficult to avoid the conclusion that export performance is an indispensable element in successful economic growth for Peru. Although Peru is not likely to re-experience a 1950's style export boom, we believe that a very respectable

TABLE I

GROWTH PERFORMANCE: RATES OF GROWTH
OF BASIC PRODUCTIVE SECTORS FOR EACH FIVE-YEAR
PERIOD 1951 - 1975

	<u>1951-1955</u>	<u>1956-1960</u>	<u>1961-1965</u>	<u>1966-1970</u>	<u>1971-1975</u>	<u>Composition: As Percent of</u>	
						<u>1960 GNP</u>	<u>1976 GDP</u>
Agriculture and Forestry	27.3	19.6	11.1	10.2	3.3	21.9	12.4
Fisheries	108.1	212.6	45.3	63.0	-41.5	1.7	0.7
Mining	50.9	71.9	16.1	11.3	1.4	7.5	5.8
Manufacturing	45.3	38.5	53.5	32.8	41.4	17.4	26.6
Total for Basic Productive Sectors	36.7	35.6	28.3	22.2	18.8	46.2	45.5
Other Sectors	31.6	14.3	45.1	24.0	38.5	56.4	54.4
Total	33.7	23.3	37.4	23.2	28.8	100.0	100.0
Exports	46.0	64.4	29.8	14.4	-23.2	24.3	11.2
Imports	79.2	13.7	84.6	26.1	68.7	24.2	18.9

Source: Pedro-Pablo Kuczynski, op.cit. pp. 285-290 (for 1950, 1955, 1960); Banco Central de Reserva del Perú, Cuentas Nacionales del Perú 1960-1974 Lima, 1976, (for 1960, 1965, 1970); Instituto Nacional de Estadística, Cuentas Nacionales, Oferta y Demanda Global 1970-1976 (for 1970-1975).

growth rates of exports can be achieved in the 1980's, particularly in minerals and non-traditional exports. Expansion of minerals exports will require substantial investment on the part of private companies and the state. New investment undertaken now could not be expected to pay off until the mid-1980's. The crucial role of mining sector investments in Peruvian growth underscores the significance of the government's recent, successfully-completed debt rescheduling, which should restore investor confidence. Based on Peru's past growth experience and given adherence to appropriate macroeconomic and sectoral policies, we suspect that Peruvian planners looking toward the mid-1980's could realistically posit annual growth targets in the range of 5-6%.

A 3% annual growth rate of agriculture is desirable to prevent further deterioration in Peru's net balance of agricultural trade with the rest of the world. It has been achieved in the past, and we believe it can be achieved again with sufficient investment and the appropriate set of policies. Our major concern is that the Peruvians not be tempted again to seek less cost effective and low employment-generating growth in the coastal areas at the expense of growth with equity possibilities in the sierra. The Mission is convinced that projects in the sierra and high jungle offer solid economic as well as equity prospects, and that payoff in this type of investment is likely to be greater over the CDSS planning period than some of the costlier coastal agriculture development schemes. This assessment is reinforced by our own experience in successful AID projects, such as rural enterprises and sierra irrigation.

b. Equity Considerations in the 1980's

In looking at equity prospects for the 1980's, we have maintained that it is critical to stimulate growth in non-coastal Peru. In so doing, we wish to avoid the temptation of suggesting that this alone will solve, neatly and forever, Peru's poverty problem. The goal of improving living conditions of Peru's poor should be undertaken with the recognition of certain important limitations: (1) Even though there is considerable scope for improving the productivity of sierra agriculture, developing small-scale mining, and adding employment through rural enterprises, we suspect that increases in production alone will not yield a major increase in per capita income for a population substantially larger than that which presently exists in most regions of the sierra. (2) Substantial migration from the sierra to the Lima metropolitan area, other coastal areas, and the high jungle will continue, even if there is a decline in sierra fertility rates. Therefore, educational health and nutritional adequacy for the sierra poor should be viewed as an investment in human capital as well as a regional income transfer. (3) Increases in employment creation in the modern sector are essential for obtaining higher incomes for the poor and an equitable distribution of income (4) Continuous production increases in the sierra are not likely to occur without increased interregional exports and, for this reason, investment in transportation, energy, urban and marketing infrastructures must complement investments in primary production.

We wish to stress also the importance of increasing domestic resource mobilization on behalf of an equity emphasis. There are few

things more important for Peru as its economy recovers than to develop a fiscal mechanism that will yield revenue to effect necessary horizontal transfers (i.e. to the agriculture sector and to the sierra and high jungle). During the period 1974-77 central government revenues approximated 15.1% of GDP and expenditures 20.7% of GDP. The government has recently undertaken measures to increase revenue collections through changes in tax law and improved tax administration. They estimate that these measures will increase revenues this year by \$110 million, which would be to about 16.1% of GDP. Assuming further improvements in collections and an enlarged tax base, we believe that toward the end of the CDSS ~~planning period~~ the system could produce additional revenues on the order of \$250-400 million (2 - 3.3% of GDP) which could be applied to investments impacting on the poor.

C. Host Country Development Plan and Budget

The previous section of the CDSS, explores the hopes and disappointments of the Peruvian revolution, and in so doing it assesses the complexities of GOP "commitment." USAID believes that the Peruvian government has pressed extremely hard for social and economic change to benefit the poor. Yet inflation and recent government fiscal austerity measures have lowered the government budget in real terms and thus reduced the possibility of significant horizontal resource transfers to the poor. The ability of the government to mount new programs for the poor during the next half-decade is limited. However, if things go right for the Peruvian economy and assuming the tax system improves, the country will realize a substantial increase in public revenues by the mid-1980's. How these increases are

spent will determine whether Peru incorporates an adequate equity emphasis in its development program.

The key choice in terms of budget and planning is whether Peru will be willing to commit major resources in the sierra and high jungle. Investment decisions in the agriculture sector will be particularly important and will determine both how and where agricultural growth will be realized. As stated in the previous section we believe that Peruvian agriculture can and should achieve 3% annual growth rates and that, for equity reasons, much of this growth can and should take place in the sierra and high jungle. However, it is technically feasible to achieve a disproportionate share of growth in coastal agriculture. There is disagreement on the cost this would entail. However, those who would argue for an exclusively coastal agricultural focus for Peru do so less on the basis of economic argument than on political realities --the coast represents the most politically vocal section of the country.

Over the next halfdecade, AID and other donors can through their project selection criteria influence Peruvian investment priorities in the direction of equity. This can occur in a variety of ways: as more projects are located in the sierra/high jungle target areas, the counterpart from the GOP budget assigned to these areas will increase; as donors discuss policies with the government during the upcoming crucial period of political transition, the importance of insuring that the sierra and high jungle get a meaningful share of growth (in macro-economic terms) and of increased revenues (in fiscal terms) must come through loud and clear. Thus, the AID program must not only finance new programs for

the poor but also help to implant a stronger equity emphasis within the GOP budget.

The government is fulfilling the terms of its fall 1978 IMF agreement and has just concluded a major debt rescheduling. The obvious next step is to define more precisely sector policies and allocations. First steps taken along these lines as demonstrated in the 1979 budget, reveal a number of encouraging planning concepts: emphasis on the importance of agriculture; de-emphasis of certain large and costly irrigation projects; a desire to apply greater funding to small projects with more immediate impact on employment and small farm productivity; and regionally-focused development planning and administration. Looking at the 1979 investment budget separately, we see that agriculture is the largest sector with 25% of the budget. Strong emphasis on agriculture also characterizes the preliminary investment plan for 1978-82, prepared by the National Planning Institute. We expect that the concepts revealed in these recent plans will carry over into the long-term investment framework which the new civilian government will be developing once it takes office.

Recent GOP budget priorities in terms of actual expenditures (investment and operating expenses) are represented, as follows:

Central Government Expenditures: 1975-77 Averages

<u>Category</u>	<u>Millions \$U.S.</u>	<u>% of Total</u>
<u>Government "Housekeeping"</u>	<u>78.3</u>	<u>2.5</u>
<u>Economic Sectors</u>	<u>586.9</u>	<u>18.7</u>
Agriculture and Food	243.7	7.8
Fishing	18.5	.59

<u>Category</u>	<u>Millions \$U.S.</u>	<u>% of Total</u>
Industry and Tourism	32.7	1.0
Energy and Mining	118.4	3.8
Transportation & Communication	112.7	3.6
Housing and Construction	29.7	1.0
Earthquake Zone	26.6	.9
Bayovar Complex	5.1	.2
<u>Human Resources</u>	<u>682.3</u>	<u>21.8</u>
Education	510.1	16.3
Health	141.6	4.5
Social Mobilization	30.6	1.0
<u>Police and Military</u>	<u>1,013.8</u>	<u>32.4</u>
<u>Interest, Amortization, Other</u> <u>Ministry of Finance</u>	<u>771.7</u>	<u>24.6</u>
TOTAL	3,133	100

Source: "Banco Central de Reserva del Perú, Memoria 1977"; statistical compendium to speech made by Dr. Manuel Moreyra Laredo (President of the Central Bank) on January 25, 1979.

D. Absorptive Capacity

Short-term limitations relate to the present erosion of the GOP budget. All Ministries, including those with which foreign aid agencies work most closely, have difficult cash flow and personnel problems as a result of declining budgets. Personnel are leaving the Peruvian public sector for better opportunities in the domestic private sector or abroad. Thus, during the first few years of the CDSS planning period there is a question as to the capacity of key Peruvian agencies to cooperate successfully with foreign

aid donors. This will be especially true of donors who provide only foreign advisors and equipment and do not finance project local costs. USAID anticipates fewer problems of this kind because we have reduced counterpart requirements to the 25% legal minimum and have a tradition of local cost financing. Nevertheless USAID could not avoid serious short-term absorptive capacity constraints to program expansion in the absence of PL 480 local currency. These currencies would be used to help finance the costs of expanded programs envisioned in the CDSS strategy and would permit additions to the operating and investment budgets of such agencies as the Ministry of Food and Agriculture and the Ministry of Health --for new personnel and for other inputs essential to program outreach in the sierra and high jungle (gasoline, vehicles, per diem and travel expenses). By the end of the CDSS planning period, we would anticipate that these additions financed by PL 480 local currency could be assumed by the GOP agencies themselves.

In the longer-term the CDSS strategy implies substantial increases in GOP programs for the poor; however, the recurrent costs of these programs are not in excess of the country's ability to pay, assuming economic recovery and a decently functioning fiscal mechanism. Indeed, if our estimates are correct additional annual revenues on the order of \$250-400 by the mid-1980's would cover sierra and high jungle investments at a level considerably higher than the annual level that is likely to be forthcoming from aid donors for these purposes in the period 1981-85.

E. Other Donors

Peru has been receiving about \$250 million annually in foreign assistance over the past few years, principally from AID, the IBRD and IDB, the UN, and other bilateral donors (especially the Netherlands, West Germany and Belgium). Though this assistance touches virtually every economic sector to some degree, the bulk of it is concentrated in industry, transportation, energy, and mining. Coastal Peru has tended to benefit from this aid to a greater extent than the sierra or high jungle. This is understandable since the effective demand for investment capital has been much greater on the coast and in the modern sector. Continued growth in these areas is important to the overall development of the country. More recently, however, some of the key donors have been increasingly stressing that the sierra and high jungle must get a bigger share of the country's growth. The recent update of the IBRD Agriculture Sector Assessment, for example, is highly supportive of the kind of strategy contained in the CDSS.

Many donors are actively developing sierra and high jungle projects. We believe this trend to be important. The more donor activity is oriented in this direction, the stronger will be the impact on GOP investment decisions in the coming years. We see numerous possibilities for complementary assistance activity --electric power in the high jungle financed by the IFI's would give considerable impetus to our own strategy; also, there is plenty of room for other donors to finance rural infrastructure investments through newly-created Regional Development Committees in the sierra and high jungle.

Donor coordination in Peru is informal, but frequent. A consultative group under IBRD chairmanship exists but has not met for several years. We would strongly support re-activating this or some similar group as a means of reviewing investment plans, coordinating aid inputs, and generating more concessional assistance for Peru.

F. AID Assistance Strategy

Peru's short-term imperatives are to restore economic growth, to manage the transition to civilian government, and to reduce the suffering of the poor during the current economic depression. These objectives are clearly inter-related, and failure on one would have adverse effects on any of the others. Though the instruments of foreign aid are more appropriate for addressing longer-term development objectives, USAID's food aid program is making and will continue to make a powerful impact on the short-term position of the poor.

Looking at the longer-term objective of moving poor Peruvians out of absolute poverty, the role of AID during the years of the CDSS planning cycle must be -- along with other donors -- to fill the gap between Peru's strong commitment to the poor and its weak fiscal position. We must face the fact that the actions Peru is taking to restore economic growth have, in the short-run, reduced the government's ability to carry out programs for the poor. If foreign aid donors do not respond generously during this period, the position of the poor will worsen and even the most promising of the reforms implemented in Peru over the past 10 years will not realize their equity potential. It is the very dependence of Peru on external financing during the CDSS period which affords the donor community an

ideal opportunity to guide Peru's medium term development strategy and insure, through the counterpart requirements of new programs and projects as well as the policy conditions of this assistance, that future budgets have a build-in basic needs bias. AID and IBRD (through its program loan negotiations) are already moving in this direction. Hopefully, the process will become more formalized with the advent of a civilian government and the possible convening of the consultative group.

The aim of our strategy is, therefore, to stimulate and sustain progress toward the elimination of absolute poverty until the Peruvian economy is able to assume this task fully and independently. Peru will not need highly concessional foreign assistance forever, but it will need it during the period being considered in the CDSS and for some time beyond.

USAID's strategy can be defined under three basic headings:

1. Sierra Social Programs -- efforts in health, family planning, education, and nutrition directed at the 6 million rural inhabitants of the poorest region of the country. Even within the sierra region, we will target first on the relatively poorer sub-regions, as identified earlier in the CDSS.

2. Sierra and High Jungle Economic Growth -- programs for food production, agricultural development, rural infrastructure and off-farm employment will be designed to increase the economic value-added of non-coastal agriculture, foster agriculture-related economic growth, and raise income of the rural poor. AID resources will be concentrated in sierra/selva sub-regions which demonstrate the greatest productive capacity, and migration from the least-productive poverty regions of the sierra to areas with greater economic potential in the sierra and high jungle will be encouraged.

3. Coastal urban basic human needs -- the plight of the urban poor is serious during the current emergency, and our strategy includes assistance to urban poor groups -- principally via food aid and housing investment guarantees -- during the CDSS strategy period. As the modern sector of the economy improves its performance, the need for sizeable feeding programs will diminish.

The strategy tends to be region-specific rather than target-group specific. We feel this approach will have a stronger impact on the poor than a more closely-targeted approach, for the following reasons:

-- Dualism, the root cause of Peru's poverty, is largely a regional phenomenon. Peru must overcome the backwardness and isolation of the sierra.

-- Since the agrarian reform, all farms in the sierra and high jungle are small to medium in size. Because there are virtually no large individual farmers left, the question of keeping the benefits of AID assistance away from wealthy landowners does not arise.

-- By taking a regional approach we can focus on investments to stimulate sierra/high jungle growth, and thus be able to address the equity question in a more hopeful long-term context.

Taking a regional approach does not mean losing sight of the target groups identified earlier. Special requirements of these different groups are essential elements in the formulation of broad regional development programs. Nor does it mean that the Mission will not develop some projects exclusively devoted to the problems of a particular target group -- e.g. OPG's for development of campesino communities, training of rural women, urban social and legal services for women.

The Mission strategy is expected to have the following impact on the major target groups:

1. Independent, market-oriented farmers (sierra and high jungle).

The strategy will enable this group to substantially increase its production. The smallest of these producers can move out of absolute poverty, while the medium-sized producers will intensify their production for the benefit of their region and the entire country. Some increase in the use of hired labor will result, though not enough to productively employ a large percentage of the landless. Given the need to get agriculture moving in Peru, we expect that the independent farmer group will participate to a greater extent than other target groups in Mission agriculture sector programs.

2. Agrarian Reform Beneficiaries. AID will not focus primary attention on this group because it tends to be better supplied already with government services. Moreover, the next few years will likely see some adjustment in the size and mode of operation of sierra associative enterprises. However, a portion of the sierra's increased production will have to come from AE's, and they will have to participate to some extent in AID's agriculture programs.

3. Campesino Communities and Groups. There is a possibility that traditional community organization can be exploited as a channel for agricultural development in the sierra. Pilot work needs to be done to ascertain the feasibility of using this channel in a regionally-focussed sierra production program. These communities can also provide a framework for effective health and family planning delivery programs, educational

efforts, and rural public works -- all of which will rely heavily on community cooperation. It would be misleading to say that five years of stepped-up AID assistance can lead all campesino communities out of poverty, but it can meaningfully improve quality of life in the communities and, in some cases, open up new economic opportunities.

4. Landless and Near Landless. This group is both the despair and the challenge of a growth with equity strategy. Impact depends essentially on success in creating off-farm employment. This in turn depends upon the ability of the agriculture sector to generate financial surpluses. We are modestly optimistic that our proposed strategy can initiate a rural-based growth process for the sierra and high jungle, and that growing numbers of the landless can find employment in rural enterprises and services and on rural infrastructure projects. Some will also find on-farm employment, either on more intensively cultivated private farms or as colonists in the high jungle. At the same time, we would expect this group to improve its position substantially through better health status and lower fertility. Nevertheless, migration of this group to the coastal cities will remain a powerful trend.

5. Urban Poor. What differences will AID's proposed urban assistance make in the lives of the urban poor? In the short run the answer is obvious -- malnutrition and suffering will be alleviated. Over the long run, AID inputs can help demonstrate a more viable pattern of urban development for Peru. Much depends on economic policy and the labor-absorptiveness of future Peruvian growth. Much depends also upon the ability of the government -- once its revenue position improves -- to replicate the model shelter

approaches which AID is already demonstrating successfully under the HIG program.

A more detailed discussion of Mission strategy follows:

Sierra Social Programs

1. Health and Family Planning - USAID's goal is to extend the benefits of a low-cost delivery system to as many of the sierra rural poor as is financially and administratively feasible over the CDSS period. When combined with nutrition inputs, we believe that over the decade of the 1980's a significant percentage of the six million sierra rural poor would be able to emerge from absolute poverty as manifested in poor health status, as a result of these proposed investments. High fertility rates -- one of the root causes of sierra impoverishment -- would decline, as would infant mortality, death rates for mothers in childbirth and the incidence of certain malnutrition-related diseases. By our calculation, \$4,000 applied each year over a five-year period to a typical sierra community of 500 people would permit the construction of a health post using donated labor, the provision of a basic stock of medicines and contraceptives, the hiring of a rural health worker under supervision of a local health committee, and the financing of simple gravity-flow water systems and other environmental sanitation improvements. The funding which USAID seeks over the CDSS time-frame could provide over 2 million sierra village inhabitants with these basic health/family planning improvements. The recurrent costs of programs in these magnitudes are well within the financial capacity of the GOP once the economy is producing greater tax revenues.

The administrative impediments to reaching the sierra poor with health/family planning services should not be underestimated. Considerable assistance in strengthening the capacity of the Ministry of Health in sierra departments will be needed, reducing somewhat the amount of financing available for direct community uses. PL 480 local currencies for personnel and related costs will be critical in overcoming existing absorptive capacity constraints in the health sector. Ways will also have to be found to involve communities themselves in financing services -- charging for certain medicines might be one possibility.

Family planning services -- following up the progressive population policy enunciated by the government two years ago -- have finally been initiated. The Mission will soon sign agreements for integrated health/family planning services in the Sur Medio health region (headquarters in Ica) and for population/sex education. The GOP will take an "integrated" approach as it adds family planning to the maternal/child health services offered in each health region. Since present services are limited (poor outreach to rural areas), both health and family planning services will have to expand greatly to have the desired effect on fertility. AID does not have the resources to finance an integrated health/FP program of nationwide scope, nor would we want to, given the geographic bias of our Sierra Social programs strategy. Generally speaking, the Mission would tend to relax that bias in the use of population funds, given the top priority of population growth as a national development constraint, and would tend to apply the bias with respect to the use of health funds, which should impact on the health of those most in need. Other donors (e.g. UNFPA) will be

crucial in helping to finance integrated health/family planning programs, as they spread throughout Peru.

2. Nutrition

Nutrition strategy is complex because it combines health, agricultural and educational activities. For example, nutrition surveillance is an important part of a community-based health delivery system. Community gardens and local production schemes to supply child feeding programs are basically agricultural in content and have considerable potential in the sierra. Nutrition relates to education not only in the sense of providing information on better food preparation, but also via school feeding activities. Finally, direct intervention through Title II offers possibilities for immediate nutritional impact. The Mission is attempting to foster a more vital nutrition planning capability within the GOP. Though it is difficult to estimate the 5-year financing requirements for nutrition elements of a sierra social programs strategy, we believe that several action programs are feasible -- e.g. child feeding as part of pre-school education, community food production activities with output channelled into local nutrition interventions, targeting malnourished children through community health committees, and specialized agricultural assistance to subsistence farmers in the production of nutritious Andean crops, e.g. quinoa or beans. US Voluntary Agencies will be strong partners with USAID in the implementation of nutrition programs.

3. Education

Despite Peru's solid performance in the area of education, serious deficiencies of outreach and quality are evident throughout the sierra.

Girls are not receiving the same benefits as boys. The disadvantages of the monolingual Quechua or Aymara-speaking child have not been remedied. Rural education infrastructure is inadequate. Although helping to develop new models for education delivery will remain an element of USAID's strategy, the Mission plans to move more in the direction of region-specific sector lending in the hopes of impacting more strongly on poverty areas. A south/central sierra loan-grant program, for example, could combine expansion of a number of innovative programs -- bilingual and pre-school education, scholarship for girls, education service centers for grades 1-8, -- with some of the more conventional, yet no less important, financial and technical requirements of the sector, e.g. teacher training, job skills and vocational training, and local production of teaching materials and aids. Pre-school education is especially attractive, as it combines nutrition and educational benefits for the most vulnerable sub-group in Peru. Provision of \$40 million over five years would, for example, provide \$40 per person for a target population of 1 million children and young adults. Investment of this magnitude would go a long way toward improving the human capital of the sierra -- young people better able to function productively in their own region or as migrants to urban areas. Strengthening education of females could also impact positively on attitudes toward family size.

Sierra and Ceja de Selva Economic Growth

Within an expanding aid program this would constitute the major funding category. The goal is to create an agriculture-based growth dynamic in the sierra and the adjacent high jungle. Such development is needed to increase income of the poor in the sierra and to provide to the extent possible, non-coastal employment opportunities.

It should be clear from the prior analysis that the growing population of the sierra cannot be supported adequately in the sierra itself. Though urban areas must take large numbers of migrants from the sierra and put them to work, there are severe limitations in a strategy which would rely exclusively on coastal absorptive capacity. Therefore, the Mission has been operating for some time on the assumption that new employment opportunities must be created in the high jungle in addition, of course, to doing what is feasible in the sierra itself. How much more employment can be provided in the sierra and the potential of the high jungle to take on migration cannot be quantified at this time, since data is weak and the requisite economic studies have not yet been undertaken.

We wish to stress the unity of the sierra and the high jungle in USAID strategy. In the emerging context of regional planning, GOP planners are in the process of identifying sub-regions of sierra and adjacent high jungle, in which they want to generate a complementary process of economic growth and population adjustment. Surplus sierra zones, designated as "expellor" areas are linked with high jungle zones called "receptor" areas. This conceptual framework appeals strongly to the Mission, for it joins economic growth potential with the basic human needs requirement of large number of people. Several of the zones identified include: Cajamarca and San Martin; Huancavelica and Junin (high jungle portion); and Ayacucho and its adjacent high jungle. Although this framework is useful, there may also be sierra areas, which are not linked to the high jungle, with solid economic prospects (e.g. Puno). One of the principal tasks for USAID over the next year will be to specify in much more detail sierra and high jungle areas

with growth potential. Because GOP and donor resources are limited, investments must be concentrated in those areas with the strongest agriculture and industrialization prospects. It is the Mission's intention to select three or four such areas, where the bulk of resources (especially for infrastructure) under a sierra/high jungle growth strategy will be committed. By the end of the CDSS period we want to have something to show for our investment in terms of a self-sustaining growth process, and we consider it unwise to dissipate resources in areas with little or no potential.

USAID's strategy for sierra and high jungle economic growth has the following elements:

1. Rural Infrastructure

a. Market town investments such as marketplaces, slaughterhouses, potable water facilities would be chosen on the basis of regional economic impact. In sub-regions with economic potential, we anticipate substantial investment requirements up and down the hierarchy of sierra/high jungle settlements. These investments will be undertaken in the Regional Development Committee context and planned for maximum strengthening of rural-urban linkages. We are also hopeful that the HIG program can help supply capital for housing and urban public services that many of the more important market towns require.

b. Rural roads - represent the primary requirement for opening the high jungle to productive activity. Many areas of the sierra also need farm-to-market roads. Roads must make sense economically, and the Regional Development planning context will hopefully be the best way of insuring this outcome.

c. Rural public works - In looking closely at the development requirements of the sierra/high jungle, one is struck by the availability of surplus labor, the willingness of communities to donate their labor, and the need for small-scale infrastructure in rural communities. A way must be found to link available labor with rural infrastructure requirements. A program exists within the GOP which provides financing for small projects which rural communities propose at the regional or departmental committee level--small bridges, road improvement, conservation. The Mission will finance expansion of this program, using primarily donated labor. Food-for-work will also be employed to amplify rural public works activity. This is one of the ways in which Title II food aid will play an important development role in Mission programming.

d. Small-scale irrigation is a prime requirement for sierra agriculture growth -- we plan to replicate approaches which are being implemented successfully under the Mission's current sierra irrigation loan.

2. Research and Extension - During the past 10 years considerable deterioration has taken place in the agricultural training, research and extension sub-system. This deterioration is not only in the capability of technical personnel and quality of program design and execution, but also in physical facilities and equipment. Since 1977 the GOP has reversed this trend in terms of policy, but lacks the resources to effect the desired revitalization. A Title XII comprehensive baseline study of the training, research and extension system, to be undertaken this year, will serve as a guide to Mission programming. We are convinced that Peruvian agriculture will continue to stagnate without an aggressive, long-term commitment in this area.

3. On-Farm Agricultural Inputs - types of investments needed to increase productivity include provision of fertilizer, land preparation (leveling, drainage, fencing, etc.), improved breeding stock (cattle, sheep, llama, alpaca), and seed multiplication. Substantial institutional constraints exist to the successful provision of inputs to target group farmers. With the exception of agrarian reform associative enterprises, farmers in the sierra and high jungle are not grouped in ways which permit adequate provision of inputs or marketing of produce. This is true especially of the independent farmers and campesino communities. The Mission plans to assist in the strengthening of small farmer organizations to help overcome this serious constraint. Government and alternative production credit channels also need to be improved.

4. Rural Enterprises - the ability of the sierra and the high jungle to generate off-farm employment depends fundamentally on the growth performance of agriculture. However, the process of small enterprises formation (under both cooperative and single-entrepreneur ownership) can be stimulated through timely input of credit and technical assistance. A highly successful credit channel created by the Industrial Bank with AID support will be expanded. New channels, e.g. a cooperative banking institution, will be explored, which would also be relevant to program element #3 (just preceding).

5. Natural Resource Preservation and Renewal - An inventory of Peru's agricultural resource base (land and water) has been completed for the coast and some selected areas of the selva and sierra. However, large areas of these latter two regions remain to be inventoried. Many of these areas are of key importance in the design of development programs targeted to the

poorest rural segments of the Peruvian population. Inventories are also needed to plan the prevention of resource deterioration already taking place -- especially stream pollution from mining and soil erosion through inadequate conservation practices on cultivated land. Based on these studies the Mission will provide financial assistance to carry out programs of soil and water conservation, water-shed management, reforestation and related investments. Community-based conservation programs in the sierra will also be encouraged through local private voluntary organizations.

6. Appropriate Rural Technology - The Mission is exploring unconventional technologies of potential benefit to the rural poor. These include: the use of treated sewage for on-farm irrigation, alternate energy sources (e.g. wind power) and intermediate technology applications in rural small industry. Potential for replication should be known toward the middle of the CDSS period.

7. Electric Power - A joint U.S. Department of Energy - Government of Peru study, which the Mission followed closely, suggests that Peru has considerable hydroelectric potential along the eastern slopes of the Andes. This potential will have to be exploited to meet the country's overall energy needs, as demand for power outstrips Peruvian supply of oil, gas and coal. While major hydroelectric investments are beyond AID's funding capabilities --even at a greatly expanded appropriation level-- the Mission sees many possibilities for small-scale, mini-hydro plants in key areas of the sierra and high jungle. Lack of electricity is a frequently-cited constraint, and a few million dollars could build a small plant to supply the electricity needs of a city as sizeable, for example, as Tarapoto. Even smaller plants of less than \$1 million are technically and economically feasible. If AID's

appropriations were to rise sufficiently, we believe that substantial use of loan funds along these lines could be justified. If grant funds could be made available for energy feasibility studies earlier in the CDSS planning period, this would also be a helpful contribution to sierra and high jungle economic development. These funds would have to be supplied over and above the Mission's regular grant allocations or from some other USG source.

Urban Basic Human Needs

USAID has attempted to support pueblo joven development principally through the housing investment guarantee program. An estimated 55,000 low-income persons have benefitted to date. Recently, the program has stressed provision of services (water, sewer, electricity hook-up) and preparing urban land for settlement (sites and services) rather than housing per se. In this way benefits can be spread more widely. USAID urban strategy assigns great importance to the continued role of the HIG program and we are exploring the feasibility of using other institutions -- in addition to the Housing Bank -- as a channel for funds in order to expand the sector's absorptive capacity.

As indicated earlier, the urban poor have been hit particularly hard by the current economic crisis. In Lima alone we estimate that about 8% -- or about 400,000 people -- are experiencing severe hunger. To combat urban malnutrition the Mission is organizing urban food-for-work programs for maximum short-term impact. Some months ago the first of such programs was initiated -- combining an OPG for costs of program administration with \$4 million in Title II food. An estimated 100,000 persons in Lima will benefit

over the course of a year. A second program being discussed with the GOP would utilize Title II to pay workers, local currency from PL 480 sales to purchase materials, grant funds for program administration, and possibly HIG funds for additional major investment capital. This program will establish a variety of essential services in coastal pueblos jóvenes, as well as employ and feed the urban poor at a time of great need. If successful, this program would be institutionalized within the GOP and not require continued AID support after several years.

As indicated earlier, family planning assistance will be provided to help meet urban basic human needs. Limited grant and, possibly, loan assistance might also be provided to test out new programs to help overcome urban poverty -- a bank for pueblo joven small enterprises is one possibility.

G. Assistance Planning Level

	<u>PAPL- by Program Emphasis</u>					
	<u>81</u>	<u>82</u>	<u>83</u>	<u>84</u>	<u>85</u>	<u>TOTAL</u>
Sierra Social Programs	46	52	44	48	42	232
Health/Family Planning	7	23	22	6	25	83
Nutrition	22	27	20	25	15	109
Education	17	2	2	17	2	40
Sierra and High Jungle Economic Growth	53	63	70	62	79	327
Rural Infrastructure	13.2	38.2	26.2	14.2	44.2	136
Agr. Research/Extension	6.5	6.5	5.5	17.5	1.5	37.5
On-Farm Agr. Inputs	32.8	7.8	7.8	24.8	2.8	76
Rural Enterprises	-	10	10	-	15	35
Natural Resource Preservation and Renewal	.5	.5	15.2	.2	.2	16.6
Appropriate Technology	-	-	5.3	.3	.3	5.9
Electric Power	-	-	-	5	15	20
Urban Basic Human Needs	30	25	21	20	19	115
GRAND TOTAL	129	140	135	130	140	674

	<u>PAPL - by Funding Category</u>					
	<u>81</u>	<u>82</u>	<u>83</u>	<u>84</u>	<u>85</u>	<u>TOTAL</u>
Sierra Social Programs	46	52	44	48	42	232
Grants	4	5	5	5	5	24
Loans	15	20	15	25	20	95

	<u>81</u>	<u>82</u>	<u>83</u>	<u>84</u>	<u>85</u>	<u>TOTAL</u>
HIG	-	-	-	-	-	-
Title II	20	20	18	13	13	84
Title III	7	7	6	5	4	29
Sierra and High Jungle Economic Growth	53	63	70	62	79	327
Grants	3	3	3	3	3	15
Loans	25	30	40	40	60	195
HIG	5	10	10	10	10	45
Title II*	-	-	-	-	-	-
Title III	20	20	17	9	6	72
Urban Basic Human Needs	30	25	21	20	19	115
Grants	2	2	2	2	2	10
Loans	-	-	-	-	-	-
HIG	15	15	15	15	15	75
Title II	10	5	2	2	2	21
Title III	3	3	2	1	-	9
GRAND TOTAL	129	140	135	130	140	674
Grants	9	10	10	10	10	49
Loans	40	50	55	65	80	290
HIG	20	25	25	25	25	120
Title II	30	25	20	15	15	105
Title III	30	30	-	15	10	110

*Food for Work portion also relates to growth goals

The PAPL represents an optimal "costing out" of the Mission strategy. It reflects annual aid levels that are roughly double the level achieved in FY 78. AID/W's Indicative Planning Allocation of \$65 million (loans and grants) is achieved by FY 83 rather than FY 85.

If the PAPL were achieved, Peru would received about \$100 million more in loans and grants than is implied in the Indicative Planning Allocation, as follows:

	<u>81</u>	<u>82</u>	<u>83</u>	<u>84</u>	<u>85</u>	
			(\$ Millions)			
PAPL	49	60	65	75	90	
IPA (Est.)	<u>30</u>	<u>35</u>	<u>45</u>	<u>55</u>	<u>65</u>	
Difference	19	25	20	20	25	+ \$109

The effect of not achieving the PAPL (i.e. of losing out on the additional \$100 million) would depend, of course, on the priorities assigned within the strategy. At lower levels, the Mission would recommend primary concentration on sierra social programs, especially health-nutrition-family planning, as well as the agriculture research/extension and on-farm inputs portion of the sierra and high jungle economic growth strategy. Obviously, rural infrastructure and electric power represent the largest demand for financing, and at aid levels below the PAPL we would be constrained in contributing to these vital programs. The sierra and high jungle need this kind of investment in order to develop. The dualism which perpetuates poverty in Peru will never be softened unless such investments are forthcoming.

If aid levels assigned to Peru were to fall much below the IPA, the Missions's impact on sierra and high jungle economic growth would be distinctly marginal. With a small program, there would be a good possibility of positive impact on fertility and certain manifestations of poor health status, but rural-based growth to sustain equity over the long-run would be less likely to emerge. Certainly the GOP will not have resources to create significant momentum along these lines during the CDSS planning period, and we doubt that other donors could fill the gap created by the absence of a significant AID input.

A shortfall of Title III resources would be especially damaging to the strategy. We are counting heavily on Title III to help overcome GOP absorptive capacity constraints during the period of economic recovery.

Grants, loans, HIG and PL 480 are all essential to the implementation of USAID's strategy:

Grants - A rising grant level is needed to provide technical assistance elements for major programs in all sectors and for pilot work in preparation for these programs. The Mission also views the grant component of major programs (e.g. Agriculture Research and Extension, which would be financed using both loan and grant funds) as the means by which the Mission can manage a larger AID effort while keeping direct hire staff increases to a minimum. OPG projects will continue to play an important role in Mission strategy -- to support an expanding Title I program, to encourage grass-roots voluntary organizations in carrying out community action programs, to provide economic opportunities for rural

and urban poor women, and to experiment with new approaches to development in agriculture, education and health.

Loans - It will be difficult to impact on absolute poverty without substantially increased levels. USAID plans to keep counterpart requirements to the legal 25% minimum through most of the CDSS period, until the Peruvian national budget gains strength from an improved economy.

HIG - This highly successful urban program should increase as Peruvian administrative capacity in the shelter sector expands. Peru could handle \$15 million annually in coastal slums and up to \$10 million in sierra and high jungle urban centers.

PL 480 Title III - Peru will become eligible for Title III during calendar 1979, as soon as the IBRD's new per capita income figures are published. Based on AID/W approval of the CDSS, the Mission would begin to develop with the GOP a 5-year Title III program. Local currencies generated under this program would support the Mission's strategy for sierra social programs and sierra and high jungle economic growth. Although continuation of Title I would be extremely helpful for Peru, our clear preference is for Title III, as its impact on the development/execution of a medium term strategy would be greater. The Title III program is shown at \$110 million from FY 81-85. The program diminishes in size during the period, as GOP capacity to finance sierra and high jungle programs rises. We assume that Title I will continue through FY 80, giving the Mission time to develop a Title III program which meets additionality requirements. The Mission would propose a program geared to budget rather than policy additionality. By FY 81 we expect that Peruvian policy in the agriculture

sector will be much better defined and would permit us to move forward with a Title III program that was supportive of policy directions and did not depend on the enactment/adoption of major new legislation and/or sector policy. In the context of budget additionality, we believe that a responsive and effective Title III program would have to direct a substantial amount of resources to meet the current expenditure requirements of expanded project and programs as well as investment needs. Such current expenditures would have to qualify for additionality purposes.

The program would utilize U.S. wheat, soybean oil and rice. It is difficult at this time to predict the supply and distribution of these commodities for the first half of the 1980's. Peru will continue to experience rice shortages from time to time due to drought. Edible oil requirements will depend heavily on the fluctuation of domestic fishoil production -- rapidly increasing production does not appear to be possible in the near future. The potential for increased wheat consumption between now and FY 85 appears to be strong, given the rapid growth of Peru's coastal urban population. Overall, we believe PL 480 sales programs in the amounts that the Mission has indicated are realistic in terms of what Peru will be importing during the CDSS period. We would also urge a flexible approach to the setting of UMR's within a Title III program, in view of the country's great need for the additional budget resources which PL 480 local currency would provide.

PL 480 Title II - USAID has tripled the size of the Title II program over the past year and a half. Still greater increases are needed to combat malnutrition in urban areas over the next 2 years. As the Peruvian economy recovers, however, Title II levels can diminish and the remaining program -- which would still be quite large -- can be focussed on the problem of rural malnutrition and underemployment. Of course, the entire Title II program can never be entirely regionally targeted, since the voluntary agencies serve the Peruvian poor nation-wide.

Staffing Implications

The Mission's current direct hire ceiling is 22, and its foreign national ceiling is 58. The PAPL would require some increase in direct hire staff, e.g. some additional project managers in the various technical areas would surely be needed by FY 85. However, the Mission believes that such increases could be kept to a minimum through the use of devices such as:

-- Financing GOP Ministry operating costs under projects and through Title III. Better project management on the government side would reduce, somewhat, the Mission's workload requirement.

-- Financing grant projects as companion to major loans. U.S. contract technicians answerable to USAID can help to reduce the Mission management burden. It is also possible to achieve some of the same results by insisting on loan-financed technical assistance within large loan projects.

-- Use of OPG's, as the Mission is doing in the case of Title II, can substantially shift management burden from the Mission to private voluntary organizations. If PVO's could develop collaborative relationship with host governments -- as some groups have in Peru -- the possibilities for management of AID projects by PVO's would be greatly enhanced.