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**PERU PRA PROJECT
Poverty Reduction and Alleviation
Contract No. 527-C-00-99-000271-00**

**FY 2004 ANNUAL REPORT
October 2003 – September 2004**

Volume 1

February 2005

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CHEMONICS INTERNATIONAL INC.

Sucursal Perú

March 3, 2005
CHP-1156-05

Mr. John Irons
Deputy Office Director / PRA Project
Economic Growth and Environment (EGT)
USAID/Peru

Ref: PRA FY2004 Annual Report
Contract No. 527-C-00-99-00271-00

Dear Mr. Irons:

It is my pleasure to submit with this letter the Annual Report for FY2004 for the Poverty Reduction and Alleviation Project (PRA).

The FY2004 PRA Annual Report is our first comprehensive submission under the amended PRA contract signed on 25 July, 2003. In this report we have not only submitted statistical data on enterprise sales, employment and investment generated respectively in each of PRA's eleven (11) Economic Service Centers (ESCs), located throughout the Peruvian *sierra* and *selva*, but we have also attempted to bring these statistics to life with an accompanying narrative discussion and analysis of the overall PRA Business component. This analysis includes a summary of the work and results of each of the eleven PRA Economics Service Centers which are responsible for generating results within their respective economic corridors.

We are pleased with the PRA Business component results for sales and employment realized during FY2004. Targets for the year, with respect to both sales and employment generation, were exceeded by a comfortable margin. However, performance for FY2004 with respect to the generation of fixed capital investment was only 88% of target—and—the USAID established annual and cumulative targets for PRA generated fixed capital investment are modest relative to the enormous need for private capital investment in the *sierra* and *selva*, including the *coca* valleys.

Five out of eleven PRA ESCs reported no investments of significance during FY2004 and three of seven Alternative Development departments serving the *coca* valleys received no PRA supported investment during FY2004. The absence or low levels of fixed capital investment in the *sierra* and *selva*, and particularly the *coca* valleys, reflects the acute and long standing risk aversion among Peruvian investors and entrepreneurs as well as the broader financial sector, including both commercial banks and the Peruvian capital market. Based on four years of PRA experience trying to mobilize private investment in the *sierra* and *selva* we can report first hand just how difficult it is to change highly negative and entrenched investor attitudes shaped over centuries and hardened further by the terrorism of the 1980s and the continuing *coca* industry of the present. If the engine of sustainable private-sector driven development is to take root and flourish in the *sierra* and *selva* on a broad scale greater attention, incentives and resources will need to be mobilized to change private sector attitudes and encourage productive investment in these historically neglected regions of Peru.

The PRA FY2004 Annual Report also describes PRA's initial and formative support to DEVIDA's and the Mission's Alternative Development Program. Despite the start-up nature of this work and the inevitable growing pains associated with introducing demand and private-sector driven concepts and practices into a traditional public sector and supply-driven program, we believe much

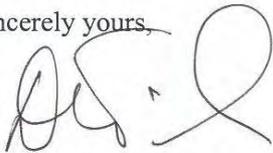


progress has been made. The results, from established commercial market chains to the presence of commercial repeat buyers, from Frito Lays (bananas for chips) to *Sierra y Selva* (organic cacao for export), demonstrate that the private sector can play an important role in the eventual eradication of *coca* from the Peruvian rural landscape.

Finally, the PRA Public-Private Partnerships (PPP) in Infrastructure Finance component presents the work and accomplishments of the PRA PPP team, which includes the design and structuring of three rural electrification projects in support of the Alternative Development Program as well as the design and structuring of two key east-west highways. These PPP highway infrastructure projects, the so-called IIRSA Eje Norte and IIRSA Eje Central highway projects, represent the Government of Peru's first major entry into the world of project finance and the opportunity project finance holds for mobilizing domestic resources from Peru's robust capital market to finance essential public sector infrastructure. These two east-west highways will open, in real commercial terms, the *sierra* and *selva* of central Peru. As outlined in our report, considerable progress has been made such that both the IIRSA Eje Norte and Eje Central projects should reach contract closure during calendar year 2005.

On behalf of the entire PRA Project team and Chemonics International we wish to express our appreciation for the excellent support we have received from the Mission in the course of the past year. Similarly, we would like to express our appreciation for the strong support and excellent professional working relationships we have enjoyed over the past year with our colleagues and counterparts from PROINVERSION, the Ministry of Transport and Communication (MTC), the Ministry of Economy and Finance (MEF) and DEVIDA.

Sincerely yours,



Douglas L. Tinsler
Chief of Party
PRA Project

CC: Hilda Arellano – Mission Director
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VOLUME 2

ANNEX A: PRA Results October 2003 – September 2004

ANNEX B: Profiles of PRA Businesses (*in Spanish*)

SECTION I

PRA Principles

The FY2004 Poverty Reduction and Alleviation Project (PRA) Annual Report is the first under PRA contract amendment No. 527-C-00-99-00271-00. As such, the Report covers not just PRA Business component results, the exclusive focus of the PRA project during its initial phase from 1999 to September, 2003, but focuses as well on the two additional components added to the project under the referenced amendment. The new activities, Support for Alternative Development and PRA Public-Private Sector Participation (PPP) in Infrastructure Finance components add two new dimensions to PRA activities which have both served to complement and deepen the development impact of PRA, particularly in the seven Alternative Development Departments which are of central concern and focus of the GOP/DEVIDA and USAID/Peru in their ongoing war against the scourge of illicit coca production.

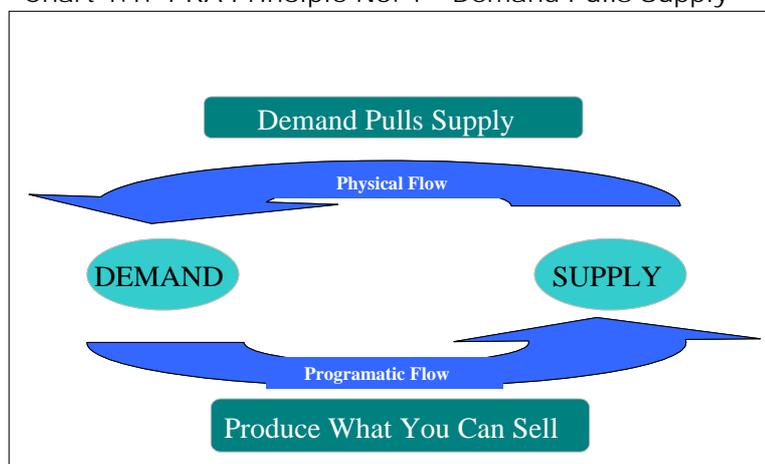
To facilitate the interpretation of the PRA FY2004 results for each of the three PRA components, a brief review of the PRA objective and operating principles is in order.

- A. The PRA Project Objective:** The objective of the PRA Project is to contribute to the reduction of poverty through the generation of sustainable income and employment through the mobilization of private sector investment in key economic corridors, defined as poor areas exhibiting economic growth potential. Several principles underpin PRA's approach to poverty reduction:

A1. The PRA Business Component: Several principles drive the business component of the PRA Project:

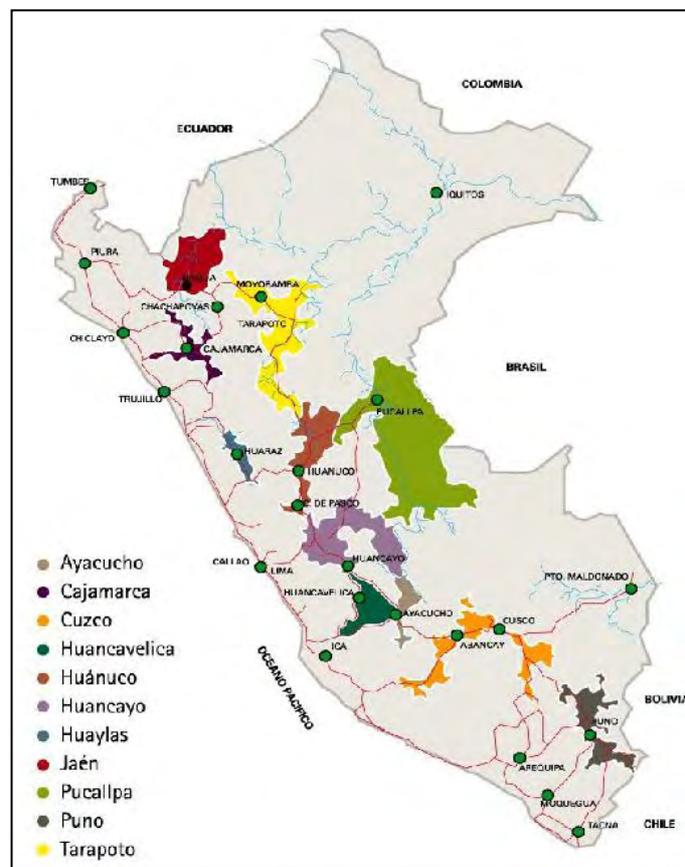
- **Demand-Driven:** As depicted in Chart 1 PRA attacks poverty through a demand-driven, private-sector led approach to economic growth. Understanding demand and recognizing that demand pulls supply is the project's central operating principle. Production is focused on what can be sold, not on selling what has been produced.

Chart 1.1: PRA Principle No. 1 - Demand Pulls Supply



- Private Sector Led:** A second but equally important principle governing PRA's implementation strategy is that demand is not established in the abstract, but by working with specific large, medium and small private enterprises with established market contacts. Each PRA enterprise client has a name, address, phone number and email address. PRA interventions are geared to enhance the ability of each supported enterprise to fully exploit its identified market potential.
- Decentralized Implementation through Regional Economic Corridors:** PRA interventions are carried out in economic corridors characterized by a high incidence of poverty but with identified economic growth potential. This decentralized "corridor" approach is carried out through eleven (11) Economic Service Centers (ESCs) located throughout Peru's *sierra* and *selva* (MAP1). These Economic Service Centers, managed and run through regional consortia of private sector enterprises, NGOs and regional universities, provide technical assistance to enterprises with identified markets to improve their competitiveness through: (i) further strengthening of market linkages and value chains; (ii) the organization of supply; (iii) improvements in technology; and (iv) the removal of specific "bottlenecks" which constrain enterprise growth. Each of the eleven ESCs are supervised by a prime contractor retained by USAID/Peru.

MAP 1.1 : Regional Economics Corridors



- **Continuous Performance Monitoring:** As documented in this Annual Report PRA results are subject to continuous performance monitoring of incremental enterprise sales, employment and investment generation.

Each of the two new components added to the PRA Project in 2003 is guided by additional operational principles:

A2. PRA Alternative Development Component Principles:

- **Intensified Focus On and Linkage with the DEVIDA/USAID Alternative Development Program in Seven (7) Priority Departments:** Since May, 2003 PRA has taken several concerted actions to further strengthen and concentrate its focus on and work in the seven (7) priority Alternative Development Departments.

A3. PRA Public-Private Sector Participation (PPP) in Infrastructure Finance Principles:

- **Alpha to Omega Technical Assistance:** To ensure comprehensive, professional and transparent project structuring and contract award, all PRA supported PPP infrastructure interventions are supported on a “turn-key”, *Alpha to Omega* basis from project conception to contract award.
- **Tap Local Capital Markets:** To reduce risk as well as tap Peruvian capital, all PRA PPP project interventions are designed to specifically tap the financial resources potentially available in the Peruvian capital market.
- **Encourage Vigorous Competition:** to encourage transparency and lowest cost to the Government and in service provision, all PRA structured PPP interventions are designed to encourage vigorous competition among PPP infrastructure providers, both domestic and international.
- **Focus PPP Infrastructure Interventions on Priority AD Departments:** All PPP Infrastructure Projects are structured to have direct impact or strong indirect impact on AD Departments.

The following FY2004 PRA Annual Report is presented in three sections, respectively Reporting on each of PRA’s three component activities: PRA Business; PRA Support for Alternative Development; and the PRA PPP Infrastructure Finance component. Additionally, Annex I contains the statistical detail on which the FY2004 PRA Annual Report is based and Annex II presents a series of case studies of PRA supported enterprises at the ESC level, involving eight crops and program activities in six of PRA’s eleven (11) ESCs.

SECTION II

PRA Business Component

- A. Background and Executive Summary** - The purpose of the Poverty Reduction and Alleviation Project (PRA) business component is to reduce poverty through the generation of sustainable income and employment. It does so by mobilizing private sector investment in poor “economic corridors” with growth potential. Presently, PRA works in 11 economic corridors (MAP 1) through Economic Service Centers (ESCs) established and staffed in each corridor through contracts competitively awarded to local consortia composed of enterprises, universities and NGOs and supervised by the USAID prime PRA contractor. The ESCs work with established as well as new business clients in each corridor, identifying market opportunities and contacts inside and outside the country. Each PRA Economic Service Center provides technical assistance to improve client competitiveness, through the organization of supply at the local level, introducing improved technologies and non-financial assistance in managing the expansion of client businesses.

PRA results in each economic corridor are measured and reported quarterly as well as annually through three business related performance indicators: (i) net incremental sales; (ii) net incremental employment; and (iii) incremental business investment. The PRA performance results for FY2004 (October, 2003-September, 2004) are presented in the following paragraphs along with accompanying analysis.

PRA supported businesses in the eleven (11) economic corridors served by the project achieved incremental sales of \$29.4 million during FY2004, representing a 66% increase over results from the previous year (Table 1 and Graph 1). Similarly, 2.8 million person/days of employment, equivalent to 14,000 full time jobs, were generated during FY2004, representing a 41 % increase over the previous year (Table 1 and Graph 3). Additionally, \$2.1 million in new PRA supported investments, representing an 88 % increase over the results of the previous year, were achieved for PRA as a whole (Table 1 and Graph 4). In sum, the PRA Project has had a banner year with strong performance against two of the three performance variables, sales and employment, included in PRA contract amendment #15.

While performance improved during FY2004 with respect to the investment performance variable, much work remains to be accomplished. We have increasingly come to believe that generating significant levels of investment in the Peruvian *sierra* and *selva* generally, and the *coca* valleys specifically, holds the key to sustainable development in these regions. While progress has been made in identifying and mobilizing private investment in the *sierra* and *selva*, it pales in comparison with the investment levels required to generate sustainable development in these historically underserved and conflicted regions of Peru.

- B. PRA Sales Performance** - PRA supported businesses achieved, in aggregate, 119% of their annual sales target for FY2004 (Graph 1). Cumulative sales since the inception of PRA in 1999 reached US\$ 64.2 million, representing 40.1% of PRA`s cumulative life of sales target (Graph2).

Of PRA's eleven (11) Economic Service Centers (ESCs), the ESCs that made the greatest contribution to FY2004 project sales results were: Jaen, Huancayo, Puno, Pucallpa and Cusco. The sum of incremental sales from these five ESCs accounted for 64 % of total PRA sales during the review period (Table 2.1).

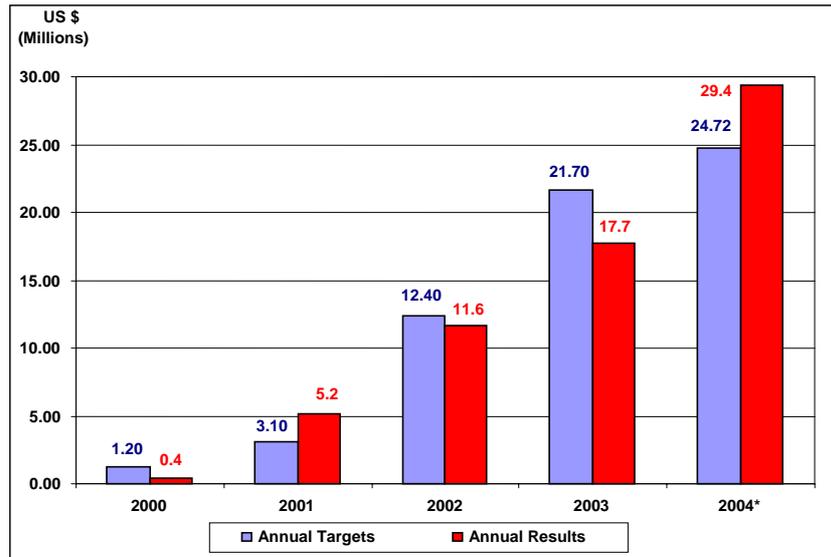
Table 2.1: Results F2003 vs. Results FY2004

Corridor	Sales (US\$ Millions)			Employment (permanent jobs)			Investment (US\$ Millions)		
	2003	2004	% Increase	2003	2004	% Increase	2003	2004	% Increase
JAEN	1.83	4.78	261%	749	747	100%	0.00	0.03	0%
HUANCAYO	3.22	3.87	120%	1,261	1,579	125%	0.24	0.46	194%
PUNO	1.75	3.78	216%	862	1,613	187%	0.00	0.10	0%
PUCALLPA	1.77	3.49	197%	2,022	1,725	85%	0.11	1.03	959%
CUSCO	2.99	3.00	101%	1,645	1,574	96%	0.00	0.00	0%
CAJAMARCA	1.95	2.99	153%	682	1,081	159%	0.09	0.04	51%
TARAPOTO	1.10	2.99	272%	833	3,186	383%	0.00	0.24	0%
HUAYLAS	0.99	2.46	249%	221	683	309%	0.71	0.24	34%
AYACUCHO	1.11	1.24	112%	1,039	1,211	117%	0.00	0.00	0%
HUANUCO	0.98	0.75	77%	493	413	84%	0.00	0.00	0%
Total	17.70	29.36	166%	9,806	13,813	141%	1.14	2.14	188%
HUANCAVELICA	0.09	0.44	496%	19	106	552%	0.00	0.00	0%

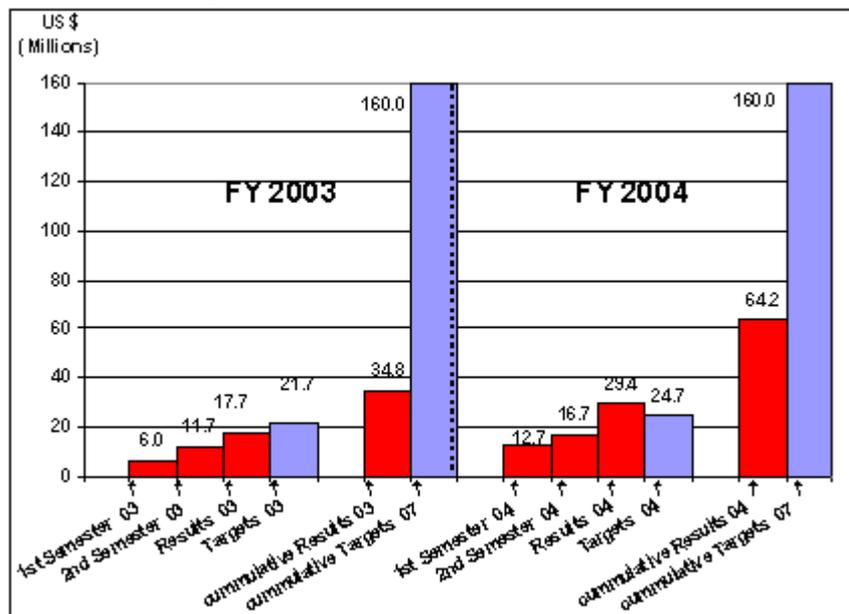
The ESCs with the greatest contributions to their respective annual sales targets were Jaen (214%), Puno (210%), Huaylas (140%), Pucallpa (137%), Huancayo (107%), Cajamarca (104%) and Tarapoto (104%). See Table 2.2 and Graph 2.2 show sales (results) versus targets for the year.

Corridor	Target	Results	%
JAEN	2.23	4.78	214%
PUNO	1.80	3.78	210%
HUAYLAS	1.77	2.46	140%
PUCALLPA	2.55	3.49	137%
HUANCAYO	3.61	3.87	107%
TARAPOTO	2.87	2.99	104%
CAJAMARCA	2.88	2.99	104%
CUSCO	3.26	3.00	92%
AYACUCHO	1.43	1.24	87%
HUANUCO	2.33	0.75	32%
Total	24.72	29.36	119%

Graph 2.1: PRA Annual Sales Results vs. Targets

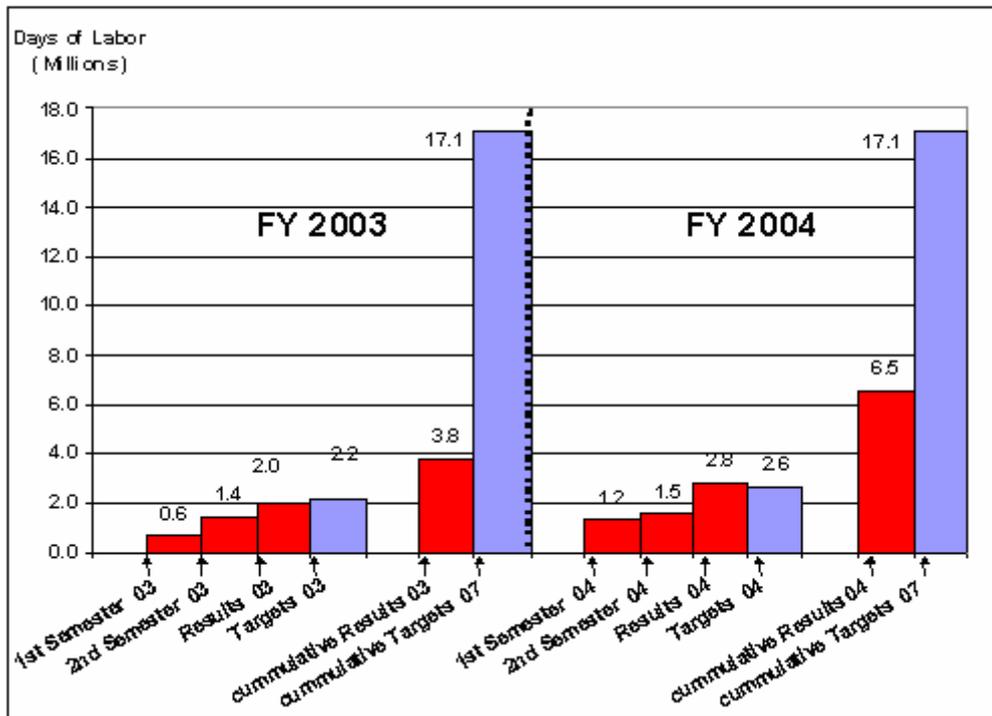


Graph 2.2: PRA Sales Targets and Results FY2003 and FY2004

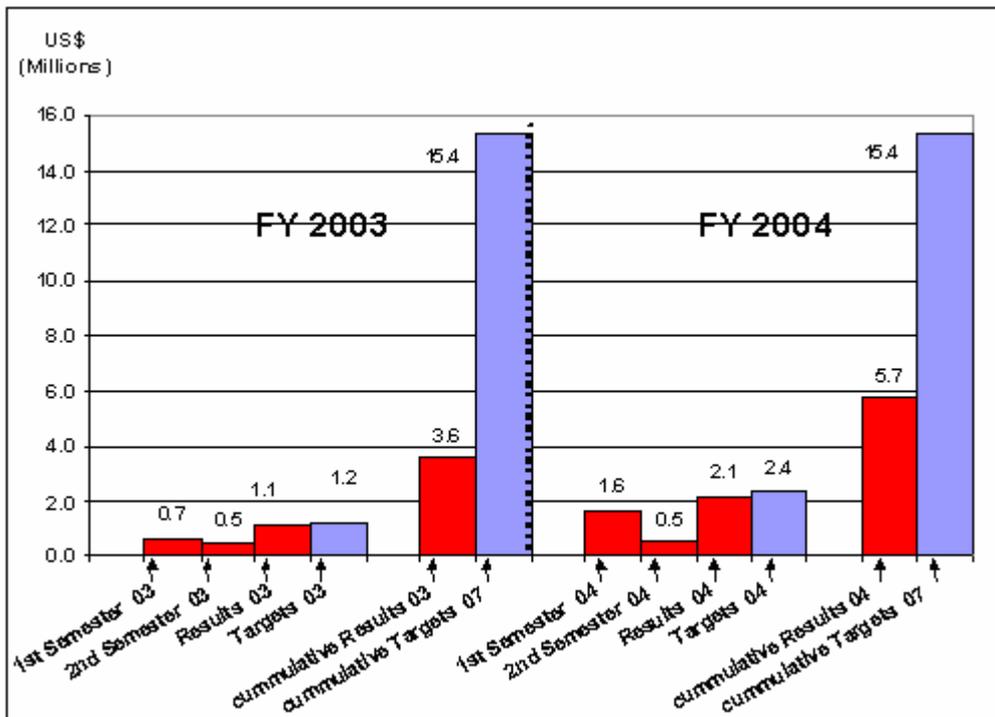


C. PRA Employment Performance - The 2.8 million person/days of labor generated during this period represented 105 % of the annual target (Graph 2.3), this is the equivalent of 14,000 permanent jobs. Thirty-nine percent of those employed were women and 22% of this employment, or 3,060 full time jobs, was generated in the four *coca* valleys served by the PRA project. The highest ratio of women participation in the “PRA workforce” occurred in the Cajamarca ESC in the jewelry (95% of workforce) and tara (59% of workforce) industries and in the Puno ESC in the warehouse and wool industries.

Graph 2.3: PRA Employment Targets and Results FY2003 and FY2004



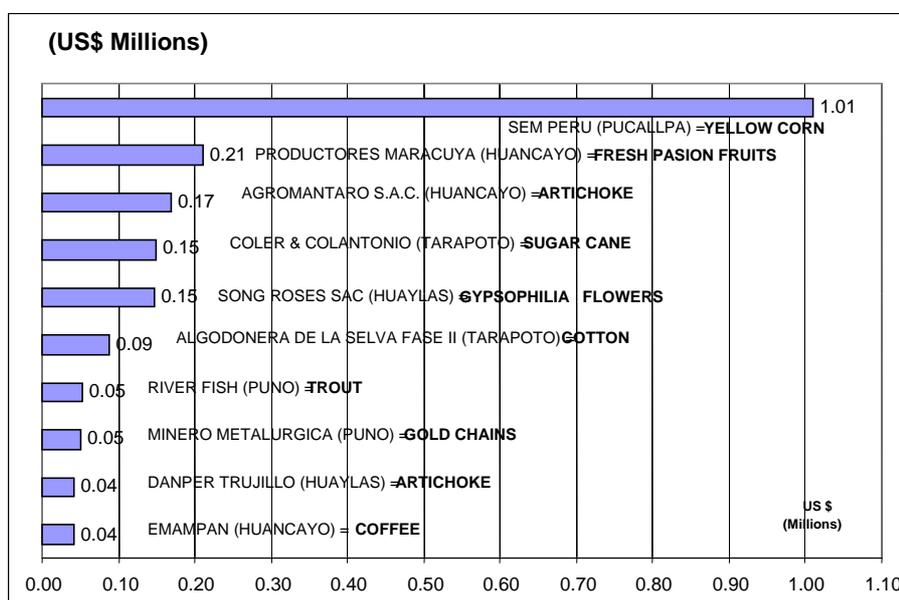
Graph 2.4: PRA Investment Targets and Results FY2003 and FY2004



D. PRA Investment Performance - PRA achieved 88 % of its annual investment target for FY2004 (Graph 2.4). New investments include: Sem Peru’s plant for drying, storing,

and processing yellow corn (Pucallpa); six new investors in artichokes, including: Agromantaro (Huancayo); Agronegocios y Consultores (Cajamarca); Cedepas Cajamarca (Cajamarca); Damper Trujillo (Huaylas), and Grupo Huancayo (Huancayo). Significant investment was made in passion fruit (Huancayo) and continued incremental investments were made by Songroses nursery (Huaylas). New investments in sugar cane by Coler y Colantonio Peru SAC for energy production were realized (Tarapoto). Algodonera de la Selva SAC and Romero Trading (Tarapoto) made significant investments in cotton. Two companies, Arin SA (Cajamarca) and Minera Metalurgica Andina SAC (Puno), made important investments in jewelry. River Fish SAC (Puno) made new investments in trout cultivation. The combination of these investments accounts for 94 % (\$ 2.0 million) of the investment results for the review period (Graph 2.5).

Graph 2.5: Top Ten Clients (35% of sales)



E. The Crucial Importance of Private Sector Investment in Relation to Coca Eradication Specifically and Development Generally

What Graph 2.4 does not tell the reader is that in five out of eleven (11) ESCs had no investment capital of significance. Three of the seven (7) AD areas (Ayacucho, Huanuco and Cusco) either in or serving the *coca* valleys, received no PRA supported investment during FY2004, reflecting the serious risk aversion that exists among Peruvian and foreign investors with respect to investing in these regions.

On a brighter note, the successful start-up this year of the \$1.0 million, PRA supported, investment by SEM Peru stands as a five star example of the type and scale of private investment that is necessary (and possible) in the *selva* and *coca* growing regions of Peru. SEM Peru sells hybrid yellow corn seed and operates a \$1.0 million drying, storage and processing facility outside the municipality of Pucallpa in Ucayali Department. At full capacity the SEM Peru operation will support 9,000 hectares of hybrid yellow corn production for feedgrain and other uses and will provide direct

employment for more than 3,000 campesinos and indirect employment for thousands more.

In the *selva* and *coca* growing regions of PERU, SEM Peru's investment stands in importance, next to that of *Palma del Espino* in Tocache in the *coca* valleys of Peru, as a magnet for attracting actual and potential *cocaleros* into fulltime, profitable, licit AND sustainable employment. Today SEM Peru figuratively stands where *Palma del Espino* stood (see photo below) in 1988 in Santa Lucia, Tocache, a legitimate business oasis in a sea of illicit *coca* production. In the 1970s and 1980s the main centers of the booming (*coca*) industry came to be located in the Upper Huallaga (valley) and the city of Tingo Maria, some 250 miles northeast of Lima.

Photo 1.1: Palma de Espino business in Tocache



Santa Lucía, 1988, eroded land caused by coca cultivation. Today, 7,500 hectares of palma aceitera grow there, providing 8,500 jobs (directly and indirectly) and creating an alternative to coca cultivation in Alto Huallaga. (CARETAS 1844)

With the advent of *Palma del Espino* and now SEM Peru the Upper Huallaga Valley as well as the Department of Ucayali can no longer be referred to as the drug capital of the world, the licit economy has a presence and a presence to stay. What is now necessary is a score or more private sector investments like SEM Peru and *Palma del Espino* in the Upper Huallaga Valley, Tingo Maria and Ucayali Department. The direct and “cluster” effect of this level of investment would literally transform the agriculture economy of Tocache Province and the Departments of San Martin and Ucayali and greatly reduce, if not eliminate, the *coca* industry from central Peru. If increased agribusiness investments like *Palma del Espino* and SEM Peru were coupled with the required infrastructure investments needed to complete the Fernando Belaunde Terry (FBT) and Federico Basadre highways sustainable, self generating development, more likely than not, would end the *coca* era of central Peru.

For this positive, re-enforcing virtuous circle of development interventions to occur, substantially greater public and private sector investment will need to take place in the *coca* valleys over and beyond those investment levels realized over the past twenty years. It is clear from four years of PRA experience working in the *coca* valleys that mobilizing this incremental investment is very difficult and requires more interventions and incentives than are currently present to mitigate the risks perceived by both investors and commercial banks.

It is fair to say, given the continuing violence, absence of state presence, poor transport infrastructure and the continued presence of the *coca* economy, that the levels of investment suggested above for central Peru are not about to materialize any time soon. This poor prognosis could be changed if the GOP and the donor community were to agree on an explicit and concerted program of interdiction in Central Peru to complement the voluntary program already in place, supported by specific USAID or other donor programs to provide equity capital participation and debt financing in the region to businesses prepared to invest in central Peru coupled with credit guarantees, such as those offered by USAID's DCA guarantee instruments and continued technical assistance to investors through the PRA Project or similar programs.

F. FY2004 Results and perspective from PRA's Economic Service Centers (ESCs)

The sales, employment and investment results reported in the previous section were realized in FY2004, as in previous years, through the planning, networking and hard work of 11 PRA ESCs teams each respectively working in one of the 11 poor economic corridors identified by USAID for priority attention under PRA (MAP 1).

USAID finances ten of the ECSs, while *Compañía de Minas Buenaventura* finances the ESC in Huancavelica, representing one of USAID's larger Global Development Alliance (GDA) programs. Competitively selected consortia of private companies, nonprofit organizations, and universities operate the centers under the overall direction of Chemonics International, Inc., the USAID prime contractor for the PRA Project.

Charts 2.1 and 2.2 display the 11 Departments where PRA ESCs are located. As vividly depicted in Charts 2.1 and 2.2, these 11 Departments have the highest concentration of population living in extreme poverty¹ ranging from a high of 74.4% of the population of Huancavelica Department to 21.4% percent in Piura.

¹ The Peruvian definition of extreme poverty is the monetary value of the basic food basket that reflects the costs necessary to meet minimal nutritional requirements. The norm frequently used is 2,318 kilocalories of 52grs. of protein/day/adult equivalent (INEI-Peru: Medición de los niveles de vida y pobreza 1996).

Chart 2.1: Peru – Incidence of Extreme Poverty by Department, 2001

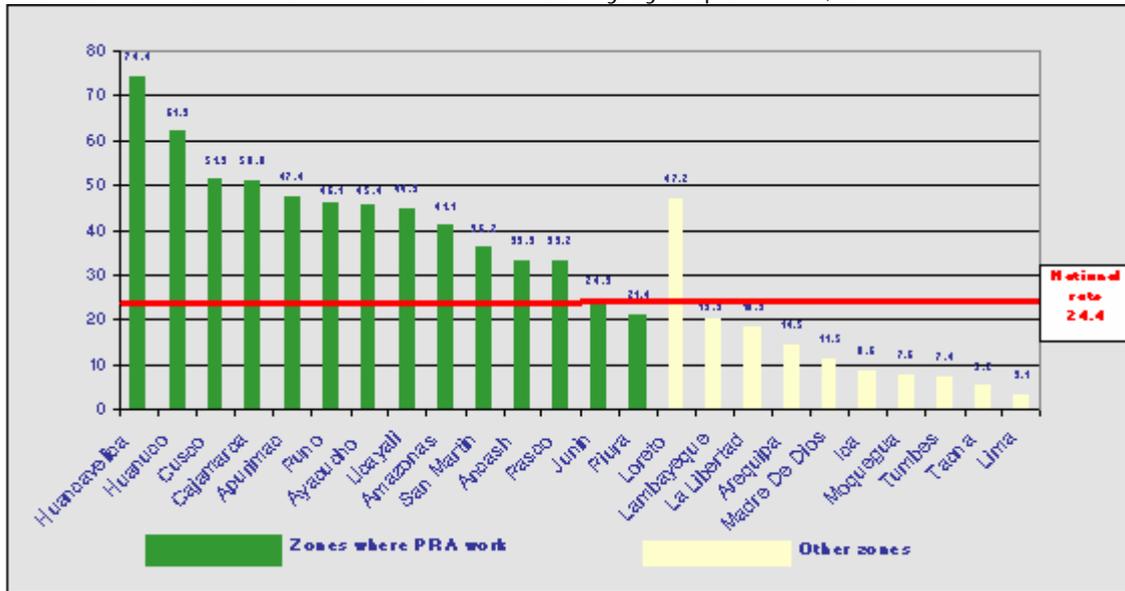
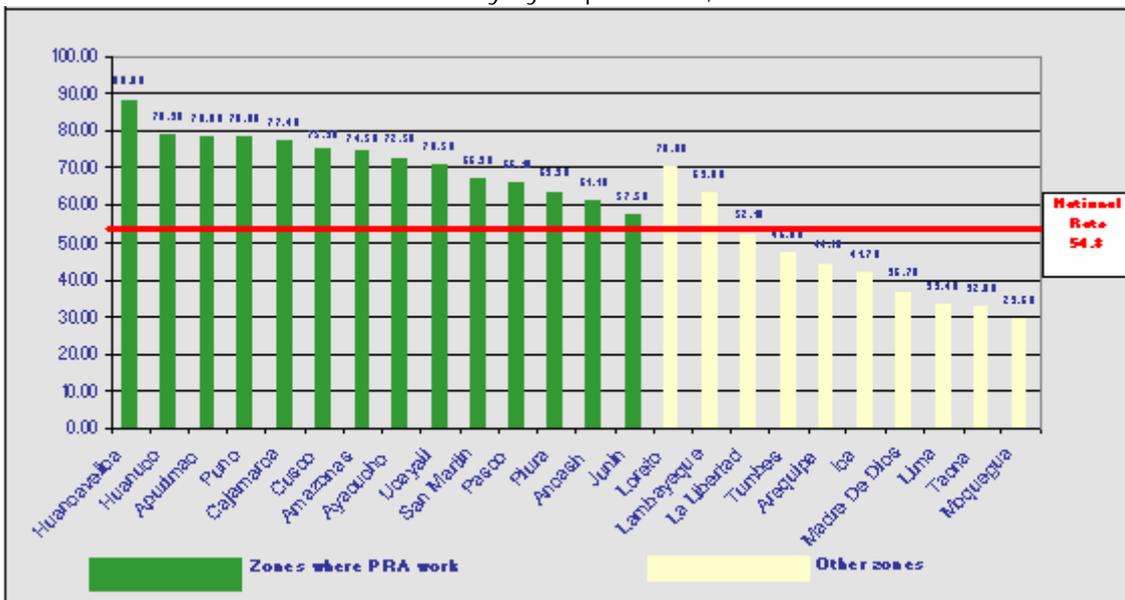


Chart 2.2: Peru – Incidence of Poverty by Department, 2001



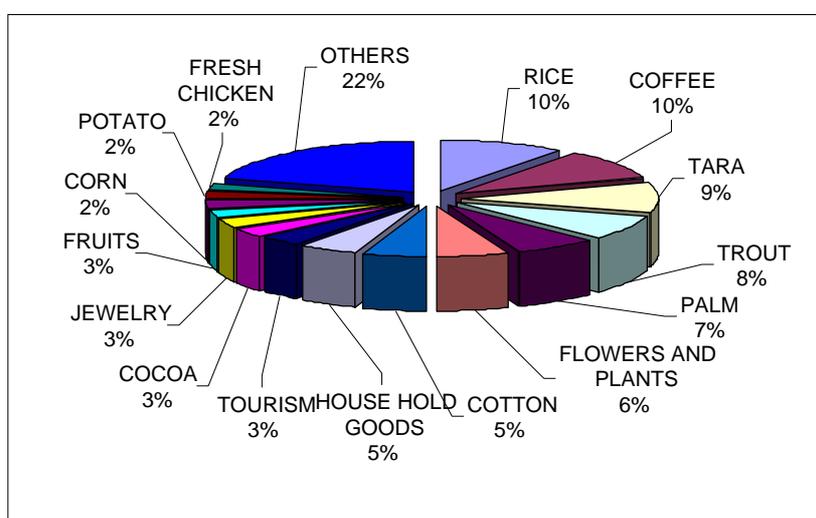
Working through the 11 ESCs, PRA, since its inception in 1999, has worked with more 400 businesses. These businesses have consisted of 248 enterprises, 112 business or producer associations and 48 individuals. During FY2004 PRA worked with 241 businesses disaggregated as follows: 167 formal enterprises; 64 business or producer associations; and 25 individuals (see Table 2.3 below).

Similarly, since 1999 PRA has worked with 67 products, including 51 in FY2004. Several of the most important include rice (16%); coffee (10%); African palm oil (8%);

cotton (8%); trout (5%); jewelry (4%); home articles/assesories (4%); tourism (3%); natural colorants (2%); and textiles (2%). (See Chart 2.3 below)

	Asociación	Comité	Cooperativa	Empresa Internacional	Empresa Nacional	Persona Natural	Total
Total PRA to September 2004	51	36	20	7	223	45	382
Total Huancavelica to September 2004	4	1			18	3	26
Total PRA year 2004	37	22	10	6	144	22	216
Total Huancavelica year 2004	4	1			17	3	25

Chart 2.3: 15 Products Make up 80% of PRA Sales



Finally, since its inception, PRA has focused on clients and products with export potential in each of the participating economic corridors (Table 2.4). Overall, 42% of PRA sales, valued at approximately \$10.8 million, were exported in FY2004 representing a 27% increase over FY2003. The principal export products are coffee, cotton, flower and plants, trout and gold jewelry (Table 2.5). Fully 37% of those exports, valued at approximately \$4.1 million in FY2004 were exported to the United States. With the expected signing of a Free Trade Agreement between Peru and the United States during 2005 we expect exports to the United States to increasingly occupy a larger and larger part of the PRA portfolio.

ESC	Total Annual Export			Exports to USA -2004		Accumulative to September 2004		
	2003 (US \$ millions)	2004 (US \$ millions)	% increase	2004 (US \$ millions)	% Export by ESC 2004	Total Net Sales (US \$ millions)	Export Sales (US \$ millions)	% of Total Net Sales September 2004
AYACUCHO	0.8	0.7	83.5%	0.2	22.0%	3.4	1.9	55.0%
CAJAMARCA	1.8	2.4	135.1%	1.4	57.3%	9.1	7.6	83.4%
CUSCO	1.4	1.3	93.6%	0.9	63.6%	7.4	3.1	41.9%
HUANCAYO	1.9	2.4	124.3%	0.6	23.4%	9.8	5.7	58.6%
HUANUCO	0.4	0.1	17.9%	0.0	35.7%	3.6	1.1	29.6%
HUAYLAS	0.2	0.2	129.6%	0.1	30.6%	4.8	0.8	17.4%
JAEN	0.6	0.2	36.0%	0.0	16.6%	8.1	1.7	21.4%
PUCALLPA	0.1	0.2	151.6%	0.0	18.2%	6.8	0.4	6.5%
PUNO	1.2	3.0	238.0%	1.1	36.0%	6.1	4.4	71.8%
TARAPOTO	0.0	0.3	100.0%	0.0	0.0%	5.1	0.4	8.1%
Total	8.4	10.7	127.4%	4.1	38.7%	64.2	27.2	42.3%
HUANCAVELICA	0.0	0.1	353.5%	0.0	46.8%	0.5	0.1	19.5%

PRODUCT	Net Sales (US\$)	Percent (%)	Net Days of Labor Associated with Exports
COFFEE	2,890,938	15.55%	2,869,165
COTTON	2,238,848	12.04%	252,330
FLOWERS AND PLANTS	2,207,824	11.87%	254,138
TROUT	1,565,820	8.42%	920,519
JEWELRY	1,293,081	6.95%	1,293,081
HOUSE HOLD GOODS	1,220,150	6.56%	465,962
TARA	1,166,878	6.27%	1,148,483
WOOL	719,894	3.87%	633,535
TOURISM	692,656	3.72%	67,738
NATURAL COLORANTS	656,455	3.53%	656,455
FABRICS	628,191	3.38%	537,849
ARTICHOKE	606,820	3.26%	398,700
WOOD	553,930	2.98%	130,617
CORN	539,122	2.90%	71,055
COCOA	434,110	2.33%	372,638
BEANS	426,423	2.29%	88,084
PROCESSED PRODUCTS	287,051	1.54%	221,709
ANDEAN CEREALS	172,111	0.93%	90,537
ROASTED RED PEPPER	91,663	0.49%	67,477
LEGUMES	70,402	0.38%	68,994
TEXTILES	59,178	0.32%	41,573
SPICES	40,903	0.22%	3,686
KIWICHA	33,335	0.18%	23,335
TRINKETS (JEWELRY)	1,141	0.01%	306
Total	18,596,923	100.00%	10,677,963

* Preliminary data

Given the central role that the PRA Economic Service Centers (ESCs) play in conceptualizing and implementing the PRA program in their respective economic corridors, we have decided this year to attempt to not only capture the statistical performance of each ESC but to try to capture, as well, the nature and dynamic of the work as each PRA ESC teams identifies and then assists their principal business clients and secondary producer clients to realize their respective annual sales, employment and investment targets.

Tables 2.6 thru 2.8 present the annual sales, employment and investment targets and performance for each ESC since the inception of PRA as well as the cumulative targets and results as of September, 2004. Individual ESC performance against these annual and cumulative targets is reviewed in the following ESC specific discussions. In PRA ESC-wide terms it is important to note that collectively all PRA ESCs have achieved 105% (\$64.2 million) of their cumulative sales target through September, 2004; 100% (32,000 full time jobs) of their cumulative employment target; and 96% (\$5.7million) of their cumulative investment targets.

To help us achieve greater insight into the workings of the each PRA ESC, beyond aggregate performance statistics, the PRA staff has prepared a series of in depth profiles of PRA sponsored enterprises at the ESC level involving eight crops, with program activities in six (6) of PRA's eleven (11) ESCs. These profile results are summarized in Annex II to this annual report.

G. AYACUCHO ECONOMIC SERVICE CENTER (ESC)

Ayacucho, historically a troubled Department, the seat of the Sendero Luminoso movement in the 1980s and today home to one of the most intractable *coca* growing regions in Peru, is also the center of one of PRA's more innovative Economic Service Centers, particularly with respect to fostering export growth and employment generation. The Ayacucho ESC has been instrumental in implementing nascent business linkages in the *coca* growing Valle del Río Apurímac y el Ene (VRAE) region located within Ayacucho Department, effectively demonstrating that the private sector can be brought into areas of conflict if the minimum requirements for the security of licit enterprises can be established so that value and market chains can develop and deepen. However, these modest licit PRA "inroads" in the VRAE have been largely offset by the almost wall-to-wall planting and harvesting of *coca* in the VRAE, effectively crowding out licit economic activity in favor of the dominant culture of *coca* and the emergence of an all encompassing social culture of *coca*, which effectively intimidates and crowds out those licit entrepreneurs who would like to earn an honest living through licit entrepreneurial activity. Given the pervasive presence of *coca* and its encompassing social culture, PRA and other "licit business" interventions are unlikely to be successful and of scale unless they are accompanied by a concerted program to strengthen the Government's presence, including a disciplined and effective program of *coca* interdiction in the VRAE.

Table 2.6 Annual Sales Vs Annual Target (US\$ Millions)

CSE	2000			2001			2002			2003			2004			2004		
	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Accumulative Target	Accumulative Results	% of Target Achieved
AYACUCHO	0.10	0.00	0%	0.26	0.41	154%	1.05	0.64	60%	1.84	1.11	60%	1.43	1.24	87%	4.69	3.40	72%
CAJAMARCA	0.09	0.09	99%	0.23	0.73	310%	0.94	3.31	354%	1.64	1.95	119%	2.88	2.99	104%	5.78	9.07	157%
CUSCO	0.17	0.00	0%	0.44	0.17	38%	1.75	1.25	71%	3.07	2.99	97%	3.26	3.00	92%	8.70	7.41	85%
HUANCAYO	0.18	0.01	4%	0.47	0.94	201%	1.87	1.74	93%	3.28	3.22	98%	3.61	3.87	107%	9.40	9.77	104%
HUANUCO	0.12	0.21	167%	0.32	0.72	225%	1.29	0.92	71%	2.25	0.98	43%	2.33	0.75	32%	6.31	3.58	57%
HUAYLAS	0.12	0.00	0%	0.32	0.37	116%	1.29	1.00	78%	2.25	0.99	44%	1.77	2.46	140%	5.75	4.83	84%
JAEN	0.07	0.00	0%	0.18	0.33	188%	0.70	1.20	171%	1.23	1.83	149%	2.23	4.78	214%	4.40	8.14	185%
PUCALLPA	0.09	0.00	0%	0.23	0.54	233%	0.94	0.95	101%	1.64	1.77	108%	2.55	3.49	137%	5.44	6.76	124%
PUNO	0.12	0.06	45%	0.32	0.24	75%	1.29	0.31	24%	2.25	1.75	78%	1.80	3.78	210%	5.78	6.14	106%
TARAPOTO	0.12	0.00	0%	0.32	0.70	219%	1.29	0.29	23%	2.25	1.10	49%	2.87	2.99	104%	6.86	5.09	74%
Total	1.20	0.36	30%	3.10	5.15	166%	12.40	11.61	94%	21.70	17.70	82%	24.72	29.36	119%	63.12	64.18	102%
HUANCAVELICA							0.58	0.00	0%	0.58	0.09	15%	1.16	0.44	38%	2.31	0.53	23%

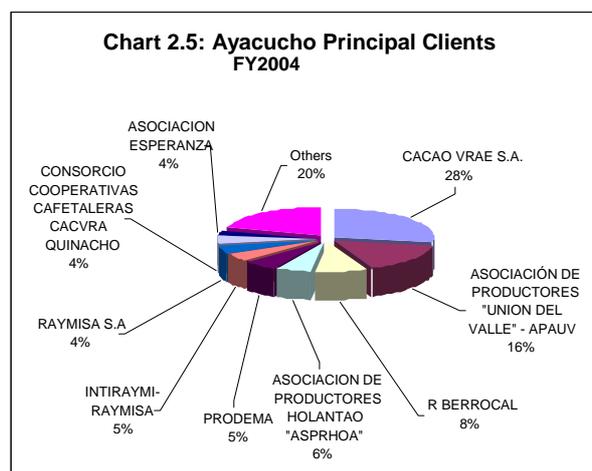
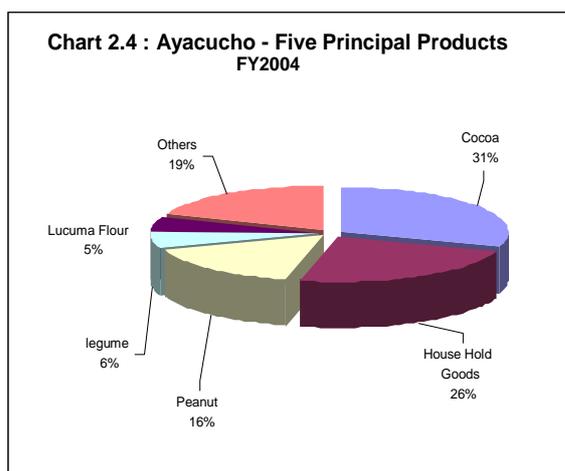
Table 2.7: Annual Employment Vs Annual Target

CSE	2000			2001			2002			2003			2004			2004		
	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Accumulative Target	Accumulative Results	% of Target Achieved
AYACUCHO	36.73	0.00	0%	130.75	156.43	120%	523.02	605.90	116%	915.28	1,039.06	114%	666.14	1,211.29	182%	2,271.93	3,012.68	133%
CAJAMARCA	32.65	61.35	188%	116.23	521.34	449%	464.91	1,042.50	224%	813.58	681.51	84%	1,749.39	1,080.68	62%	3,176.75	3,387.38	107%
CUSCO	61.22	0.00	0%	217.92	24.52	11%	871.70	399.27	46%	1,525.47	1,645.11	108%	1,733.98	1,574.21	91%	4,410.29	3,643.11	83%
HUANCAYO	65.30	2.36	4%	232.45	134.24	58%	929.81	692.07	74%	1,627.17	1,261.07	78%	2,127.64	1,579.06	74%	4,982.37	3,668.81	74%
HUANUCO	44.89	66.65	148%	159.81	329.13	206%	639.25	436.36	68%	1,118.68	493.37	44%	1,286.19	412.86	32%	3,248.82	1,738.38	54%
HUAYLAS	44.89	0.00	0%	159.81	174.69	109%	639.25	344.57	54%	1,118.68	220.74	20%	1,062.43	682.74	64%	3,025.06	1,422.74	47%
JAEN	24.49	0.00	0%	87.17	267.18	307%	348.68	1,092.04	313%	610.19	748.74	123%	1,139.84	747.39	66%	2,210.36	2,855.35	129%
PUCALLPA	32.65	0.00	0%	116.23	778.33	670%	464.91	1,209.79	260%	813.58	2,021.53	248%	895.17	1,725.13	193%	2,322.54	5,734.78	247%
PUNO	44.89	13.08	29%	159.81	54.86	34%	639.25	139.04	22%	1,118.68	861.76	77%	1,018.03	1,613.21	158%	2,980.65	2,681.95	90%
TARAPOTO	44.89	0.01	0%	159.81	274.08	172%	639.25	163.23	26%	1,118.68	833.04	74%	1,536.30	3,186.50	207%	3,498.92	4,456.86	127%
Total	432.60	143.46	33%	1,540.00	2,714.81	176%	6,160.00	6,124.77	99%	10,780.00	9,805.93	91%	13,215.09	13,813.06	105%	32,127.69	32,602.03	101%
HUANCAVELICA							284.43	0.00	0%	284.43	19.12	7%	568.86	105.59	19%	1,137.71	124.71	11%

Table 2.8: Annual Investment Vs Annual Target (US\$ Millions)

CSE	2000			2001			2002			2003			2004			2004		
	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Annual Target	Annual Results	% of Target Achieved	Accumulative Target	Accumulative Results	% of Target Achieved
AYACUCHO	0.02	0.00	0%	0.05	0.02	44%	0.11	0.00	2%	0.11	0.00	0%	0.16	0.00	0%	0.45	0.03	6%
CAJAMARCA	0.02	0.00	0%	0.05	0.04	90%	0.09	0.20	218%	0.09	0.09	94%	0.30	0.04	15%	0.55	0.38	69%
CUSCO	0.03	0.00	0%	0.09	0.00	0%	0.09	0.02	9%	0.18	0.00	0%	0.39	0.00	0%	0.86	0.02	2%
HUANCAYO	0.04	0.00	0%	0.09	0.05	59%	0.19	0.14	73%	0.19	0.24	126%	0.33	0.46	137%	0.84	0.89	106%
HUANUCO	0.02	0.02	76%	0.06	0.02	28%	0.13	0.00	1%	0.13	0.00	0%	0.24	0.00	0%	0.59	0.04	6%
HUAYLAS	0.02	0.00	0%	0.06	0.04	60%	0.13	0.97	752%	0.13	0.71	550%	0.13	0.24	191%	0.47	1.95	414%
JAEN	0.01	0.00	0%	0.04	0.03	86%	0.07	0.00	3%	0.07	0.00	0%	0.25	0.03	12%	0.43	0.06	14%
PUCALLPA	0.02	0.00	0%	0.05	0.02	51%	0.09	0.04	42%	0.09	0.11	114%	0.25	1.03	417%	0.50	1.20	240%
PUNO	0.02	0.01	20%	0.06	0.02	23%	0.13	0.00	0%	0.13	0.00	0%	0.19	0.10	54%	0.54	0.12	23%
TARAPOTO	0.02	0.00	0%	0.06	0.02	35%	0.13	0.75	583%	0.13	0.00	0%	0.13	0.24	194%	0.47	1.02	215%
Total	0.24	0.02	10%	0.62	0.27	43%	1.24	2.12	171%	1.24	1.14	92%	2.36	2.14	91%	5.70	5.70	100%
HUANCAVELICA							0.17	0.00	0%	0.17	0.00	0%	0.33	0.00	0%	0.66	0.00	0%

G1. Ayacucho Sales Performance - The portfolio of the Ayacucho ESC is composed of 17 products. In terms of sales value three products dominate the portfolio, cacao, peanuts and handicrafts (Chart 2.4). These three product lines accounted for 70% of ESC sales during FY2004 valued at \$870,000. The cacao and peanut campaigns implemented



during FY2004 were designed and implemented jointly with the PDAP project and directly benefited more than 2,859 ex-cocaleros who had agreed voluntarily to eradicate their *coca* under PDAP program sponsored by DEVIDA and USAID.

In terms of sales performance against its established targets for FY2004 (Graph 2.6) the Ayacucho ESC performed well. With sales of \$1.24 million the Ayacucho ESC achieved 87% of its annual target, with cacao, peanuts and handicrafts accounting for the lion's share of ESC sales. With respect to year end to year end comparative performance, ESC Ayacucho sales were 11% or \$130,000 greater than in 2003. Since the inception of PRA the Ayacucho ESC has achieved 72% of its sales targets with a cumulative sales value of \$3.4 million.

G2. Ayacucho Employment Performance - The Ayacucho ESC generated the equivalent to 1,210 new fulltime jobs during FY2004, exceeding the established annual target by 82%. These employment opportunities were generated largely in the artesanal and household goods sectors with important employment opportunities afforded as well by the PRA/PDAP interventions in the VRAE with respect to cacao and peanuts. Progress was also made in generating employment with promising new products connected with Ayacucho's search for economic growth opportunities particularly in export markets.

One of the promising new products to emerge is snow peas (*Holantao*) which PRA first promoted in 2002. In Ayachucho the stage is now set for the growth of a dynamic new, labor intensive export crop. Working with INTIPA, an export company, and an association of *Snow Peas Producers (ASPRHOA)*, 23.5 hectares of snow peas were planted in 2004 and exported by INTIPA to the U.S. with a value of more than \$70,000. This successful export experience has prompted INTIPA, with PRA support, to exponentially expand its purchase of snow peas in 2005 to the equivalent of 150 hectares. The Peruvian market window for snow peas in the U.S. is very narrow as it is only open for a short six week period, during the off season for U.S. and Guatemalan production.

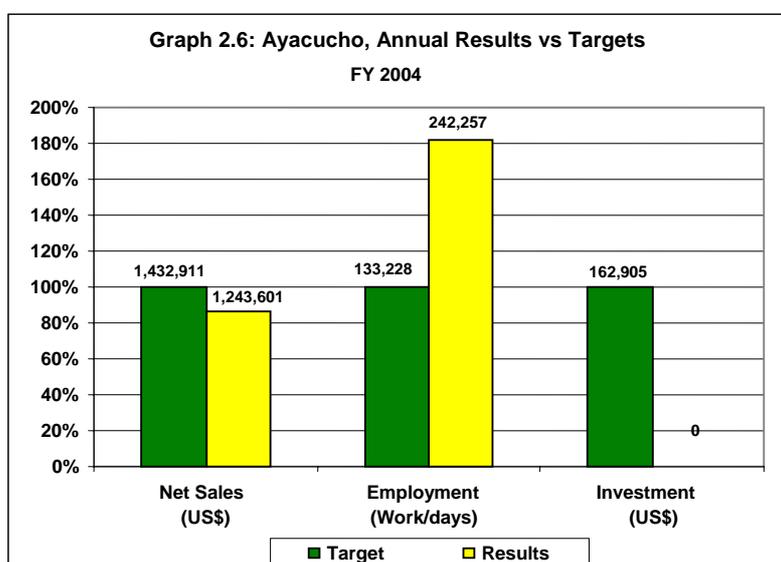


Table 2.9: Ayacucho ESC – Production of Snow Peas

Annual	Client	Has	Production TM	Price x Kg US \$	Total Sales US \$	Country	Value Exported US \$
2002	Hortiflora	23.5	120	0.73	87,600	EE UU	87,600
2003	INTIPA FLOWERS	55	160	0.45	72,000	EE UU	68,400
						Europa	3,600
2004	INTIPA FLOWERS	14	64	1	64,000	EE UU	60,800
						Europa	3,200
	A & L Exportaciones y Servicios	9	41	1	41,000	EE.UU	41,000
2005 *	INTIPA FLOWERS	150					
	A & L Exportaciones y Servicios	20					

* Forecast – crop year 2005

Photo 2.2: Snow Peas, Ayacucho ESC



Since the Ayacucho ESC entered the PRA program in 2001 it has exceeded each year its employment target by a comfortable margin. On a cumulative basis, the ESC Ayacucho has created more than 3,000 full time jobs comfortably exceeding its life of project (LOP) employment program target by 33% as of September, 2004. In a region with the more than 45% of the population living in extreme poverty (Chart 2.1) and earning less than US\$ 3.60/day PRA generated full time employment represents an extremely important contribution.

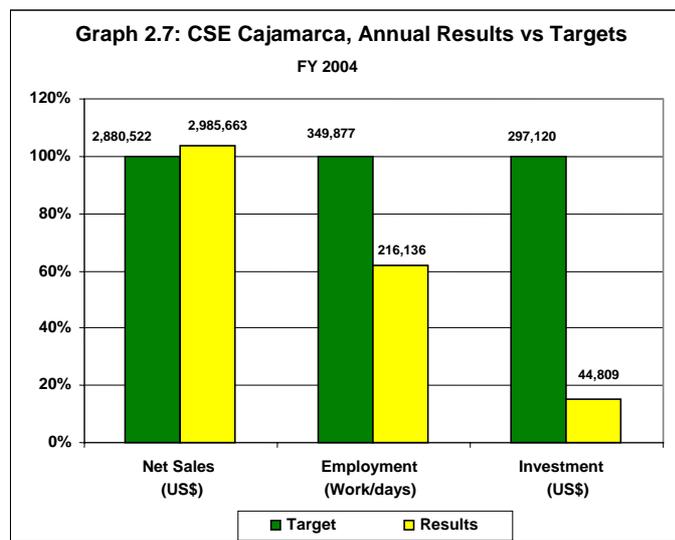
G3. Ayacucho Investment Performance - Mirroring the historically poor performance of all the ESCs serving the *coca* valleys, or more broadly, the alternative development departments, ESC Ayacucho made no progress in FY2004 in attracting fixed capital, private sector investment (Graph 2.6). This poor performance, or perhaps better put, non-performance, in mobilizing private investment is characteristic of all PRA ESCs, particularly those serving the Alternative Development Departments. A counterpoint to this dismal investment picture is PRA's success story with SEM PERU, discussed earlier and featured further on in our discussion of the accomplishments of the Pucallpa ESC.

H. CAJAMARCA ECONOMICS SERVICE CENTER (ESC)

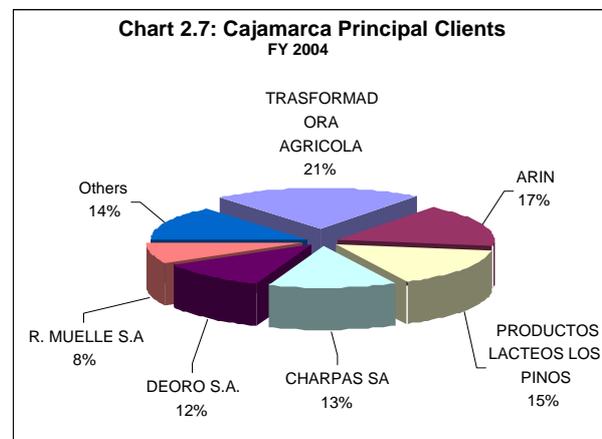
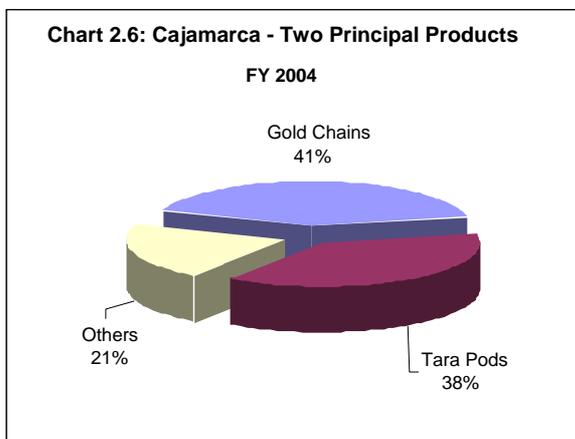
With a population of 1.53 million and with approximately 51% of the population living in extreme poverty (Charts 2.1 and 2.2), generating local employment or out-migration are the only real alternatives for the poor of Cajamarca to improve their lot. The *coca* regions are an important destination for Cajamarca's destitute. Hence, since the inception of the PRA Program in Cajamarca, the PRA team has given priority to finding profitable, labor intensive business solutions and with Tara and hand made gold jewelry the PRA ESC team has exceeded beyond expectation, if not beyond the magnitude and gravity of the dismal employment situation in Cajamarca. Unfortunately this progress cannot continue in the years ahead with USAID support as USAID's Development Assistance (DA) budget has been severely reduced for FY2005 and beyond. The DA budget was the source of financing for those ESCs not located directly in the *coca* growing departments. Consequently USAID directed the PRA contractor to close the Cajamarca ESC by 31 November, 2004. We would like to emphasize that this closure

was necessitated by USAID budget constraints rather than for any performance deficiencies *per se* which is evident from the performance review recorded below.

H1. Cajamarca Sales Performance - The portfolio of the Cajamarca ESC is composed of six products (Chart 2.6). The Cajamarca ESC consistently has been one of PRA’s top performing ESCs in terms of sales, with cumulative sales of over \$9.0 million, (Table 2.6) and in exports, with FY2004 export value of \$2.4 million (Table 2.4). For FY2004 the Cajamarca ESC exceeded its sales target by 4.0% with sales of approximately \$3.0 million (Graph 2.7). Almost since its inception in 1999 the Cajamarca ESC has consistently, and by a wide margin, exceeded its annual sales targets.



Two export products, Tara and gold chains, coupled with milk-based products produced for the domestic market, have driven sales performance this year as in years past accounting for 98%, or \$2.9 million, of the Cajamarca ESC’s sales performance (Chart 2.6).



- *Hand Made Gold Chains:* Through a unique “swap” agreement PRA arranged for Minera Yanacocha, the world’s second largest gold producer, to deliver gold to three Peruvian jewelry makers who, with PRA assistance, have organized hundreds of women workers in Cajamarca to assemble gold chains. By transforming “raw” gold into gold chains Peru has added significant value to one of its principal mineral exports, creating hundreds of full time, sustainable jobs for women in Cajamarca in the process. The U.S. imports more than 300 TM annually of gold chains and Peru has been meeting an increasing share of this market with exports of 21 TM in November 2002 to 23 TM in 2004. The elimination of a 17% tariff on the import of processed gold by the U.S. under the ATPDEA has greatly facilitated the growth of this PRA business, contributing to improve value-added and employment generation in Cajamarca. In FY2004 gold chain exports accounted for 42% of ESC Cajamarca’s sales worth \$1.2 million.
- *Tara:* Tara constitutes the second most important business activity of the Cajamarca ESC, accounting for 38% of sales in FY2004 realized through three different exporting companies: Transformadora Agrícola SAC; R. Muelle S.A.; and, y Agro Export Cajamarca SAC. Tara is an organic substitute for chrome used in tanning leather for use in the automotive industry.

Photo 2.3: Tara, Cajamarca ESC



Tara, which is presently collected wild from forests has unique properties of interest to the automotive industry, particularly European manufacturers, which must re-use or recover 85% of each vehicle by 2006 and 95% by 2015. Tara produces a full, soft leather with fine and tight grain, imparts very little color to leather, and leathers tanned with Tara fade and crack less than leathers tanned with other vegetable tannins. These properties are unique to Tara and Tara is produced mainly in Peru. The principal organic competition to Tara is Mimosa produced by Brazil and South Africa. Mimosa presently accounts for 45% of the market for organic tannins with Tara accounting for 8%. Because of its superior tanning qualities and the fact that only 5% of the 60 million square meters of leather tanned annually is chrome free, Peruvian Tara faces a bright future if the supply of Tara can be greatly increased and stabilized. For this to happen substantial investment in organized and monitored cultivation, as opposed to the current practice of harvesting Tara in the wild, will be necessary. As we have

noted, mobilizing investment in the *sierra* and *selva* has proven very difficult, but the first step have been taken in Cajamarca with PRA support, two European companies have invested in Tara plantations with two Peruvian exporters.

H2. Cajamarca Employment Performance: The Cajamarca ESC generated the equivalent to 1,080 new fulltime jobs during FY2004, falling short of its annual target by some 38%. Notwithstanding this poor FY2004 showing the Cajamarca ESC has generated more than 3,380 full-time jobs since it joined the program in 1991, ranking number five (5) among the eleven (11) PRA ESCs in terms of job creation.

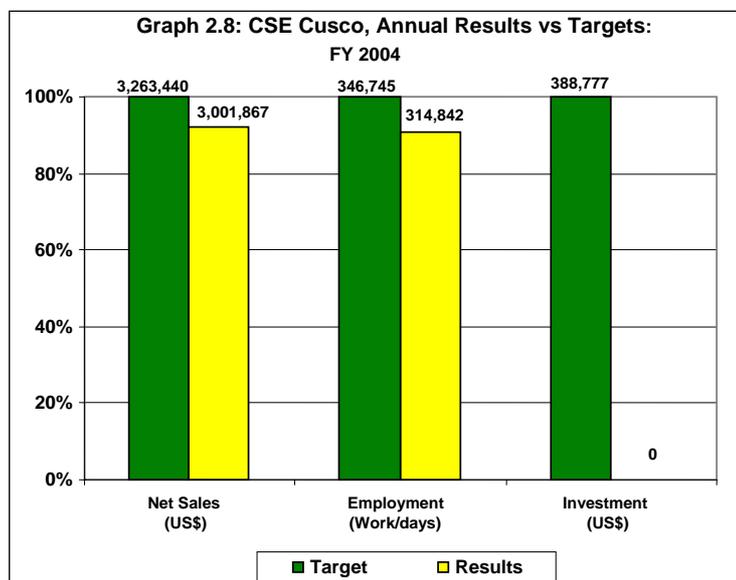
H3. Cajamarca Investment Performance: Investment performance in Cajamarca was disappointing in FY2004 as with most other ESCs. The same poor performance noted in FY2004 has been recorded over the life of project for ESC Cajamarca, which has achieved only 60% of its cumulative investment target to date, representing an investment of approximately \$3.0 million. What is note worthy about Cajamarca is that this dismal investment picture could be about to change, and change dramatically. After several years of developing the Tara market by harvesting Tara “wild” in the forests near Cajamarca, both Peruvian and foreign investors have begun to realize the enormous potential of cultivating Tara on plantations in lieu of harvesting it in the wild. This past year two companies in conjunction with exporters have invested in plantations of 30 and 200 hectares respectively. There is no doubt that a large export market for Tara powder exists, particularly in Europe. Peruvian Tara has only 8% of the 200,000 TM world market for vegetable tannins. The three main vegetable tannins producers all have higher processing costs because their tannins are derived from heartwood or bark and they cannot be processed into powder as easily as Tara pods. The only factors holding back the expansion of Tara production is the current high price and the inconsistency of Peruvian supply and, most significantly, the risk aversion of domestic and foreign investors to invest in the Peruvian *sierra* and *selva*. PRA studies and on-the-ground results have demonstrated that Tara has a bright future, not just in ten or twenty years, but for at least thirty years, any beyond.

I. CUSCO ECONOMIC SERVICE CENTER (ESC)

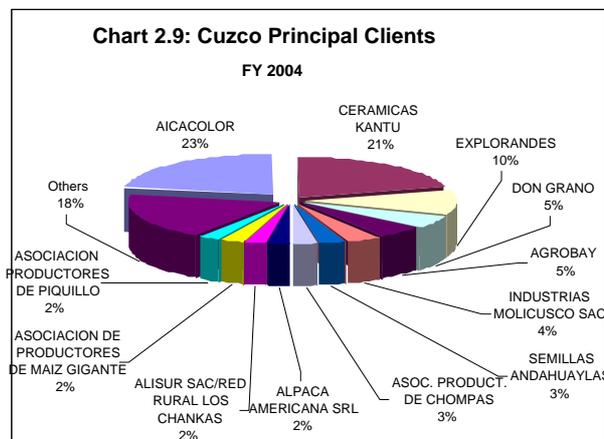
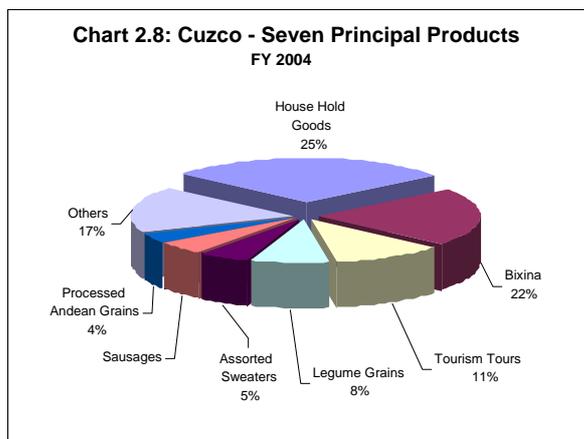
Cusco, one of Peru’s largest cities with a population of 1.24 millions, has always had a central presence in Peruvian culture and history. In 1553 Pizarro sealed the defeat of the Inca Empire and consolidated Spanish control of Peru with his victorious entry into the city and coronation of the new Inca (and Spanish puppet) Manco. After the capture of Cusco, the Spaniards were quickly able to assume control of the core of the Inca Empire, roughly corresponding to the boundaries of modern Peru. Today Cusco is the *de facto* seat of Peru’s tourist industry and an important production and market center. Notwithstanding the historical, cultural and economic prominence of the city of Cusco, the Department of Cusco, in terms of the incidence of extreme poverty, is only surpassed by the Departments of Huanuco and Huancavelica. Today, more than 51.3% of the population lives in extreme poverty (Chart 2.1). As with Cajamarca and other impoverished *sierra* population centers, the lure of land in the *selva* and prospect of enhanced incomes through the cultivation of *coca* stand as powerful magnets pulling the

impoverished of Cusco to a new life built around the illicit *coca* economy. Understandably, PRA’s efforts in Cusco are focused on increasing the number of profitable, labor intensive enterprises.

Performance of the Cusco ESC was less than forecast for FY2004 due, at least in part, to an abrupt management change necessitated by PRA’s commitment to provide strong support to emerging enterprise activities in the four *coca* growing valleys (Graph 2.8). In this regard, the Director of the Cusco ESC was transferred in mid-FY2004 to head-up a newly created Economic Service Center housed and managed under the USAID financed PDAP project. Notwithstanding the impact of this management change on the work of the Cusco ESC, the ESC still achieved 92% of its sales target and 91% of its employment generation target for FY2004. Investment performance was negligible reflecting the poor investment in climate in Peru generally and the *sierra* specifically.



I1. Cusco Sales Performance - The portfolio of the Cusco ESC is well diversified and composed of seventeen (17) different products (Chart 2.8). The Cusco ESC works with 35 clients composed of: 21 enterprises, 8 producers associations and cooperatives and 6 persons (Chart 2.9).



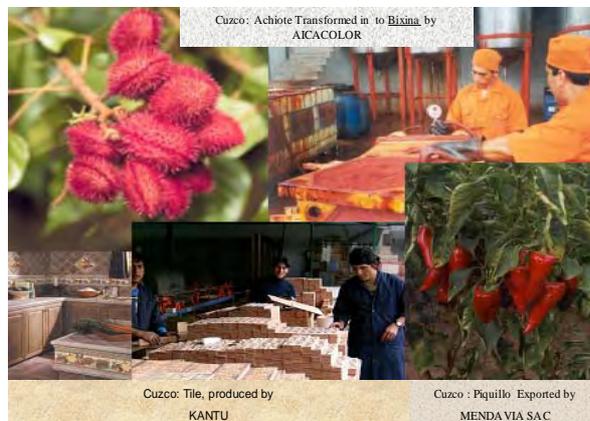
Twelve clients account for 82% of sales. Within this universe, 53% of sales were generated by three enterprises and their respective products: Bixina (a natural colorant); ceramics produced for the domestic market; and tourism.

In terms of performance against its established sales target for FY2004 (Graph 2.8), the Cusco ESC performed well, achieving 92% of its annual sales target with sales of approximately \$3.0 million. Cusco ESC sales for FY2004 were only marginally higher than for FY2003. Since the inception of PRA, the Cusco ESC has achieved 79% of its cumulative sales target through September 2004 with an aggregate sales value of \$7.4 million (Table 2.7), ranking the Cusco ESC fourth among the ten (10) USAID financed ESCs in terms of cumulative sales value.

Several examples of PRA support serve to demonstrate the breath of PRA activities in the Cusco economic corridor:

- Tourism:** Not surprisingly PRA has played and continues to play an important supporting role in Cusco's dynamic and evolving tourism market. Tourist arrivals wishing to hike the "Inca Trail" have surpassed the carrying capacity of the trail itself, causing the Government to limit the number of tourists allowed each day on the trail. PRA has worked with EXPLORANDES to open an alternative route to Machu Pichu oriented to the needs of foreign tourists (the new route is Colca, Ocuvi, Lampa y Capachica – Llachon; another route is Cusco, Choquequirao, Cusco).
- Agriculture:** This year PRA culminated several years of work and support for AICACOLOR, a business producing natural dyes (Bixina and Norbixina) from *achiote* by helping resolve a processing bottleneck which prevented the optimum concentration of bixina. Resolution of this problem has enabled AICACOLOR to notably increase its exports to foreign buyers during FY2004. Working with MENDAVIA SAC the Cusco PRA team played an important role in testing/adapting *Pimiento Piquillo* to the agro-climatic conditions found in Cusco corridor and then working with four farmers' associations expanding production to 60 hectares.

Photo 2.4: Bixina, Cusco ESC



- *Industry:* PRA support for Cerámica KANTU, a manufacturer of ceramic tile, helped to improve tile design and production processing enabling Kantu's tile to effectively penetrate the domestic market and significantly increase sales in FY2004.

12. Cusco Employment Performance - The Cusco ESC generated the equivalent of 1,574 new fulltime jobs during FY2004, falling short of its annual target by some 9%. Since joining the PRA program in 2000 the CUSCO ESC has generated 3,643 fulltime jobs, ranking the ESC number five among the eleven (11) PRA ESCs in terms of job creation.

13. Cusco Investment Performance - PRA supported private investment in Cusco has been negligible, across all project years. The Cusco ESC ranks next to last among the 11 PRA ESCs against this important performance variable.

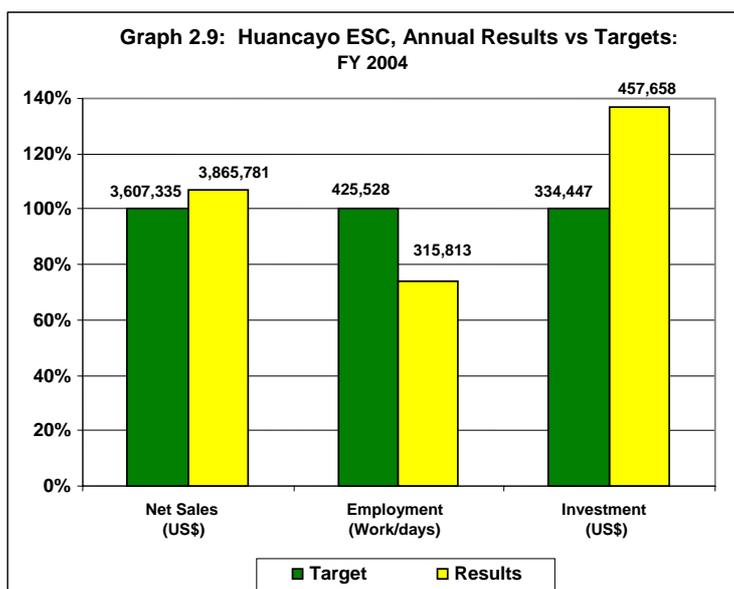
J. HUANCAYO ECONOMIC SERVICE CENTER (ESC)

The Huancayo Economic Service Center (ESC) serves two alternative development departments, Junín and Pasco, both of which have a significant percentage of their populations, 24.3% and 33.2% respectively, living in extreme poverty. In 2004 the population of Junín was estimated at 1.3 million while that of Pasco stood at approximately 280,000.

The area served by the Huancayo ESC is considered the “food basket” of Lima, specializing in commodities for basic food consumption. The commercialized food system is characterized by cycles of over production and sharp price declines and the presence of numerous intermediaries which tend to drive farm gate prices down.

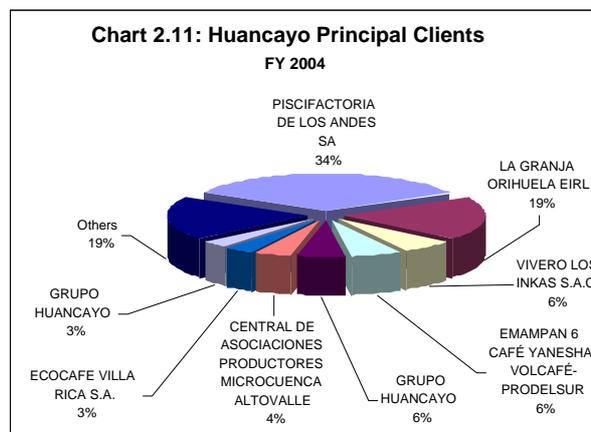
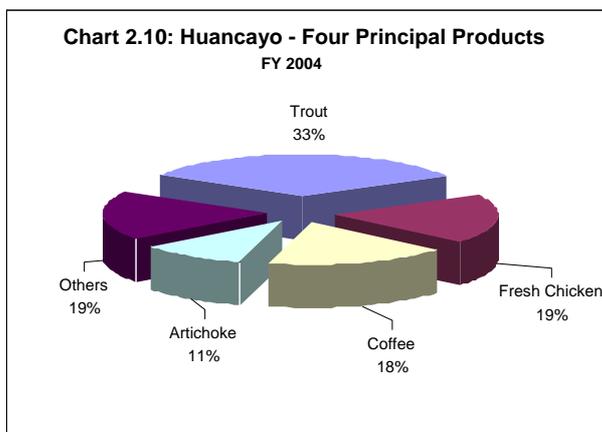
Confronted by this environment of extreme poverty and volatile and risky production cycles PRA has focused on agribusiness interventions related to both the domestic and export food industries. This strategy has centered on mobilizing private investments in

the incipient, but burgeoning artichoke export market; forming alliances among buyers/producers of trout, coffee, and processed products; and on the arduous process of organizing large volumes of quality production from small scale farm holdings. The combined impact of this work on the part of the ESC Huancayo has been to reduce the number of market intermediaries, thereby increasing the prices offered to producers as well as moderating price fluctuations. Equally important, these ESC sponsored activities, both with respect to field activities as well as plant investment, have generated substantial incremental employment through the deepening and integration of specific value chains.



J1. Huancayo ESC Sales Performance - In FY2004 the Huancayo ESC exceeded its sales target by 7% with sales valued at \$3.9 million (Graph 2.9). Since its incorporation into the PRA program ESC Huancayo has consistently exceeded its annual sales targets and presently stands at 104% of its 2000-2004 sales performance target with cumulative sales of \$9.8 million.

Part of Huancayo’s success over the years has been due to the ESC’s ability to diversify its sales base both in terms of clients and products. Seven (7) businesses account for 98% of ESC Huancayo’s sales results for FY2004, as follows: trout (34%); poultry industry (19%); coffee (18%); artichokes (11%); processed food products, (7%); flowers and plants (6%) and textiles/clothes (4%).



- Artichokes:** Artichokes “stole the show” among ESC Huancayos major products in FY2004 through existing and new clients as well as investments by Agromantaro and Talsa in two new processing plants valued at US\$1.0 million which will further stimulate artichoke production in FY2005. During FY2004 ESC Huancayo promoted the planting of an additional 250 hectares of artichokes and expects to directly support planning of an additional 300 hectares during FY2005. It is expected that 60 to 70% of this production will be exported to the United States taking advantages of the APTDEA and in FY2005 the expected Peru-U.S. Free Trade Agreement. PRA’s systematic and integrated approach to value chain development, from production support to product transformation and export, is clearly visible through ESC Huancayo’s work with artichokes.
- Trout:** The production of trout in cages and aquaculture (fish ponds) facilities has begun to take off in Peru, led by Piscifactoria Los Andes. Both domestic and export demand far exceed production capability at this time. Working closely with Piscifactoria Los Andes, PRA Huancayo has focused on eliminating production bottlenecks. The strategy employed has been to link small and medium trout farm facilities and producers with the technology, input and market expertise of the Piscifactoria Los Andes as well as negotiate marketing and price agreements between these small producers and Piscifactoria Los Andes. The formula is working well and has recently expanded to the Puno and Huancavelica ESCs where regional governments are prepared to give long term operating concessions to the private sector to utilize the various alpine lakes for trout cultivation. PRA expects trout cultivation to grow at an exponential rate over the next several years.
- Coffee:** ESC Huancayo has employed a selective strategy with respect to coffee cultivation and marketing by taking advantage of the price differentials offered for specialty coffees, particularly coffees grown organically and at elevations in excess of 800 meters. PRA Huancayo has promoted direct alliances between numerous producer groups and quality buyers such as Starbucks (USA): Lvazza (Italy), Tchibo (German); and Rucquoy Freres (Belgium). This PRA

intervention strategy has resulted, in various instances, where growers have obtained premium prices over the prevailing market price. For example, the PRA supported producers association APA Gramazu received from Lavazza (Italy) a premium price of \$8.00/quintal over the prevailing local price. By mutual agreement \$4.0 of this premium was paid directly to each producer and the balance was contributed to an investment fund dedicated to improving the quality of the association's production generally.

Photo 2.5: Artichokes, Trout, Coffee – Huancayo ESC



J2. Huancayo Employment Performance - In FY2004 Huancayo generated the equivalent of 1,579 full-time jobs, 74% of the established target for the year. Since the inception of the Huancayo ESC in 2000, 3,669 full time jobs have been generated. Sixty five percent (65%) of these jobs have been generated through PRA support to four businesses: Vivero Los Inkas (flowers and plants); Creaciones Carant (textiles); Productores de Maracuyá (fresh passion fruit); and Piscifactoria Los Andes (trout). It is worth noting as well that coffee producers have returned to their trees with the recent increase in coffee prices. These areas had previously been abandoned in favor of migration to the nearby *coca* producing areas. PRA, working with seven different coffee producer associations, is supporting the reactivation of these coffee producing areas, their institutions and the associated employment generated through the provision of technical assistance as well as linking producer associations with solid market contacts. Similar employment opportunities are being generated by the extensive planting of artichokes in the region stimulated by the investment in two post-harvest processing plants arranged by PRA.

J3. Huancayo Investment Performance - Huancayo ESC performance in mobilizing investment during FY2004 has been exemplary, exceeding its target by 37% and mobilizing in the process \$400,000 in new investment. With the FY2004 results, ESC Huancayo has mobilized more than \$900,000 in incremental investments since 2000. Thanks to this PRA effort Huancayo has in place two additional artichoke processing and packing plants, a passion fruit processing facility, and several new coffee drying and processing facilities. The scope of this investment as well as the amounts involved stand as a model for other PRA ESCs to emulate.

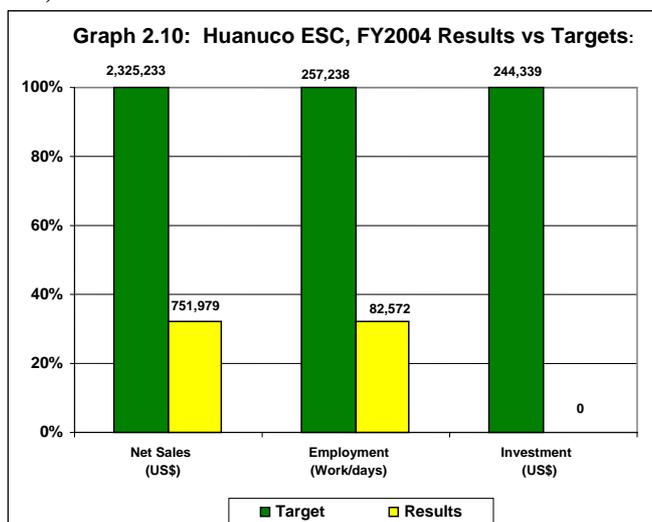
K. HUANUCO ECONOMICS SERVICE CENTER (ESC):

The Huanuco ESC encompasses the Alternative Development Department of Huanuco and a small part of Pasco and encompasses both *sierra* and *selva*. With a population of 830,000, Huanuco has the second highest incidence of poverty in Peru with 62% of the population living in extreme poverty.

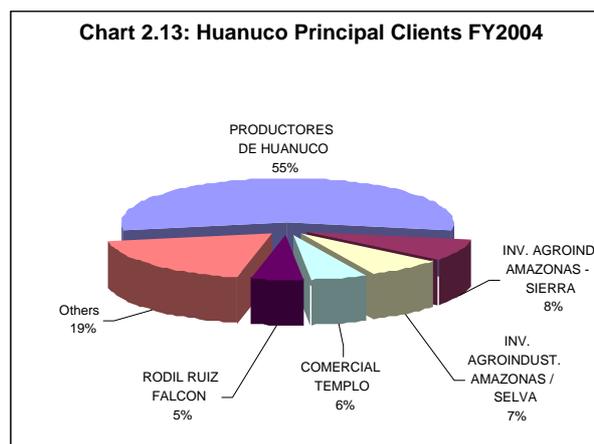
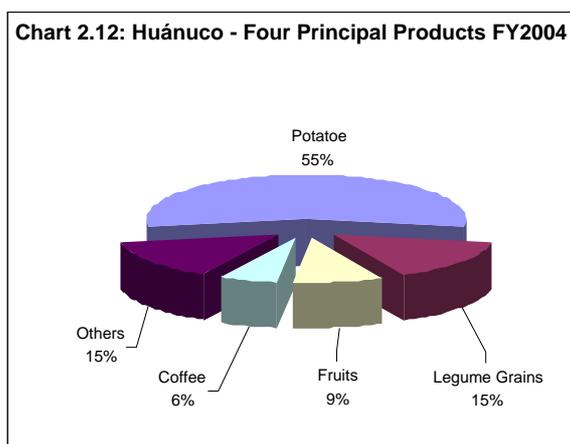
PRA activities en Huanuco have been underway since 2000 in both the *sierra* and *selva*. Activities have been concentrated in the province of Leoncio Prado, which includes the “Alto Huallaga” valley, home to the long standing *coca* growing areas of Tingo Maria, Aucayacu and Monzon. As a consequence, from its inception in FY2000, the Huanuco ESC has focused its business interventions on improving market opportunities for licit production and has made significant progress working with ex-cocaleros in developing viable commercial operations particularly with respect to cacao, coffee and bananas (see Section III: PRA Support for Alternative Development).

In the *sierra*, ESC Huanuco has been working to improve market linkages for crops grown in the region such as potatoes, beans, flowers and fruit (*granadilla*). In this regard, PRA’s work with Frito Lay (Snacks America Latina) with *papa capiro*, a potato indigenous to the region, is of particular interests. Frito Lay, until the intervention of PRA, imported its potatoes for the production of potato chips for the domestic market. With Frito Lay’s acceptance of quality production of *papa capiro* to exacting standards, organized by ESC Huanuco, a potential solution has been found, not only to increase *campesino* income, but also to put a break on seasonable migration of *campesino* labor to the nearby *coca* growing regions. This experience highlights the importance, as well as the potential, of creating sustainable employment opportunities in the *sierra* as an alternative to seasonal or permanent migration to areas of *coca* cultivation in the *selva*.

K1. Huanuco Sales Performance - In FY 2004, ESC Huanuco only achieved 32% of its annual sales target with a value of \$750,000. Since its entrance into the PRA program in FY2000 ESC Huanuco has generated \$3.5 million in incremental sales for its clients (Graph 2.10).

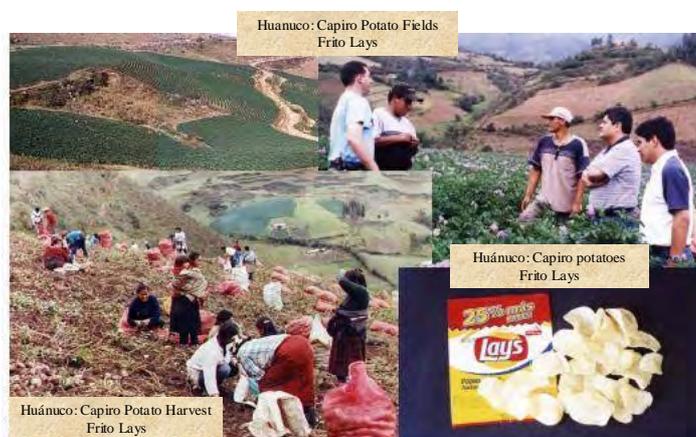


Seventy percent (70%) of FY2004 sales, totaling \$520,000, were generated by ESC Huanuco clients producing *papa capiro* and beans. Statistical reporting of ESC Huanuco’s work in the *selva*, with new plantings of cacao, coffee and bananas, has been pickup by the ESC PDAP and is reported separately here in Section III: PRA Support for Alternative Development.



- Papa Capiro- Frito Lay (Snacks América Latina):* Work with Frito Lay and *potato capiro* began in FY2000 with a one hectare demonstration of the production potential of *potato capiro* for subsequent processing into potato chips. By FY2004 this single hectare had expanded into several production “clusters” covering 169 hectares, with partial financing arranged through Agrobanco. The steady evolution of small groups of *campesinos* into “clusters” has been a key factor in ensuring the production of *potato capiro* to the exacting standards demanded by Frito Lay. For FY2005 390 hectares of *potato capiro* will be produced, under contract to Frito Lay, with an estimated market value of \$1.7 million.

Photo 2.6: Potato Production and Commercialization, Huanuco ESC



K2. Huanuco Employment Performance - During FY2004 ESC Huanuco generated 32% of its employment target in the *sierra*, resulting in the creation of approximately 412 new jobs, most associated with the Frito Lay initiative discussed previously. Employment results for ESC Huanuco in the *selva* are reported separately in Section III: PRA Support for Alternative Development. Since FY2000 ESC Huanuco has generated approximately 1,730 full time permanent jobs.

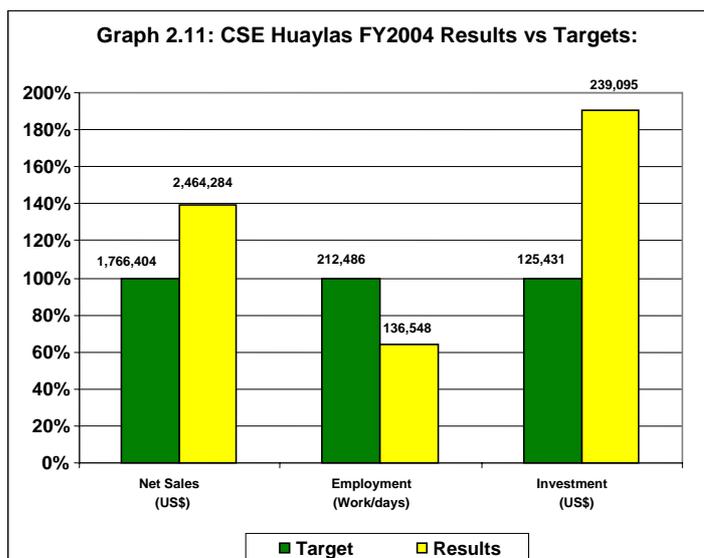
K3. Huanuco Investment Performance - The Huanuco ESC's most important investment contribution since its inception in FY2000 was realized this year with the start-up operation of a \$1.0 million yellow corn drying, classifying and processing facility located outside of Pucallpa in Ucayali Department. Although physically located outside the ESC Huanuco economic corridor for technical reasons, the project and the investment behind it, were the "brain child" of the Huanuco ESC team. After three years of arduous work, the plant is now in full operation, allowing SEM Peru to develop its program for the sale of highbred yellow corn seed and the development of more than 9,000 hectares, over the next several years, of yellow corn for feed grain and other purposes in the *selva*. This first time effort in the *selva*, represents a pioneering, indeed revolutionary step in the transformation of the *selva* into a viable licit, agriculture economy serving Peru. While time will tell, this \$1.0 million private investment could be the single most important expenditure in the decades-long war against *coca* in the Peruvian *selva*.

L. HUAYLAS ECONOMIC SERVICE CENTER (ESC)

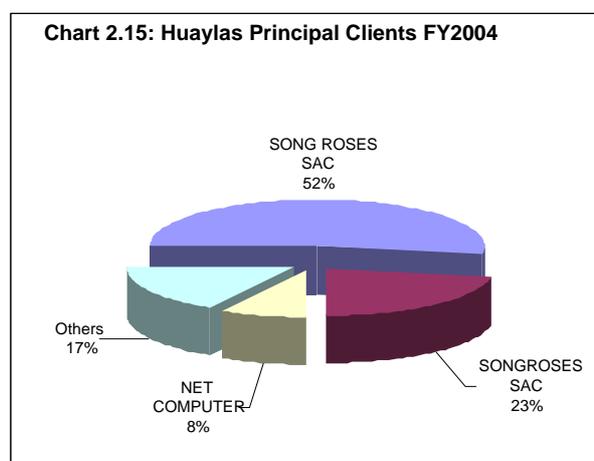
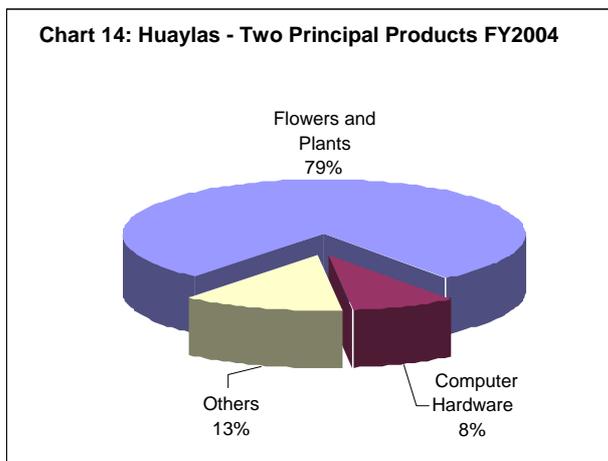
The economic corridor of Huaylas encompasses the geographic region of Ancash (*sierra de Ancash*), with a population of 1.14 million of which more than 33% live in extreme poverty considerably above the national average of 24.4%. Given the proximity of Ancash to Huanuco there is significant seasonal migration to *coca* growing areas of Monzon and Tingo Maria as well as to the coastal areas, specifically Trujillo, Chimbote and Lima. The portfolio of ESC Huaylas has evolved somewhat slowly but is now on the verge of major growth. Unfortunately, for USAID budgetary reasons, the Huaylas ESC program was terminated at the end of November 2004. We would like to emphasize that this closure was necessitated by USAID budget constraints rather than for any performance deficiencies *per se* which is evident from the performance review recorded below.

L1. Huaylas Sales Performance - During FY2004 the Huaylas ESC reached 140% of its target for the year with sales of \$2.46 million (Graph 2.11). With respect to year end to year end comparative sales performance, the Huaylas ESC performance was 140% or US\$990,000 greater than in 2003. As noted below, the stage is for a second stage of rapid growth among PRA ESC Huaylas clients.

ESC Huaylas sales since joining PRA in 2000 total \$4.83 million equivalent to 84% of its cumulative target through FY2004.



The portfolio of the Huaylas ESC during FY2004 was composed of five (5) products and 18 clients, led by cut flowers and plants produced by PRA client Songroses and to a lesser extent Zulex, whose combined sales reached \$1.94 million during FY2004 representing 78% of Huaylas ESC sales (Charts 2.14 and 2.15).



Huaylas FY2004 sales are discussed below in terms of their relative contribution to ESC sales results:

- Flowers and Plants:* Thanks to specific PRA technical assistance to Songroses (roses and bouquets), Zulex International (Gypsophila), and Flores del Callejón (Gypsophila) quality production and productivity of roses and Gypsophila has increased significantly. Sales of roses reached \$1.85 million and for Gypsophila \$92,000, with \$740,000 of the combined total in exports receipts.
- Artichokes.* The artichoke revolution is underway in Huaylas, still small but growing rapidly with PRA support. The Huaylas ESC has brought together small producers with ACSE SAC to organize 33 hectares of artichoke

production with spines and an additional 10 hectares without spines. Damper Trujillo SAC serves as the processing and export agent and exported \$130,000 of ESC supported production during FY2004.

For FY2005 PRA is assisting the planting of an additional 86 hectares through two companies, Campo Sol and Zulex, and a cooperative, Chaquinquirá. The artichoke industry is establishing roots not only in the Huaylas economic corridor, but in Huancayo and Huancavelica as well, with a “cluster” of artichoke processing companies emerging in the city of Trujillo. During FY2004, PRA carried out a comprehensive study of the Peruvian artichoke industry and two PRA experts gave keynote presentations at the 2nd Annual Artichoke Conference held in Lima in August 2004.

L2. Huaylas Employment Performance - The Huaylas ESC generated the equivalent of 683 full-time jobs during FY2004, reaching 54% of its employment target for the period. Since its inception into the PRA program in 2000, the Huaylas ESC has generated more than 1,422 full-time jobs. This rather low performance is a result of the relatively low employment intensity of the cut flower industry. Conversely, the incipient emergence of labor intensive (180 labor days/Ha) artichoke cultivation bodes well for employment generation over the next few years as this industry takes hold in Huaylas.

L3. Huaylas Investment Performance - During FY2004 the Huaylas ESC generated \$230,000 in fixed investment principally from Songroses (roses) and Damper Trujillo (artichokes). The Songroses investment was the culmination of several years of PRA work which commenced in 2001 with assistance to move Songroses base of operation from Ica to Huaylas which was much more suitable for flower cultivation. Songroses' \$180,000 investment in FY2004 for 4.5 additional hectares of greenhouses and post harvest cold storage and packing equipment served to fully anchor the production capacity of this promising business venture and set the stage for greatly increased sales and employment generation during 2005.

M. JAEN ECONOMIC SERVICE CENTER (ESC)

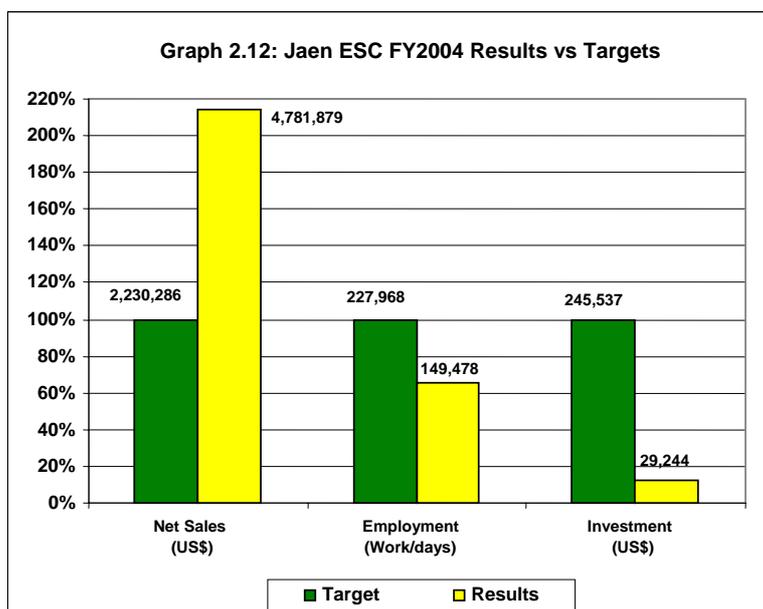
The Jaen economic corridor occupies the northern part of the Department of Cajamarca and a central section of the *Amazonas* Department. The population of Cajamarca in 2004 was 1.5 million while that of *Amazonas* was 443,025. Poverty is endemic to both regions with the incidence of extreme poverty well above the national average of 24.4%. In the case of Jaen 50.8% of the population live in extreme poverty while 41.1% of the population of *Amazonas* live at or below the defined national level for extreme poverty. Both regions have extensive areas of *selva* geographically connected with *coca* growing regions such as Rioja, Nueva Cajamarca and other areas in San Martín where *coca* has been traditionally cultivated. Not surprisingly, given the existence of extreme poverty found in both sections of the Jaen economic corridor, there is significant seasonal migration from the Jaen corridor to the *coca* fields of the *selva*. From the inception of PRA activity in Jaen in 2000 our efforts have been directed toward generating business opportunities capable of offering remunerative and sustainable

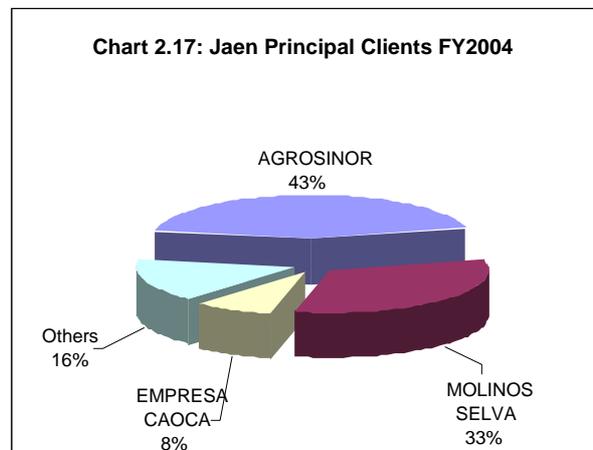
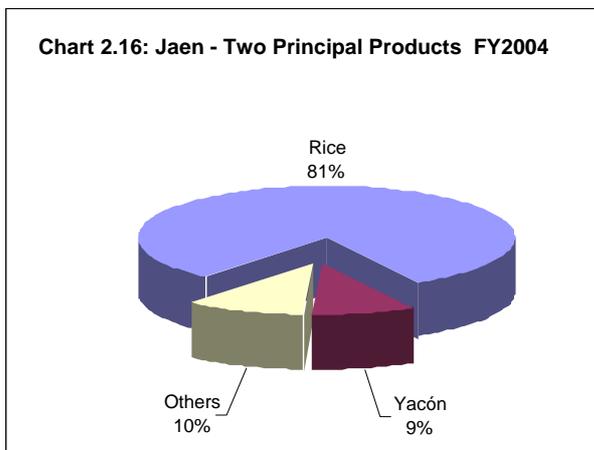
employment to corridor residents particularly those living in extreme poverty. The results, as demonstrated below, have been impressive.

The production and commercial marketing of *yacón* which generates 1.8 to 6.0 times the income per hectare derived from traditional crops, stands as one of ESC Jaén’s achievements in 2004. Another includes the identification and exploitation of niche markets for quality coffee.

M1. Jaén Sales Performance - In 2004 the Jaén ESC surpassed its annual sales target by 214% with sales of \$4.8 million due to strong performance across its portfolio especially with rice, where regional mills, supported by PRA, benefited greatly as a result of price increases caused by the extended drought in rice growing areas on the Pacific coast. Since the inception of operations in 2000, ESC Jaén has realized over \$8.1 million in sales representing 185% of its cumulative sales target through FY2004.

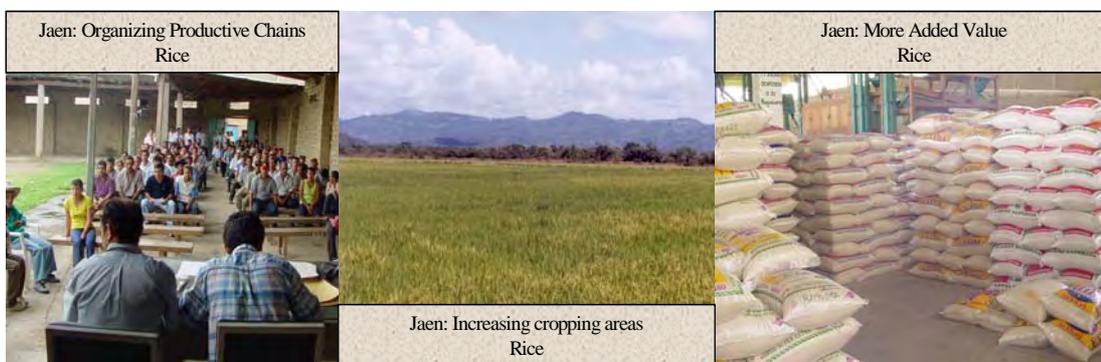
The portfolio of the Jaén ESC is composed of 10 products of which five (rice, *yacón*, coffee, fruit and yellow corn), account for 98% of the ESC’s sale performance. The Jaén ESC has 20 clients, of which 11 are businesses (Charts 2.16 and 2.17).





- Rice:* PRA’s initial support of the rice industry in the corridor (2002-2003) was centered on gaining access to the wholesale markets surrounding Lima to take advantage of the installed milling capacity of Agrosinor, a regional rice mill. In a second phase operation during 2004 the Jaen ESC supported the installation of a second rice mill (MoliSelva) and worked with both Agrosinor and MoliSelva to guarantee the supply of unhusked rice to the two mills. This effort resulted in both mills operating at capacity and selling 100% of their milled rice output.

Photo 2.7: Rice Production, Jaén ESC



- Yacón:* Yacón was introduced by the Jaen ESC in Bagua through the formation of a value chain composed of an association of producers (Association Virgen de la Asuncion del Espital), local collectors and a regional market wholesaler (Cerro Azul) and a final distributor (Caoca) in Lima and other cities, particularly for the supermarket chains of Santa Isabel and Plaza Vea.

PRA, through ESC Jaen, is continuing to explore markets for *yacón* particularly in its concentrated form as jam or honey. In this regard, PRA is presently working with Peruvian Heritage SAC, Agronaturales and Cabex. *Yacón* jam obtained through the concentration of filtered *yacón* juice has 50% less calories than honey from bees due to the high concentration of *oligofructanos* and *fructose*. The potential of *yacón* as a natural sweetener for diabetics is under

study and holds excellent prospects as an export crop. Currently, *yacón* generates six times the income per hectare compared with traditional crops such as yellow corn.

- *Coffee*: ESC Jaen's successful coffee initiative, known as *café mujer* (woman's coffee) was set back this year with the sale by PRODELSUR, the international coffee giant, of its local subsidiary. Nonetheless, the *café mujer* program produced excellent results and now continues, in modified form, through a PRA engineered alliance between the Bagua Grande Cooperative and Rainforest an NGO.

M2. Jaén Employment Performance - 747 new jobs were generated in the Jaen ESC during 2004. The substantial difference in employment performance between FY2003 and 2004 is explained, in large part, by the temporary reduction in employment caused by PRODELSUR'S sale of its Peruvian subsidiary and the consequent disruption in the Café Mujer program. We expect employment levels to recover during FY2005. Looking to the future *yacón* production is expected to expand to 180 hectares and generate an addition 94 full time jobs in the Jaen service area.

M3. Jaén Investment Performance - Although investment levels for the Jaén ESC total only \$30,000 for FY2004 (Table 2.6) we hasten to add that the ESC Jaen played an important role in bringing to closure the rice milling investment, discussed above, by MoliSelva. However, the level of PRA support to this initiative was not judged sufficient to integrate the value of the rice mill investment into PRA's reported investment results. Similarly, the new coffee mill (*beneficio*) presently being installed by Cooperative Bagua Grande in cooperation with the Rainforest Alliance has not been reported as it will become operative in 2005 with the investment results captured and presented in ESC Jaen's FY2005 investment results.

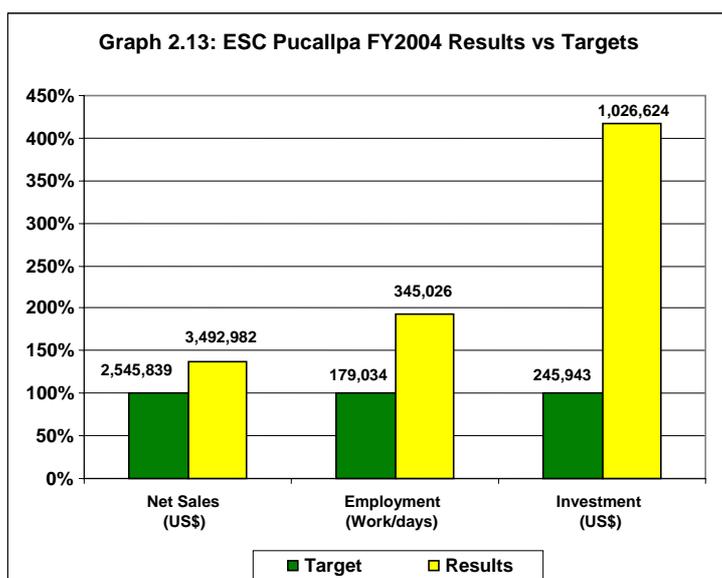
N. PUCALLPA ECONOMIC SERVICE CENTRES (ESC)

The Pucallpa economic corridor is located in the Department of Ucayali with a population of 464,399 inhabitants in 2004. Approximately 45% of the population lives in extreme poverty (Chart 2.1). The Pucallpa economic corridor includes both high and low tropical (*selva*) environment, which provides extensive opportunities for both sustainable forestry and agriculture.

In contrast with the Valle del Río Apurímac y Ene (VRAE) Region, where illicit *coca* production dominates the agriculture landscape, the Pucallpa economic corridor supports a relatively broad range of licit agriculture activity interspersed with illicit *coca* production. The dominate crops with sustainable development potential include bananas, cotton, African palm oil and yellow corn, to mention a few. With each of these crops and others, PRA, in conjunction with the PDAP, is working with a range of formal businesses and producers associations to develop value changes which offer a sustainable alternative to illicit *coca* cultivation.

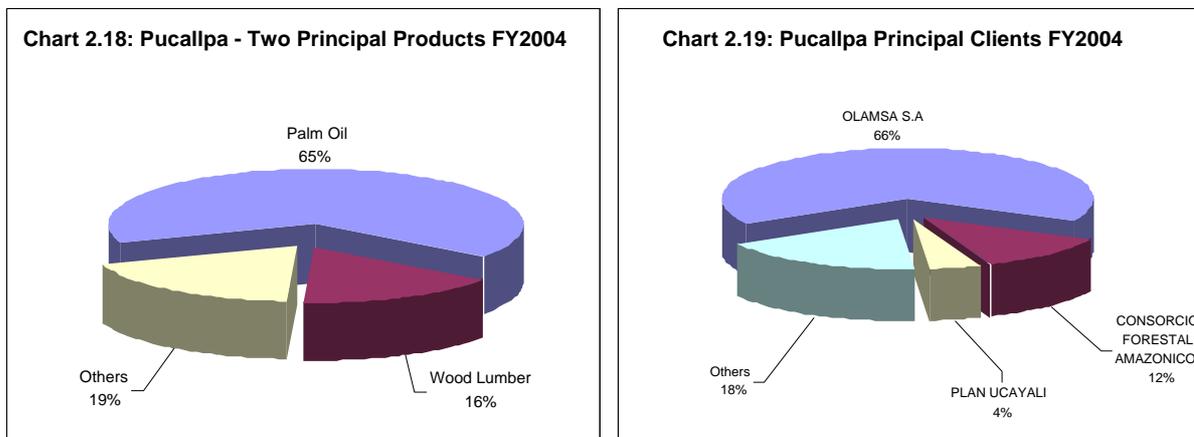
N1. Pucallpa Sales Performance - The Pucallpa Economic Service Center (ESC) has been working in Ucayali Department since 2001 with local and international businesses as well as producer association and has major programs underway focused on African palm oil, sustainable forestry, cotton and hard yellow corn.

In FY2004 the Pucallpa ESC surpassed its sales target by 34% with sales of \$3.5 million (Graph 2.13). Since its inception in 2000 the Pucallpa ESC has realized sales of \$6.8 million representing 124% of its cumulative PRA sales target through 2004.



The current portfolio of the Pucallpa ESC is concentrated around four enterprise activities: African palm oil (65%); forest products (16%); cotton (8%); and yellow corn (6%) which collectively accounted for 95% of FY2004 sales with a value of \$3.3 million (Chart 2.18).

PRA’s most important clients include Olamsa S.A, with FY2004 palm oil sales of \$2.3 million; Consorcio Forestal Amazonico with sustainable forest product sales of \$420,000; and Plan COPASO with \$150,000 in FY2004 cotton sales (Chart 2.19).



PRA Pucallpa's ESC work with three crops, presented below, illustrates PRA activities in the Pucallpa economic corridor:

- Forestry Products:** PRA's business strategy with respect to forest products is to work with forest concessionaires authorized and licensed by the Government and who have been certified to apply sustainable forest management practices in the operation of their respective concessions. PRA provides concessionaires with technical "know-how", drawing on Chemonics' extensive experience with forest concession management in Bolivia under the USAID financed BOLFOR Project. PRA's support centers on carrying out forest inventories employing satellites and the preparation of annual operating plans for timber extraction. ESC Pucallpa's principal clients are Consorcio Forestal Amazonico (U.S./Taiwán) and Alpi Rosa SAC (Peru).
- Cotton:** PRA has supported the development of the cotton industry in Ucayali since 2001 through several companies, notably ASFERA SAC., Cooperativa Agraria El Algodonero LTDA.; Plan Ucayali; and Ecomusa Señor de los Milagros in association with S&S Ingenieros.

The initial three years of PRA's support to the above cotton processing businesses permitted PRA to support the USAID voluntary *coca* eradication program (PDAP) by offering ex-cocaleros the opportunity to become cotton farmers and to organize these farmers into a strong producers association – Consorcio de Productores de Algodon de la Selva Oriental (COPASO). With PRA support COPASO formed a joint venture with the principal cotton gin, Plan Ucayali, to plant approximately 3,700Ha of cotton. In the context of the COPASO/Ucayali joint venture PRA assisted participating cotton farmers to secure credit to finance the cotton harvest and collection. Through this arrangement COPASO was able to negotiate better prices for its members' cotton as well as secure 50% of the cotton seed for subsequent processing into cotton seed oil. This PRA engineered business-producer alliance worked to the financial advantage of both the producer and the ginners of cotton. For FY2005 COPASO is presently strengthening its managerial capabilities and is working

with PRA to establish a credit line of S/600,000, which is offered by USAID through the Caja Rural Señor de Luren.

Photo 2.8: Hybrid Yellow Corn, Pucallpa-Ucayali ESCs



- *Hard Yellow Corn*: With respect to yellow corn ESC Pucallpa has applied its previous experience in developing recessional agriculture on the banks of Ucayali river to offer the opportunity to SEM Peru to implement a large scale commercial yellow corn program with participation of small and medium producers and with ex-cocaleros to produce and market hybrid yellow corn.

Working through SEM Peru, ESC Pucallpa promoted the development of two areas in 2004, in Neshuya/Curimana and on the riverbank of the Ucayali river. The results from the initial planting of 500 hectares of hybrid yellow corn has resulted in an average production of 7.5TM/Ha against the historical average of 2.4TM/Ha. The planting of hybrid yellow corn on a large scale has been made possible by PRA's earlier work to mobilize private financing by SEM Peru for the construction of a modern corn drying and processing facilities in Pucallpa.

The excellent results obtained through the initial planting of hybrid yellow corn on the banks of the Ucayali river has created an excellent opportunity to generate income and licit employment for ex-cocaleros. SEM Peru and PRA are presently working to greatly expand the hectarage of yellow corn in recessional agriculture along the banks of the Ucayali river during FY2005 and plan to have 9,000 Ha of yellow corn under cultivation by the end of the current USAID financed PRA contract.

N2. Pucallpa ESC employment performance - The ESC Pucallpa achieved 193% of its employment target for FY2004 having generated the equivalent of more than 1,700 permanent jobs. Since its inception, ESC Pucallpa has generated 247% of its cumulative employment target through September 2004, equivalent to 5,700 permanent jobs.

PRA related employment has been generated principally through the cotton industry, which includes the production and harvesting of the cotton crop, its collection and

ginning. This industry contributed 42% of the jobs generated as a result of PRA support in FY 2004. A second important source of employment has been the labor generated in the planting and processing of African palm oil, which constituted 39% of the employment generated through PRA in Pucallpa corridor during FY2004. A final important source of employment generation in the Pucallpa economic corridor has been yellow corn and wood products, each of which generated 5% of the full time employment attributable to PRA during FY2004.

During FY2005 SEM Peru plans to plant an additional 1,000 Ha of hybrid yellow corn, which when coupled with employment generated during the post harvest period will make yellow corn production and processing an important source of employment in the Pucallpa economic order. Of particular importance in the Pucallpa economic corridor is the licit employment generated in the alternative development areas. In this regard, employment generated with respect to cotton and bananas assumes special importance.

N3. Pucallpa Investment Performance - The Pucallpa ESC amply achieved its investment target by 288%. In this regard, the Pucallpa ESC booked the US\$1.0 million investment of SEM Peru in a yellow corn post harvest processing facility with modern drying, cleaning, classification and storage equipment.

Campesino corn farmers in Pucallpa can now increase in their productivity up to 30% as a result of the post harvest, yellow corn handling and processing facilities now available to them. To the average Campesino, this represents a saving of S/.300/Ha.

The business of producing and processing yellow corn, through recessional agriculture on the banks of the Ucayali river stands as an example of the type of private sector investment which can be made in the *sierra* and *selva*, including the *coca* producing areas and which yields a high return to both the lead investors and the participating campesinos.

O. PUNO ECONOMIC SERVICE CENTER(ESC)

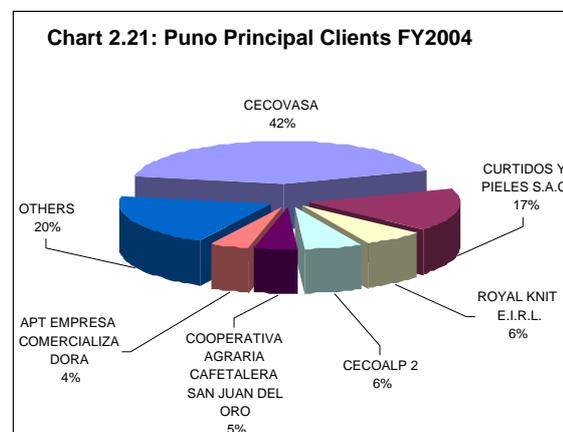
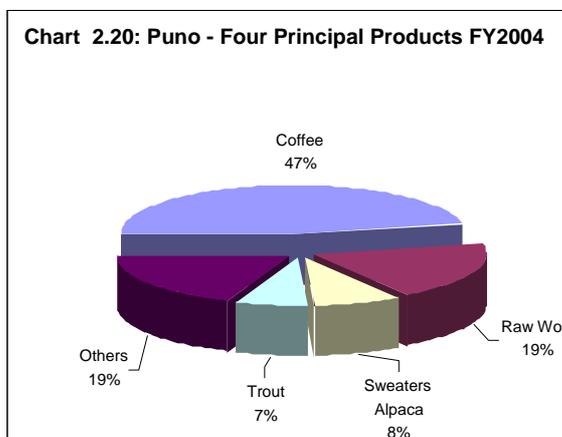
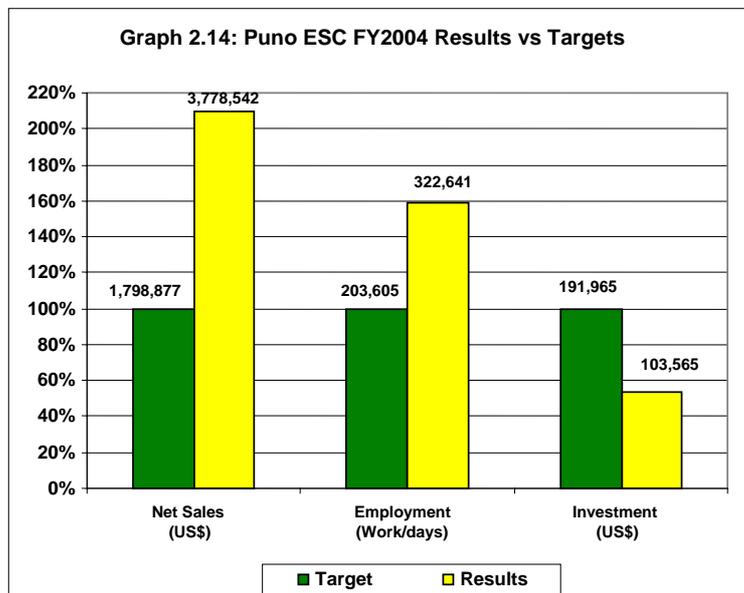
The Puno Economic Service Center is located in the Department of Puno and covers extensive areas of both *sierra* and *selva*. Approximately 520,000 persons (46%) of the population of 1.3 million live in extreme poverty. It is common for the poor to seasonally migrate from the *sierra* to the *selva*, particularly to the jungle areas of Sandia and San Gaban where *coca* is often planted and harvested.

O1. Puno Sales Performance - During FY2004 the Puno ESC surpassed its \$1.8 million sales target by 210% with sales of \$3.78 million (Graph 2.14). Since its inception in FY2000, the Puno ESC has realized sales of US\$6.14 million, representing 106% of its cumulative sales target through FY2004. During FY2004 a good part of the coffee campaign took place in the Inambari and Tambopata (Sandia Province) Valleys despite the presence of *coca* growers and drug dealers.

The portfolio of the Puno ESC is composed of 12 products with coffee and wool the most important, accounting for 66% for sales in FY2004, valued at \$2.48 million (Chart 2.20). The Puno ESC presently serves 21 clients, the most important of which are: Cecovasa, Curtidos, Pieles SAC and Royal Knit, which contributed 65% of Puno sales during FY2004.

Puno ESC FY2004 sales are discussed below in terms of their relative contribution to ESC sales results:

- *Coffee*: Working with two cooperatives in the *selva*, Cecovasa and San Juan del Oro, Puno ESC sales related to coffee reached \$1.76 million in FY2004.



Cecovasa. PRA support for Cecovasa has helped to expand the areas producing certified organic coffee, from 755 hectares in 2002, which benefited 18% of Cecovasa's members to 2,810 hectares in 2004, reaching 37% of Cecovasa membership. Due, in part, to PRA's technical assistance, average productivity has increased from 10 Quintals/Ha in 2002 to 15 Quintal/Ha in 2004. Additionally, the Puno ESC has assisted Cecovasa to significantly increase their coffee sales to Starbucks (8 containers to 30) and to Equal Exchange by 10%. Cecovasa's presence in fair market activities has increased from 16% in 2002 to 40% in 2003.

When the Puno ESC initiated its work with the SJL Cooperative in 2004, SJL had 864 hectares of coffee certified with 480 members. At the onset of the 2005 seasonal campaign an additional 130 hectares had been certified and 40 new members had joined the cooperative. Presently, SJL is certified by Naturland, NOP-USDA and Bird Friendly. During FY2004, PRA introduced SJL to two new buyers, ATEXA, which purchased 50% of SJL production and Equal Exchange, which is presently negotiating its working relationship with SJL.

- *Wool:* ESC Puno's sales of wool during FY2004 reached \$720,000 through two clients, Curtipiel and Ascrigar.

Curtipiel. Since starting to work with the Puno ESC 19 months ago Curtipiel has captured 15% of the wool market in Puno. As a result of this competition with traditional buyers wool prices have increased over the past two years from S/0.5 c/lb to approximately S/.2.5 c/lb. The impact of rising wool prices has encouraged producers to improve the quality of their flocks. In response, ESC Puno, in association with CARE, has launched a program to genetically upgrade flocks and improve classification and sheep shearing practices.

- *Trout:* Trout sales reached \$250,000 in Puno during FY2004 and Piscifactoría Los Andes joined existing trout production and processing companies (ARAPA, APT, RIVER FISH), giving further impetus to this dynamic and growing industry. With the presence of Piscifactoría Los Andes Puno trout producers have a further and important link to international markets, as well as access to essential technologies including the importation of high quality fertilized trout eggs, the introduction of floating cages and increasing pressure to adhere to quality control regulations in all aspects of the trout production and marketing process.

Photo 2.9: Trout farm, Puno ESC



The presence of these companies, enhanced now with the arrival of Piscifactoría Los Andes, has served to encourage the emergence of important complimentary services such as transportation, freezing, and equipment maintenance services. A “trout development” cluster is beginning to emerge in Puno on the shores of lake Titicaca. Incremental trout sales for FY2005 are estimated to increase to \$700,000 and to \$1.20 million in FY2006.

02. Puno ESC Employment Performance - In FY2004 the Puno ESC generated the equivalent of 1,613 fulltime jobs, exceeding by 58% its annual employment target (Graph 2.14). Job creation was dominated by the coffee sector, generating 1,202 fulltime jobs, 37% of which were filled by women. Other ESC business initiatives generating jobs were found in textiles with 10% (160 jobs) and wool with 4.8% of the annual ESC employment target (79 permanent jobs).

Since the Puno ESC was established in FY2000 it has largely met its employment targets creating approximately 2,682 permanent jobs through FY2004. These results are very important since more than 46% of the population lives in extreme poverty, earning approximately S/. 10 per day.

03. Puno ESC Investment Performance - Private, ESC related investment in Puno achieved only 54% of the established target for the year, equivalent to \$100,000 by River Fish SAC. In this poor region, with the presence of illegal *coca* and intense trade in contraband, the presence of legitimate businesses and employers such as River Fish and Piscifactoría Los Andes, with approximately \$500,000 in projected direct sales for 2005, is very important to the regional economy and the reduction of poverty.

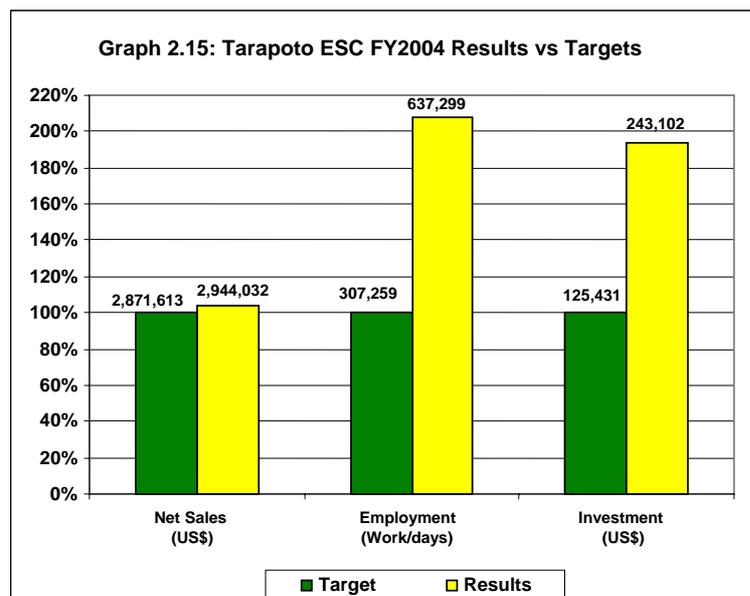
P. TARAPOTO ECONOMIC SERVICE CENTER (ESC)

The Tarapoto Economic Service Center (ESC) serves mainly the Department of San Martín as well as parts of the Department of Loreto. In FY2004 San Martín had a population of 778,000, of which approximately 36% live in extreme poverty. The population of Loreto was 931,444, of which approximately 47% live in extreme poverty. Tarapoto, where the PRA ESC is located, serves as a center for integrating commercial activities.

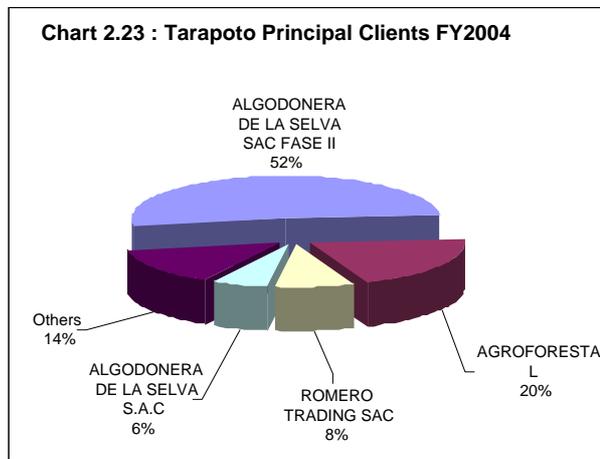
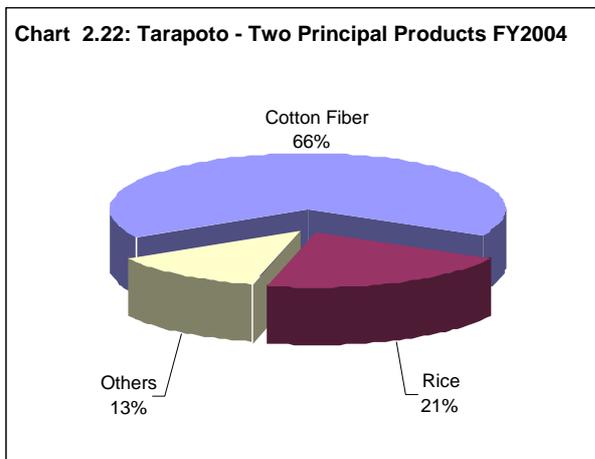
As a result, businesses supported by PRA have effectively reached out to adjacent Alternative Development (AD) areas and have made important contributions, creating sustainable employment for ex-cocaleros. \$1.7 million of ESC Tarapoto FY2004 sales, representing 57% of the Tarapoto sales results, were realized in AD zones of San Martin. These contributions were made through a varied portfolio including: cotton, rice, coffee, hard yellow corn, horticulture crops, beans and others. In FY2004 cotton made a special contribution in the Alternative Development areas and production has expanded rapidly. A new, privately financed cotton gin came into operation in Juanjui during FY2004.

Among others, two businesses hold potential for offering large-scale employment alternatives to *coca* production in the *coca* producing regions of the *selva*. African palm oil, 7500 hectares of which is presently cultivated in Tocache by *Palma del Espino*, has the potential for large scale, profitable expansion to *coca* producing communities in the Tocache-Uchiza area. Similar possibilities exist for the production of sugar cane to ethanol. Coler & Colantonio (C&C), a USA-based environmental and energy firm, is presently growing-out a sugar cane seedbed of 72 hectares, for future commercial production of sugar cane for the production of ethanol. The potential, at a minimum, is 2,000 hectares to feed the ethanol requirements of C&C for sugar cane so they can meet their ethanol product requirement to Iquitos under contract to Petro-Peru. The bottleneck to large-scale commercialization of these and other crops in the *selva* is the absence of private sector equity investment and the reluctance of the commercial banking sector to provide the debt financing necessary for both of these crops and many others. Risk aversion to almost any type of investment in the *selva* by the Peruvian private sector is universal and almost absolute. Until such time as private sector investment and associated entrepreneurial talent move to the *selva*, it is our judgment that *coca* production will remain a viable economic alternative.

P1. Tarapoto Sales Performance - The Tarapoto ESC achieved 104% of its FY2004 goal with sales valued at \$3.0 million (Graph 2.15). Since its entrance into the PRA program in FY2000 Tarapoto has generated \$5.1 million in incremental sales through 2004 for its clients.



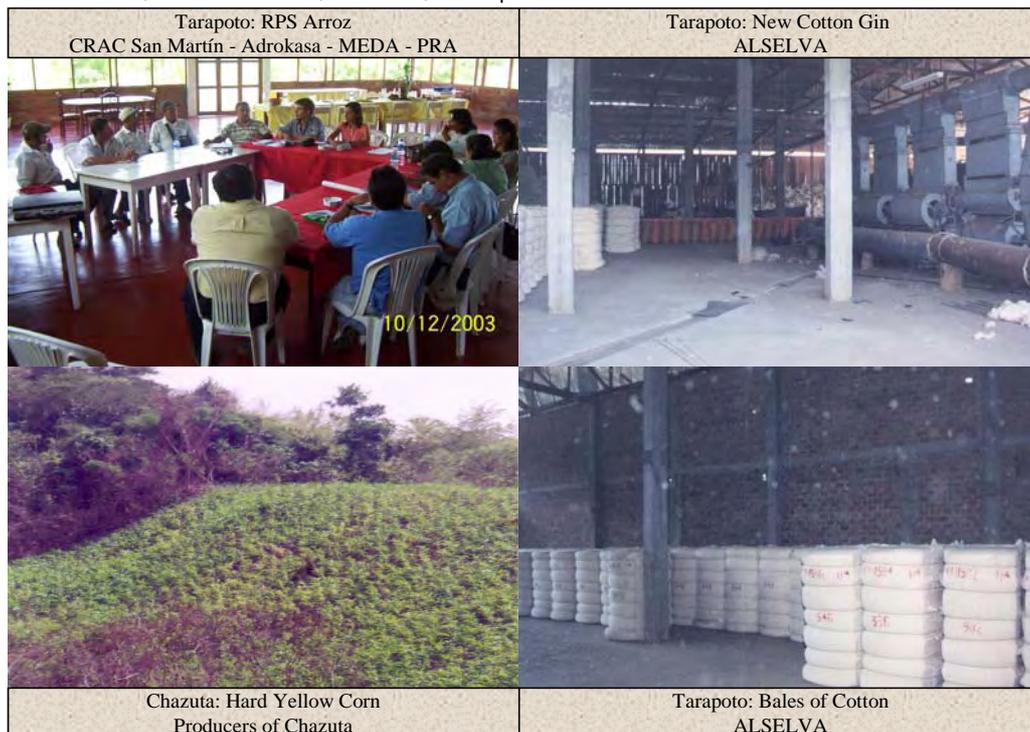
The business portfolio of the Tarapoto ESC is composed of eight products (Chart 2.22), of which two products (cotton fiber and rice) are responsible for 87% of the sales results for FY2004.



- Cotton:* The strong demand for cotton in the United States (and the favorable trade regime created by the APTDEA) and in Japan has been behind the resurgence of the cotton industry in San Martín. The principal clients of Tarapoto ESC, are: Romero Trading SAC; Algodonera de la Selva SAC; and Amazon Cotton. The Tarapoto ESC has supported this cotton initiative through field trails of new seed varieties and the demonstration of productivity enhancing cultivation techniques, and through the introduction of new warehousing and storage practices to help moderate price fluctuations.

In FY2005 the Tarapoto ESC will promote the commercial sowing of improved cotton seed INIA-801-BJA-594 to increase productivity.

Photo 2.10: Rice, Yellow Corn, Cotton, Tarapoto ESC



- *Rice:* Rice is the second most important contributor to Tarapoto ESC results, generating 21% of FY2004 sales. ESC Tarapoto's principal achievement has been the creation and testing of a new credit program where input suppliers have channeled funds to trusts "accounts" for onward lending, on a non-collateralized basis and has coupled this loan program with a USAID sponsored DCA loss guarantee program. This program, known as the *Red Productiva Sindicada (RPS)*, has decreased the risks of lenders and has facilitated access to formal credit by poor campesinos, many of whom are ex-cocaleros.

P2. Tarapoto Employment Performance - The Tarapoto ESC generated the equivalent to 3,186 new fulltime jobs during FY2004, more than twice its annual target. These employment opportunities were generated largely in cotton and hard yellow corn (MAD). Twenty eight (28%) of the permanent jobs generated by Tarapoto ESC were drawn from the female workforce (904 permanent jobs).

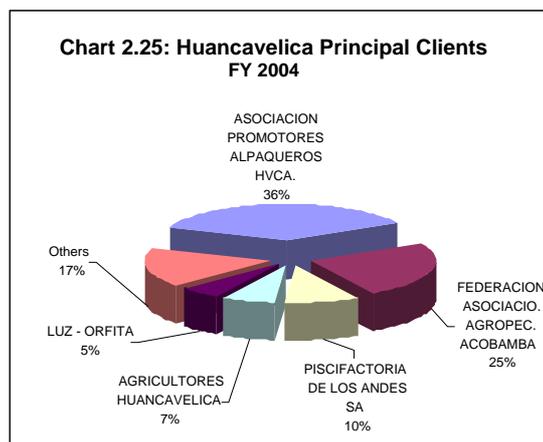
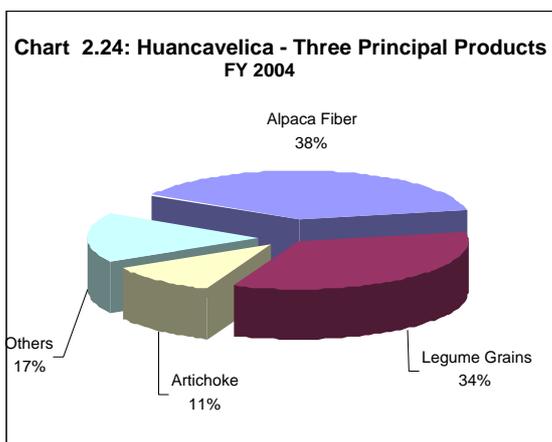
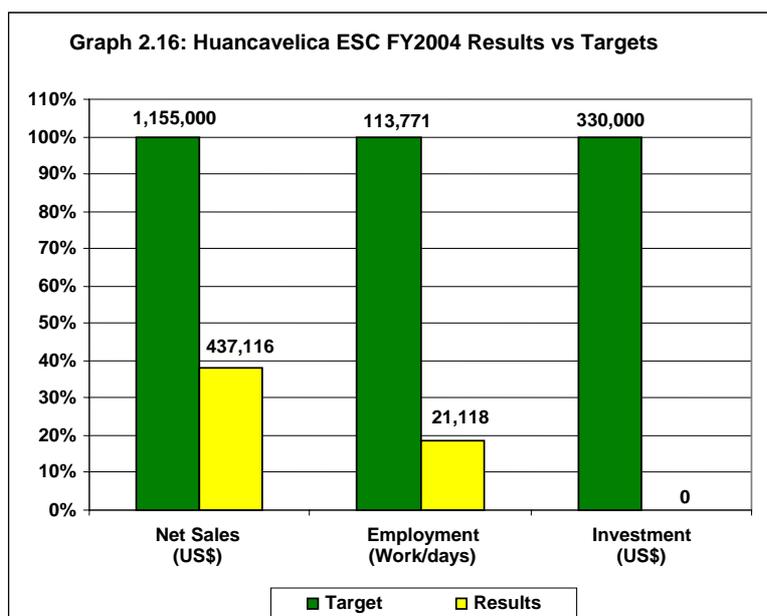
P3. Tarapoto Investment Performance - The Tarapoto ESC exceeded its investment target by almost 100% , representing an investment of approximately \$200,000, principally in cotton ginning facilities by *Algodonera de la Selva* in Juanjui and the installation of renovated ginning equipment by Romero Trading.

Q. HUANCVELICA ECONOMIC SERVICE CENTER (ESC)

Seventy-four percent (74%) of Huancavelica's population of 450,000 lives at or below the defined level of extreme poverty, marking Huancavelica as Peru's poorest department. Huancavelica has been sustained by the silver production of Minas Buenaventura until recent years. However, the mine is nearing the end of its profitable and useful life. In an effort to mitigate the negative impact on Huancavelica's population resulting from the inevitable closure of the mine, Minas Buenaventura proposed to USAID the creation of a PRA Economic Service Center in Huancavelica, financed by Minas Buenaventura and managed by USAID's prime contractor for the PRA Project, Chemonics International. In May 2002, a Memorandum of Agreement was signed between Minas Buenaventura and USAID creating one of USAID's largest Global Development Alliances (GDA) and offering an important new institution, the PRA Huancavelica Economic Service Center (ESC), to advocate and advance development in Huancavelica. The main enterprises developed by the Huancavelica ESC to date center on alpaca and vicuña fiber marketing, trout and artichoke production, textiles and beans.

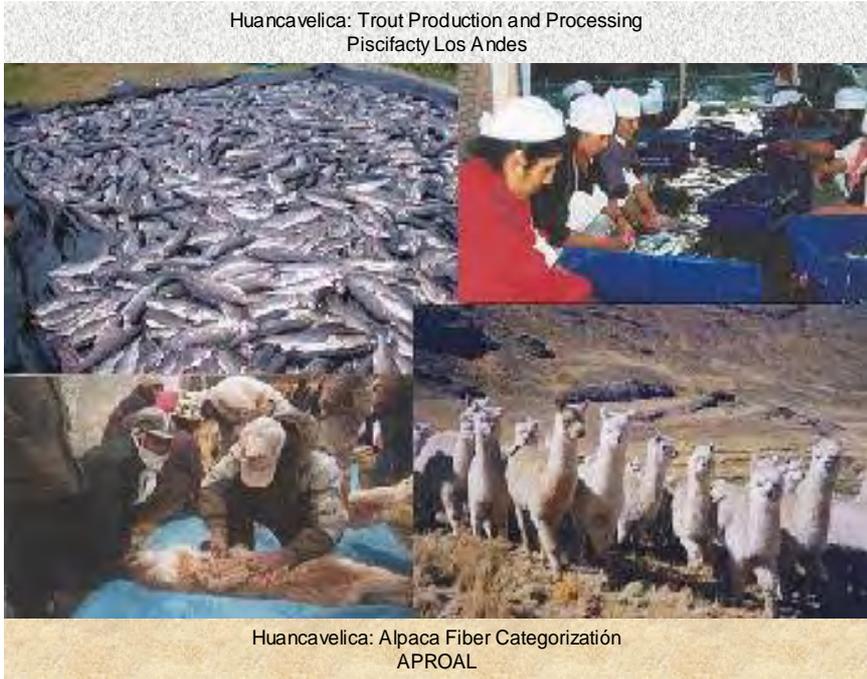
Q1. Huancavelica Sales Performance - During FY2004 the Huancavelica ESC achieved 38% of its \$1.2 million annual sales target with sales of \$440,000 (Graph 2.16). Cumulative sales since its inception in 2002 stand at \$530,000, 83% of which was generated during FY2004. For practical purposes the PRA Huancavelica ESC actually began to effectively function only during FY2004.

The portfolio of the Huancavelica ESC is concentrated around alpaca and vicuña fiber marketing through the Asociación Promotores Alpaqueros de Huancavelica y El Comité de Criadores de Camélidos Silvestres de Huancavelica - Vicuñeros, and beans (legume grains) through the Federación de Asociaciones Productoras Agropecuarias de Acobamba. These two products collectively accounted for 72% of FY2004 sales (Charts 2.24 and 2.25).



- Alpaca Fiber:* This business being developed together with the Asociación de Promotores Alpaqueros (APROAL) is centered primarily on the introduction of alpaca fiber grading to differentiate various grades of alpaca fiber and through this differentiation increase the final sales price to APROAL herders. Additional business activity supported by the ESC includes shearing and warehousing. Clients for APROAL fiber, mainly located in Arequipa and Lima are: Incatops, Fibrandina and Artesanía Lanera Andina. Sales projections for 2005 are \$190,000.
- Trout:* Trout farming in Huancavelica represents a business with great potential and a bright future. In conjunction with the municipalities of Lircay and Acoria PRA arranged to concession existing municipal fish ponds to Piscifactoría De los Andes, Peru’s leader in aquaculture and the main exporter of trout from Peru. Following the success of the Lircay concession process PRA is presently assisting new clients, such as the municipalities of Acoria and Sumac Challua, to concession their existing trout production facilities to the private sector. In addition to providing leadership for the concession process PRA has also provided technical assistance in all phases of trout production and commercialization from sowing to quality control. Sales projections for FY2005 are \$200,000.

Photo 2.11: Trout and Alpaca, Huancavelica ESC



Q2. Huancavelica Employment Performance - During FY2004, the Huancavelica ESC achieved only 19% of its annual employment target, creating since its inception 125 permanent jobs. This poor performance was, in fact, the result of operational differences between the PRA operator selected by Minas Buenaventuras and the PRA project itself, which consciously operates to select businesses for support that have demonstrable market potential. This operating/management conflict has been overcome, we believe, and FY2005 should be a year for rapid growth in both sales and employment..

Q3. Huancavelica Investment Performance - The Huancavelica ESC has only recently begun to generate investment in the corridor. Of particular importance this year was PRA’s structuring of a \$500,000 investment in trout production in Lake Choclocha by Piscifactoria de Los Andes, backed by medium-term loan financing from Minas Buenaventura. Following the Piscifactoria de Los Andes example River Fish SAC is also considering a substantial investment in trout culture as well during FY2005.

SECTION III

PRA Activities in Alternative Development Areas

The PRA Project began in 1999 with the objective of contributing to the reduction of poverty through the generation of sustainable jobs and incomes by mobilizing private investment in ten economic corridors throughout Peru.

In 2003, the U.S. Agency for International Development (USAID/Peru), along with the government of Peru through DEVIDA, launched the Alternative Development Program, which advanced a “Common Agenda for Development” among regional and local governments. This common agenda sought to promote integral development in various zones in the interior of the country to help these areas escape poverty and underdevelopment. The common agenda required the creation of a climate of security that would facilitate private investment in these areas. Central to the common agenda was a component program to eliminate illegal *coca* production on a voluntary and gradual basis. To accomplish this, an integral development strategy was designed, focusing on the following seven *coca*-producing departments – Ucayali, San Martín, Huanuco, Ayacucho, Junín, Pasco, and Cusco.

Using its own demand-driven and private sector-led methodology, PRA was to contribute to this strategy by generating alternative employment in these areas and establishing competitive businesses that contribute to local development and attract private investment. In June 2003 PRA opened satellite offices in the principal *coca* producing valleys in order to promote businesses among communities that had signed eradication agreements. New offices were opened in Aguaytía and the Valle del Río Apurímac y Ene (VRAE), and operations were strengthened in Tocache and Tingo María.

USAID’s *Proyecto de Desarrollo Alternativo Participativo* (PDAP), also managed by Chemonics, was charged with implementing the integral development strategy which was to include productive projects to guarantee the long-term economic viability of those communities that voluntarily eradicated illegal *coca*. Within this integral development strategy, PRA’s market-driven approach and private sector focus was to be adapted and put into practice in alternative development zones in order to promote sustainable, licit economic activities. The fact that both projects were managed by the same firm should facilitate the efficient implementation of the Mission’s Alternative Development strategy and, as a result, help convince *coca* producers to abandon illicit crop production.

Between April 2003 and September 2004, PRA and PDAP worked closely and successfully together in the four *coca* valleys. Together the two projects achieved unprecedented success in Aguaytía, which included: the voluntary reduction of 4,000 hectares of *coca* (in addition to 1,500 hectares eradicated under the previous Pilot Program); the establishment and consolidation of eight value chains involving 15 large buyers and affecting 4,280 *ex-cocalera* families; and new investment of \$2.6 million to develop and maintain 4,871 hectares of licit crops, financed within the framework of the voluntary eradication agreements. The prospect of new, licit businesses in this area is promising and serves as a model that can be replicated in the other *coca* valleys.

An important factor in the success of this experience was PRA's ability to adapt its programmatic focus to the conditions and requirements of the *coca* zones. This was possible because PRA's management structure allowed for rapid decision-making consistent with PRA's methodology: the facilitation and promotion of businesses through market contacts and technical assistance to organize supply according to the quality, volume, and timing required by the buyer.

A. Adapting PRA's market focus to alternative development zones: reduce transaction costs, develop markets, and attract private investment

Before the voluntary eradication strategy, only 6% of PRA's sales results were obtained in the four *coca* valleys. This illustrated the difficulty in developing formal businesses in these areas due to the presence of drug trafficking and the insecurity associated with it. By design, PRA was able to select with whom and where it worked. Obviously, to achieve results in the short-term PRA chose areas and businesses with the greatest potential and competitive and comparative advantages.

By contrast, PDAP's mandate required it to work in areas with a high presence of illegal *coca* and all of the problems associated with it. This insecurity drives away private investors and legitimate businesses. The perceived risk for private investors is extremely high in these areas. Without a serious program to generate and sustain the confidence of private investors in *coca* zones, only very highly profitable activities will entice risk-averse investors to these areas.

The valleys of VRAE, Tingo Maria-Tocache, and Aguaytía possess excellent soil and climate conditions for forestry and agricultural crops with excellent market potential. High transaction costs related to poor infrastructure and the presence of drug trafficking has prevented private investors from capitalizing on the agricultural and business potential of these regions. Clearly, the absence of private business and investment in these areas is not due to a lack of potential or resources, but to a lack of developed markets. High transaction costs generated by illegal *coca* activity and high transportation costs have driven away licit, formal businesses – producers, buyers, investors – from these areas. The lack of infrastructure and communication in these areas contribute to the high transaction costs that lead to failures of the market.

The Grupo Romero's *Palma del Espino* business in Tocache is evidence that the presence of entrepreneurship can change the reality in *coca* growing zones. Despite a decade of terrorism and poor transportation infrastructure, *Palma del Espino* capitalized on the excellent conditions and resources in the area and developed a prosperous business. Today, *Palma del Espino* manages and processes more than 7,500 hectares of African palm and directly employs more than 1,300 people on a full-time basis. Twenty-five years ago, Santa Lucía was the capital of *coca* in Tocache. Today it forms the economic and employment heart of the Tocache economy.

The voluntary eradication strategy should be seen as an opportunity to create the conditions for development based on markets and private initiative. To accomplish this, we should apply the strategy of economic corridors to *coca* growing regions. The voluntary eradication strategy simultaneously attacks two problems central to the high transaction costs in these areas. Reducing or eliminating the *coca* crops takes away the fuel that sustains the illegal *coca* trade, thereby reducing the presence of

narcotraffickers and the principal cause of the high transaction costs. By assuming a portion of the start-up costs for new licit economic activities through incentive payments to communities, PDAP sets the stage for future private investment.

While these *coca* growing areas were not attractive to PRA at first, the voluntary eradication strategy has boosted their potential for generating sales, jobs, and investment. Eliminating problems of insecurity and reducing transaction costs creates opportunities for expanding sales, facilitating investment, and creating new jobs in these areas that were previously considered outside the “realm” of the legitimate business environment.

B. Results during FY 2004

During part of FY 2003 and through June 2004, the PRA Project was responsible for technical assistance and business promotion in the communities that signed eradication agreements. In April 2004 a new PDAP Economic Service Center (ESC) was formed, becoming the 12th ESC under PRA’s technical direction. The results reported here, therefore, were achieved through the joint effort of both the PRA and PDAP projects during the last fiscal year.

B1. Results related to voluntary eradication agreements: 20,000 hectares of new crops and maintenance of existing crops

During FY 2004, the PRA and PDAP projects worked together to carry out the productive side of the voluntary eradication agreements signed between communities and DEVIDA. In FY2004, USAID, through PDAP, committed approximately US\$8.77 million to develop 14,232 hectares of new crops and to maintain and renovate an additional 6,576 hectares. These crops were grouped into ten productive chains, which will contribute approximately US\$38.8 million in new sales to the zone’s economy over the next three years, as shown in Table 3.1 below.

Through June 2004, PRA Economic Service Center subcontractors were responsible to PDAP for organizing all technical assistance (logistics, extension strategy, etc) needed to ensure that the seeds, inputs, workdays, etc., were used to develop and maintain these 20,000 hectares under the voluntary eradication agreements. This objective was achieved, a considerable success given the short timeframe, distance, and limited technical ability of many of the participating communities in some areas.

Table 3.1: Productive Chains Promoted by PRA and PDAP in AD Zones

PROJECTS	TOTAL HECTARES				PROJECTED SALES BY 2007 (SOLES)	%
	NEW CROPS	MAINTENANCE	RENOVATION	TOTAL		
PLANTAIN	439	300	0	739	26,061,200	19%
PINEAPPLE	12	40	0	52	13,698,000	10%
CACAO	6,418	2,613	1,273	10,304	44,281,600	33%
COTTON	4,370	0	0	4,370	11,799,000	9%
MAÍZ AMARILLO DURO	1,719	0	0	1,719	9,215,640	7%
COFFEE	325	1,669	603	2,597	18,454,530	14%
CAMU CAMU	0	78	0	78	1,060,800	1%
PAPAYA	34	0	0	34	856,800	1%
CITRUS	144	0	0	144	0	0%
PEANUTS	771	0	0	771	10,362,240	8%
TOTAL	14,232	4,700	1,876	20,807	135,789,818	100%
TOTAL US \$					38,797,091	

B2. Results related to the growth of licit businesses in Alternative Development areas: Cumulative sales of licit businesses in Alternative Development zones grew 79% during FY2004

At the end of FY 2003, cumulative sales in priority alternative development districts reached US\$4.5 million, representing only 8% of total PRA project sales. By the end of FY2004 these sales reached US\$8.1 million, representing nearly 12% of total PRA sales (Table 3.2 below). Cumulative sales have grown 79% in the last year due to greater emphasis by PRA and PDAP on promoting licit businesses in these areas.

In addition, PRA sales in the rest of the alternative development departments (excluding the priority AD districts) increased US\$11.2 million, with a total of US\$26.0 million in sales for the year. This represents growth of 75% in annual sales. (Note that sales in priority AD districts grew slightly more.)

Table 3.2: Indicators of Growth of Licit Businesses in AD Zones

CUMULATIVE SALES IN US\$ THROUGH SEPTEMBER 2004 BY REGION				
	DEPARTMENT	PRIORITY A.D. DISTRICTS	REST OF DEPARTMENT	TOTAL
A.D. DEPARTMENTS	JUNIN	165,078	8,414,187	8,579,264
	UCAYALI	1,457,596	4,857,751	6,315,347
	CUSCO	275,792	5,668,810	5,944,601
	SAN MARTIN	3,040,809	2,062,913	5,103,722
	HUANUCO	2,055,621	1,700,549	3,756,170
	AYACUCHO	1,118,677	1,860,630	2,979,307
	PASCO		1,521,668	1,521,668
		TOTAL SALES (US\$)	8,113,572	26,086,507

The sustained development of businesses in areas adjacent to Alternative Development zones is very important for the sustainability of *coca* eradication. Research demonstrates that *campesino* families, due to their limited assets, obtain more than 50% of their household income by working as laborers outside of their own farms. Given this reality, a strong surrounding economy is the perfect complement to a sustainable *coca* eradication strategy that seeks to improve licit incomes for families that sign voluntary eradication agreements. In addition to improving incomes for *campesinos* working their own farms, it is important to improve employment opportunities outside of their own farms.

B3. Business chains established in Alternative Development zones through joint effort by PRA and PDAP

The most important institutional change introduced by PRA during FY2004 was the formation of productive chains in *coca* valleys and the connection of producer groups with specific, private buyers.

In Aguaytía there are seven productive chains currently functioning, formally linking buyers and producer associations. In some case buyers/traders are directly providing production inputs to their cooperating producer associations. Two productive chains and their associated businesses merit special mention for their achievements – cotton and bananas.

In the Valle del Río Apurímac y el Ene (VRAE) PRA is working principally with three chains – cacao, coffee, and peanuts. Together these crops assisted by PRA cover 6,730

hectares, including 1,843 hectares of new crops and the maintenance of 4,887 hectares of existing crops. It should be pointed out that the peanut production, which began with 271 hectares (identified by PRA and financed by PDAP) in August 2003 yielded more than 300 metric tons in November 2003, all of which was sold. A second crop was planted in January 2004 with PRA assistance covering 460 hectares, financed entirely with private investment by the producers themselves and with credit from the firm Quimica Suiza, which was convinced of the viability of the business of these *ex-cocaleros*.

In Tingo María most PDAP investment has gone into cultivating new lands with crops such as cacao, with 1,401 hectares under production. In addition, three new chains are emerging around the zone's important supply of cacao and coffee. In the department of San Martín, PRA is working in three areas (Tocache-Nuvo Progreso-Uciza, Huicungo-Pachiza-Juanjuí, and Chazuta) to develop three productive chains focused on coffee, cacao, and yellow corn.

Table 3.3 below shows the existing chains, identifying both producers associations and buyers.

B4. Description of businesses established in alternative development zones

Aguaytía

- *Bananas* -The commercialization of bananas in Aguaytía affects the majority of the population, since Aguaytía is known as a banana producer *par excellence* with recognized comparative advantages.

The principal obstacles, aside from lack of market contacts and developed markets, were a lack of supply organization and a lack of coordination among producer groups.

First, PRA helped to establish market contacts with the supermarket chains Santa Isabel, Plaza Vea, and Mini Sol, each owned by Grupo AHOLD. PRA also made market contacts with Patt Fresh, supplier to supermarket chains Wong and Metro, as well as other secondary markets. At the same time, the project made contact with Frito Lay and turned its attention to the benefits of Aguaytía.

With important buyers lined up, the next challenge was the organization of supply. The market requires centralized supply. In response, the producers, with PRA assistance, formed the Consortium of Plátano Producers of Ucayali (COPPU), made up of six base organizations.

COPPU represents the producers and is able to negotiate prices for its members. The producers have adopted agricultural techniques to better manage their plantations, and are now producing high quality bananas according to market requirements and meeting demand for fresh bananas from Lima's various supermarket chains. In addition, with PRA support COPPU has developed a strong market relationship with Frito Lay, with weekly orders of 90,000 bananas for processing as *chifles* snack chips.

Table 3.3: Productive Chains in AD Zones

ZONE / PRODUCT	PROVIDER ORGANIZATION	ANNUAL SUPPLY	BUYERS
AGUAYTIA			
PLANTAINS	Consorcio de Productores de Plátano de Ucayali	1200 tons	Santa Isabel and Plaza Vea Supermarkets, Patt Fresh, Frito Lay
PINEAPPLE	Asociación de Productores Piñeros de Shambillo	300 tons	Agrícola Italia
CACAO	Asociación de Productores Cacaoteros de Padre Abad	200 tons	Machu Pichu SAC; Jungle and Mountain Exports;
COTTON	Consorcio de Productores de Algodón Selva Oriental	2,450 tons	Plan Ucayali, ACUDE, Jungle Cotton Company, S&C Engineers
MAÍZ AMARILO DURO	Comité Flor del Valle	1,500 tons	Halley SAC
COFFEE	Asociación de Productores Cafetaleros La Divisoria	1,280 quintals	Volcafé Group-Prodelsur
CAMU CAMU	Asociación de Productores de Camu Camu de Aguaytía		Peru Amazon - H. Yamakawa
VRAE			
CACAO	Asociación de Productores Agropecuarios La Esperanza; Asociación de Productores Agropecuarios Unión del Valle; ONG Primavera; Asociación de Productores Agropecuarios Valle Esmeralda; Asociación Carlos Cantella de Sivia; APM	2,000 tons	MachuPichu SAC
PEANUTS	Asociación de Productores Agropecuarios Unión del Valle	1,000 tons	Mayoristas, Brocos
COFFEE (Conventional)	Asociación Carlos Cantella de Sivia; Asociación de Productores Sierra y Selva del VRA; Cooperativa Agraria cafetalera del valle del río Apurímac y Ene; Asociación de Servicio Múltiple Nuevo Progreso; Asociación de Productores Agropecuarios Zonal Rosario	30,000 quintals	Apurímac River Valley Coffee Cooperative; El Quincho Coffee Cooperative; Volcafé-Prodelsur
ORGANIC COFFEE	Asociación Carlos Cantella de Sivia; Asociación de Productores Sierra y Selva del VRA; Cooperativa Agraria cafetalera del valle del río Apurímac y Ene; Asociación de Servicio Múltiple Nuevo Progreso; Asociación de Productores Agropecuarios Zonal Rosario	700 tons	Volcafé-Prodelsur
TINGO MARIA			
CACAO	Asociación de Productores Hermilio Valdizán ; Asociación Agraria de Aucayacu; Asociación de Agricultores ganaderos y Forestales del caserío de Nuevo San Martín;	800 tons	MachuPichu SAC; Mountain and Jungle Exports
COFFEE (conventional and organic)	Asociación de Productores Hermilio Valdizán; Cooperativa Agraria Cafetalera La Divisoria	18,116 quintals	Villa High Land Coffee; Volcafé-Prodelsur
PAPAYA AND PLANTAINS	Asociación de Productores Hermilio Valdizán; Empresa Agroforestal Pendencia SRL	720 tons 1200 tons	Patt Fresh; Mayoristas
TOCACHE-CHAZUTA			
CACAO	Asociación de Productores Agropecuarios Protectores del medio Ambiente e Industriales Pachiza; Asociación Central de Productores Agropecuarios de la Microcuenca del Valle del Bajo Huallaga; Cooperativa Industrial Tocache	2,000 tons	MachuPichu SAC; Mountain and Jungle Exports
MAÍZ AMARILLO DURO	Asociación Central de Productores Agropecuarios de la Microcuenca del Valle del Bajo Huallaga;	1,800 tons	Agrícola Don Pollo; Agrícola San Fernando
COFFEE (conventional and organic)	Asociación de Familias Productoras de Café	2,800 quintals	Coinca-Perú Café

COPPU has forged strategic alliances with several buyers and has in effect shortened the production chain. Through efficient agricultural and business management, commercial relationships, and logistics to transport perishable products from Aguaytía to Lima, COPPU has been able to eliminate the middle man and bring the producers closer to the final market.

The banana producers of Aguaytía have presented a proposal to the *Caja Señor de Luren* for a \$140,000 loan to develop 1,500 additional hectares of bananas with the use of new technology. The loan will be guaranteed by the sale of the bananas produced on these new hectares, and will serve as a model for other producers interested in increasing their production.

PRA's intervention to help COPPU marketing the region's traditional crop has been received positively. For the first time, these banana producers have been able to enter important markets that were previously not available to them. The involvement of formal, concrete private buyers has been key to establishing PRA's credibility in the area.

- Cotton*- With PRA's intervention, five producer associations in Aguaytía merged to form the *Consorcio de Productores de Algodón Selva Oriental* (COPASO). The involvement of the private sector has been important in developing this nascent cotton business. COPASO formed an important strategic alliance with the cotton processing firm Plan UCAYALI SAC, with very favourable terms for the COPASO producers. In addition, COPASO is now supplying cotton to the firm ACUDE SAC. COPASO has received a loan of \$76,000 from ACUDE SAC and \$180,000 from the *Caja Rural Señor de Luren* to finance their operation, which is expected to broker the sale of 1.5 million kg of cotton wool. ACUDE is interested in opening a cotton gin in the area, with a view to establishing a cotton seed oil processing plant as well, with markets ensured by existing demand. PRA's intervention and private sector involvement are helping the region to becoming a leading producer of *algodón áspero*.
- Cacao*- The success of the cacao business in Aguaytía is a result of improvements in quality achieved by the *Asociación de Cacaoteros Tecnificados de Padre Abad* (ACATPA). Two companies, *Exportaciones Sierra y Selva* and Machu Picchu Coffee Trading purchased all of the region's cacao production and paid a premium price for the high quality of the product. For land already under production, PRA helped the producers apply technology to improve quality. For new crop production, PRA assisted in seed selection from mature trees with proven productivity and quality. PRA also helped to improve the management of greenhouses in order to ensure the production of high quality seedlings.

Exportaciones Sierra y Selva sells certified organic cacao to the European market. PRA's role was to attract the interest of *Exportaciones Sierra y Selva*, which was unaware of the high quality of cacao produced in Aguaytía.

Machu Picchu Coffee Trading has two processing plants located in Pisco and exports cacao liquor, butter, and powder to the U.S. market. PRA introduced Machu Picchu Coffee Trading to the ACATPA producers association and their high quality cacao from Aguaytía.

The commercial relationships that have been established and good management by the producers have resulted in improved cacao quality and new markets. The commitment of *Exportaciones Sierra y Selva* to certify 450 hectares has allowed the producers to sell "certified organic" cacao for a premium price.

- Pineapple* - The *Asociación de Productores de Piña* (APP) in Shambillo has sold its entire production to the company *Agrícola Italia*, a supplier to supermarket chains Santa Isabela and Plaza Veá. The association has signed a strategic alliance with *Agrícola Italia* for the management and commercialization of its pineapple crop. The PRA project helped to formalize

this alliance through the development and signing of a public agreement between *Agrícola Italia* and APP. The *Cayena Lisa* pineapple in Aguaytía is sweeter than other varieties, an advantage for sale as fresh produce.

With its own resources, the association of producers has acquired a small processing plant in order to salvage the unused by-products of the pineapple production and convert them into nectars and jams. A valuable resource that was previously wasted is now processed and sold as a value added product.

Ayacucho-VRAE

- *Peanuts*- The peanut business here began with a grant to producers who had signed *coca* reduction agreements in return for assistance to plant 250 hectares of peanuts. The first harvest was sold to Broco's, a buyer based in Lima.

PRA became more involved in the second agricultural season, inserting its market-focused, demand-driven methodology. The project introduced the firm *Multiagros*, which agreed to provide direct credit to the producers, a debt which would be repaid at the time of harvest. With no additional grant funds, the growers harvested and sold 450 hectares of peanuts mainly to regional markets. In the absence of any real competition in these markets, the VRAE peanut crop attracted excellent prices.

Multiagros' direct credit to producers continued in the third season. In addition, the production chain was rounded out by the involvement of the following peanut buyers: i) *Agronegocios Unión del Valle*, ii) *Corporación del Bosque*, and iii) *Multiagros Export e Import*. These buyers were attracted by the quality of the previous harvests. Currently, the productivity of the VRAE peanut producers stands at approximately 1,200 kg/hectare per harvest.

- *Cacao*- The *Valle del Río Apurímac* is the leading cacao producing region in the country with the capacity to produce a large volume of cacao beans and cacao derivatives for export. The project is working to improve quality in order to stand out and attract private sector buyers.

Because the VRAE is a major cacao producing regions, all of the major cacao buyers have a presence there. But the prices were less than flattering for the producers, mainly because of poor product quality. The project is working with growers to overcome this bottleneck and change this reality.

To date, the project has worked with the *Cooperativa Cafetalera Valle del Río Apurímac y Ene*, the *Cooperativa Cafetalera El Quinacho*, and the firm *Cacao VRAE*, which together have exported cacao beans to a number of European and U.S. markets. Machu Picchu Coffee Trading has also purchased cacao from VRAE, paying a premium price for quality, moisture, and cleanliness.

- *Coffee* - The coffee producers associations have centralized the supply for the *Cooperativa Cafetalera Valle del Río Apurímac y Ene* and for the company

COINCA. The Cooperativa exports certified organic coffee to Swiss and German markets. COINCA exports green coffee primarily to the U.S. market.

Tocache-Chazuta-Juanjuí

With the assistance of CRAC San Martin, project-supported yellow corn producers have adopted technology for the use of hybrid seed in order to improve quality and yield.

AGROBANCO has agreed to finance two rice production chains, with cofinancing from a local milling company, *Molino La Selva*, who is in negotiations to finance an additional production chain.

Given the demonstrated viability of this financing model, new rice production chains are now being formed with other milling companies in Tocache. The project has helped to attract the interest of Banco Continental and Interbank in financing other projects in the area. Banco Continental is considering a proposal to finance 500 hectares of *palma aceitera*.

C. Problems and Obstacles

Because the timing of eradication agreements and socialization processes often does not coincide with the agricultural calendar, there have been delays in the transfer and delivery of the crops promised in the agreements.

The vocal political opposition to the voluntary eradication program can drive away private investment in alternative development zones, notably reducing the potential impact of private investment in these areas. We must persist, improve communication with the private sector, and align producers and proponents of the voluntary eradication program in order to gain the trust of private investors and commercial buyers and traders.

Such a large and complicated program requires significant prior preparation, especially in the areas of logistics and technical assistance. Unfortunately, pressure to make good on promises prevented this from happening in an optimal manner, resulting in various technical problems and mistakes at the field level. Despite these problems, though, PDAP/PRA results have been positive.

Some problems arose when producer associations began to assume roles above and beyond organizing production under the Alternative Development Program. PRA has, since its inception, successfully organized *campesinos* into producer associations to overcome the inherent problem of small holder agriculture, i.e., the inability to mobilize a production base large enough to attract serious buyers. PRA believes that producer associations serve a very important, but limited function at the field level in their role as organizers of farmers and the production base. But in the early days of PRA-PDAP cooperation, nascent producer associations were expected to transform into more sophisticated institutions capable of receiving grants financed by USAID and then subsequently passing them on to participating farmers. This new role required producer associations to jump to a higher and more complex level of organizational ability than is typically found at the farmer/community level. In the end, inputs were successfully

distributed to 35 producer associations with only three having serious problems and associated mismanagement of the donated assistance. But the question remains open as to the appropriate role for donor supported producer associations. PRA maintains that producer associations should be organized for the sole purpose of conveying knowledge to the farm community and organizing the production base to facilitate planting and harvest and, most importantly, fostering linkages with the formal marketing sector. Other market actors/institutions should take on the role of input supply leaving producer associations to do what they do best - convey information and knowledge and organize the production base.

The time and effort required to develop 14,000 hectares and maintain another 6,000 has meant that some areas (Tingo and Tocache) have neglected the promotion of private businesses without subsidies or financial support, as PRA does in other parts of the country. This should be corrected, using Aguaytía and VRAE as examples, where there are businesses up and running with little or no direct support from PDAP in terms of inputs. Instead, the project supplies information to buyers, investors and banks, and technical assistance to solve specific bottlenecks.

C1. Managements issues

FY2004 was particularly complicated in terms of managing the start-up of licit economic activities in alternative development zones. Through June 2004 PRA was fully responsible for forming productive chains around the projects approved in the voluntary eradication agreements. After that date, this responsibility was shifted to PDAP. An Economic Service Center (ESC) was formed within PDAP to work closely with the management of PRA. Three months after this change the ESC director for PDAP resigned as a result of professional differences with the project management. This generated a series of challenges and required the reorganization of the project.

PDAP's new management approved a reorganization process based on delegation of authority and managing for results in the alternative development ESC. PRA's National ESC director has joined the PDAP management team and PRA is directly committed to the results of the alternative development ESC, with regard to both productive projects and development of new business opportunities.

Both the PRA and PDAP teams have overcome initial management problems, and Chemonics presently is able to respond as one company to the challenges before us.

At the regional level, we are aware that we must reinforce the direction of PDAP's sub-ESCs if we expect them to have the ability and independence to make decisions. We are currently evaluating the sub-ESC personnel in order to ensure retention of professional staff with a strong business background and entrepreneurial attitude.

C2. Policy Issues

The politicized nature of the *coca* problem can drive away private investment in alternative development zones, despite their recognized potential. In the Alternative Development areas the Peruvian government needs a firm, clear position on the problem of illegal *coca* cultivation. In addition, the GOP should undertake major efforts along

with interested donors to actively encourage and promote direct private investment in the four principal *coca* valleys.

It is necessary to deepen the approach to the alternative development program and move the emphasis from an entitlement-focused program of *asistencialismo*, to a program based on building market linkages and direct commercial relationships between *ex-cocaleros*, their communities and private sector buyers/ traders and, most importantly agribusiness investors. This change in perspective is still incipient and actual changes of the scale necessary to transform the *coca* valleys is a long way off without a substantial increase in private sector investment.

Likewise, it is necessary to increase substantially the transaction costs of the illegal *coca* business, in order to create real incentives for producers to dedicate more effort to developing a licit economy in the *coca* valleys. If taking part in the illegal *coca* business has no real penalty, then licit economic activities will always be at a disadvantage.

SECTION IV

Public-Private Partnerships (PPP) in Infrastructure Finance

A. Objective

In only 12 months, PRA's Public-Private Partnership (PPP) in Infrastructure Finance component has made significant progress. Important milestones have been achieved in support of the Government of Peru's (GOP) effort to increase the supply of basic infrastructure services to facilitate enterprise development, improve productivity and competitiveness, and spur economic growth in key regions of Peru. In this capacity PRA is assisting with the design, structuring, negotiation and implementation of four to six PPP transactions to finance, build, operate and maintain major infrastructure projects in the transport (ports and roads), energy and water and sanitation sectors. Over the past year PRA's PPP team has worked closely with the GOP in the design and implementation of the following PPP transactions:

Transaction	Investments	Status as of October 31 st , 2004
Amazon North (AN) highway concession: 960 Km. between Paita and Yurimaguas	US \$158 million	Phase I (design): Completed Phase II (implementation): on-going Award expected on April 2005
Amazon Central highway concession: 864 Km. between Lima and Pucallpa	US \$63 million	Phase I (design): Completed Phase II (implementation): on-going Award expected on November 2005
FBT Road project: 460 Km. between Tarapoto and Tingo Maria	US \$162 million	Phase I (design): Completed
Rural electrification (transmission and distribution) in VRAE y UCAYALI	US \$10.1 million	Completed

B. Main Results

B1. Transport Sector

Amazon North and Amazon Central. Design work has been largely completed for two PPP transactions that will ensure the financing, construction, rehabilitation, operation and maintenance of more than 1,900 kilometers of national highway, representing more than 18% of the national asphalted highway network (see Map 2 at the end of this section). These will be two of the largest, in terms of length, road concession projects in the world. Once completed, these highways will integrate, along two different routes, the coastal, mountain (*sierra*) and jungle (*selva*) regions of Peru and will connect Peru to Brazil, the region's largest economy:

- *The Amazon North (AN)* highway concession is a 20-year transaction to finance, construct, rehabilitate, operate and maintain 964 km. of national highway between the cities of Paita, in the department of Piura on the Pacific coast, and the river port of Yurimaguas, in the eastern department of Loreto. The selected concessionaire is expected to raise approximately \$158 million in private financing to cover investment costs as well as finance annual maintenance of the highway, in accordance with international service quality standards, for the duration of the concession contract. The concession contract is expected to be awarded in June 2005;

- **The Amazon Central (AC)** highway concession is a variable term transaction (up to 30 years) to improve, construct, operate and maintain 867 Km. of national highway between the cities of Lima, on the Pacific Coast, and Pucallpa in the eastern department of Ucayali. The selected concessionaire is expected to raise approximately \$70 million in private funding to cover the initial investments and will guarantee the maintenance of the road, in accordance with international service quality standards, for the term of the concession contract. The concession contract is expected to be awarded in November 2005. The main accomplishments related to these two transactions are:
 - *The assessment of the amount and timing of the required government contributions to the project (PAO and PAMO) was completed and submitted to the MEF (Ministry of Economics and Finance) for approval.*
 - *A partial credit guarantee (PCG) for the AN concession of up to US \$60 million dollars was approved by Cabinet Council and negotiated with the Inter-American Development Bank (IDB). The PCG will not only allow the concessionaire to obtain better financial terms, but will also facilitate access to the domestic capital market in order to secure funding of over \$160 million. The AN PCG will be the first guarantee of its kind granted by the GOP and the first PCG granted by the IDB through its public sector window.*
 - *Two Infrastructure Bonds have been developed for respectively financing each of the highway concessions. The AN Bond received a shadow rating of AAA (pe) in local currency and AA (pe) in foreign currency by Apoyo & Asociados, an affiliate of Fitch Ratings. The AC Bond will be rated shortly.*
 - *Transaction documents for the AN concession have been completed. The AN Concession Contract represents a “second generation” contract, as it not only contains significant improvements over similar PPP contracts for other concessions in Peru’s transportation sector, but also incorporates industry-specific international best practices.*
 - *Procedures for determining quality of service indicators, control procedures and sanction mechanisms have been developed. This document, which is an integral part of the concession contracts for the AN and AC transactions, is the first of its kind for highway concessions in Peru.*
 - *The first-ever Strategic Environmental Evaluation (SEE) for an infrastructure project in Peru is under development coupled with the preparation of six (6) environmental impact statements for each of the highway sections that make up the AN concession. These two environmental management tools will ensure that all environmental protection requirements of the GOP, the IDB as well as USAID, Section 216 requirements, will be met for both the AN and AC concessions.*
 - *Public consultations along the AN corridor to disseminate the potential environmental impacts of the project and the corresponding mitigating measures have been completed in all twelve (12) municipalities served by the AN highway as well as in the four (4) indigenous communities living within its area of influence.*
 - *Nine (9) financially sound, technically qualified and internationally known firms and consortia, with extensive track records in the construction and operation of highways, have been pre-qualified to participate in the AN highway concession bidding process. The AN highway competition promises to be, for the benefit of the GOP and AN highway users, one of the most competitive infrastructure concession processes to be held in Peru and in South America in general*

Fernando Belaunde Terry (FBT) Roadway Project. The financial design for the proposed 480 Km. FBT roadway concession between the city of Tarapoto, in the Department of San Martín, and the town of Tingo María in the Department of Huanuco, has been completed. The FBT highway concession would require a substantial contribution from the GOP (or other sources) to make it financially viable and attractive to private investors as a PPP concession.

B2. Energy Sector

Rural electrification project completed. The rural electrification design work, carried out by the US National Rural Electrification Cooperative Association (NRECA) under contract with PRA, has been completed. The feasibility study includes a complete project appraisal and plan of action to develop four projects, including transmission and electricity distribution in the VRAE, distribution in Tocache, and complementing the on-going distribution project in Ucayali.

C. Main Activities

C1. General Activities

Definitional Study. This initial assessment served to identify and select potential PPP projects and to pinpoint existing legal, institutional, technical and economic constraints and limitations to the implementation of such projects, as well as to outline a clear strategy for the implementation of the selected PPP transactions.

C2. Amazonas Norte Road Concession

Organization of the Data Room. All existing information and documentation pertaining to the project was gathered and organized. The data room is located at Proinversión and is available to all pre-qualified bidders.

Technical Structuring. A series of actions were put in place in order to ensure: i) that the proposed project would meet the technical, economic and environmental requirements to mitigate and minimize possible risks to the concessionaire; and ii) that a sufficient level of reliable engineering information would be available to bidders for the preparation of technical proposals. To this end, the following activities were carried out:

Review of reference project and alternate project proposal. Engineering studies were reviewed in order to determine the technical viability of the proposed project and to estimate the amount of investment required in order to achieve realistic levels of service, in accordance with traffic levels during the concession period. We also examined potential modifications to the reference project aimed at offering flexibility to bidders in the presentation of technical proposals and at mitigating the risk of underestimating investment costs. Additionally, an analysis of possible expropriations was conducted in order to ensure that the lands are ready to be delivered to the concessionaire for the execution of the respective works.

Calculation of Operating and Maintenance Costs. Routine and periodic maintenance costs were calculated using the HDM-III Model¹. The maintenance and operating costs were used

¹ Highway Design and Maintenance Standards Model (HDM), HDM Manager Version 3.0, June 1995. Transport Division, Transportation, Water & Urban Development Department, the World Bank

to determine the maximum amount to be paid by the GOP for the Annual Maintenance and Operation Payment (PAMO). The prepared document explains the procedure for calculating this amount.

Maintenance and Operation Procedures and Procedures for Monitoring the Performance of the Concessionaire. Procedures for measuring and monitoring the performance of the concessionaire were developed. This is the first time these procedures will be implemented in a concession contract in Peru.

Traffic Study. The study included vehicle counts and origin-destination surveys. Both the low level of traffic in the corridor and the need for government subsidies were confirmed.

Environmental Assessment. The following activities were carried out:

Updates to the Environmental Impact Assessments (EIA). Following a comprehensive analysis of the engineering studies conducted on six segments of the Amazonas Norte roadway, it was determined that said sections of road did not comply with the environmental regulations of the GOP, and less so with Section 216 of the Environmental Code of the United States of America. Therefore, we decided to perform an environmental impact assessment on the Piura-Olmos roadway and to update the environmental impact assessments for all other segments of the road.

Strategic Environmental Assessment (SEA). The SEA is designed to evaluate the corridor under an integrated, systematic and comprehensive framework in order to ensure that it includes an environmental management system for defining environmental responsibility for the operation and conservation of this corridor.

Socio-Economic Evaluation. A cost-benefit analysis was conducted in accordance with the methodology used by the Ministry of Transportation and Communication (MTC) for interurban road infrastructure projects. Furthermore, the study was carried out in conformity with the requirements set forth in the regulations of the National Public Investment System (SNIP). Following an evaluation of the economic benefits of the corridor, including the interventions defined in the concession, and an analysis of three demand scenarios, it was determined that the project is socially profitable.

Financial Structuring. The following activities were carried out:

Determination of the PAO and PAMO. Given that this project is not financially self-sustaining due to the current level of traffic flow, a financing scheme was designed in which the GOP will fund this project with direct contributions over the long-term. The project will be funded through two payments to be made by the GOP to the concessionaire, as follows:

- Annual Payment for Works (PAO), for construction or rehabilitation of the works comprising the investment made during the first four years of the concession, to be paid semi-annually over a period of 12 years beginning in month 24 of the concession; and
- Annual Maintenance and Operation Payment (PAMO) for maintenance of the works over the course of the concession. This payment will be made on a quarterly basis and corresponds to the difference between the PAMO payment requested by the bidder in its financial offer and the quarterly income obtained from toll collection.

The determination of the PAO and PAMO was made for the purpose of providing a methodological explanation of how these amounts are calculated, taking into account that such payments are bid variables and therefore their final value will only be known at the time the concession is awarded.

Analysis of the capital markets and of the need for credit enhancements. We examined the possibility of procuring financing for the project in the Peruvian capital market and the need to receive credit enhancements available through loan guarantees offered by multilateral and bilateral lending agencies. Obtaining long-term financing through the capital market is key to facilitating the development of infrastructure projects through PPP schemes since this will reduce the risk of refinancing due to the fact that institutional investors (mainly pension funds and insurance companies) can offer longer terms, in accordance with the development of the project; this type of financing also reduces the exchange risk because the project generates income in local currency; and may also potentially reduce the cost of capital.

Simulation of Long-Term Financing. In order to ensure the viability of financing the investment for the rehabilitation and improvement projects, the issuance of bonds was simulated in two series, which were called Amazonas Norte Bonds. Series “A” would be issued for US\$73.2 million and would be paid quarterly in 28 equal coupons. The PAOs will be the source of payment for the Amazonas Norte Bonds coupons.

Shadow Rating. The credit rating agency “Apoyo & Asociados”, an affiliate of Fitch Ratings that ranks among the top three global rating agencies, was asked to rate the Amazonas Norte Bonds and provide a shadow rating on the risk of the instruments to be issued in order to fund the maintenance and rehabilitation projects of the Amazonas Norte Corridor. In the opinion of Apoyo/Fitch, the irrevocable nature of the PAO is the primary strength of the financing structure. In accordance with the methodology of Apoyo/Fitch, the rating of the Amazonas Norte Bonds is AAA(pe) in local currency and A(pe) in foreign currency. The difference between these ratings is based on the State’s monetary control over its own currency, which is not the case with foreign currency. However, if the PAO were partially guaranteed by a Guarantor with an “A” rating or higher on the international Fitch Ratings scale through a Partial Credit Guarantee that would guarantee a whole number of coupons for a maximum face amount of US\$60 million, the Rating Agency believes that this would raise the debt rating by three notches, that is, from A(pe) to AA(pe) for the foreign currency obligation.

Partial Credit Guarantee (PCG). A partial credit guarantee was designed in order to: i) directly cover the commitments of the Republic of Peru in the performance of the annual payments for works (PAO), which are deferred over time; and ii) to indirectly guarantee service of interest and long-term amortizations by the Concessionaire, whether through an incurred bank debt or bonds issued in the financial market, given that these types of financing are backed by said PAO payments. We also worked together with the national government (Proinversión and the Ministry of Economy and Finance, or MEF) on the identification and evaluation of the various types of credit enhancement instruments offered by the major multilateral agencies in the region (CAF, World Bank and IDB). Finally, IDB was selected by the Government of Peru for the design of the guarantees, and intense efforts are being made in order to complete the structure of the PCG before the close of the bidding process.

Bid Documents. Support was provided to Proinversión in the preparation and updating of all documents included in the bid process. The following activities were carried out:

Terms of Reference and Clarification Notices. The Terms of Reference were issued in August, 2003. Since that time, we have worked together with Proinversión on the preparation of twenty four (24) clarification notices that substantially modify such terms and provide greater flexibility to the bid process and the project. Annex 9 was also prepared and provides a detailed description of the reference project and the technical development alternatives. This document will be an essential reference for bidders for the successful preparation of their proposals.

Concession Contract. The concession contract was prepared and has been modified on four occasions. Its fourth version was approved and took effect in August, 2004.

C3. Amazonas Centro Road Concession

Organization of the Data Room. All existing information and documentation pertaining to the project was gathered and organized.

Technical Structuring. A series of actions were put in place in order to ensure: i) that the proposed project would meet the technical, economic and environmental requirements for reducing possible intervention risks to the concessionaire; and ii) that a sufficient level of reliable engineering information would be available to bidders for the preparation of technical proposals. To this end, the following activities were carried out:

Review of the reference project. Several on-site visits were made and existing engineering studies were reviewed in order to determine the technical viability of the proposed project and to estimate the amount of investment required in order to achieve realistic levels of service, in accordance with traffic levels during the concession period. These activities were key factors in the analysis and in formulating financial projections.

Calculation of Operating and Maintenance Costs. Routine and Periodic maintenance costs were calculated for the compliance alternative for conditions and service standards using the HDM-III Model.

Maintenance and operation procedures and procedures for monitoring the performance of the concessionaire. Procedures for measuring and monitoring the performance of the concessionaire were developed.

Demand Study. A demand study targeted to investors and financiers was initiated in August of this year and aims to complement and enhance the information of the existing demand study of the MTC. This study is crucial in view of the fact that the financing for this road concession is based solely on the projected traffic levels of the highway and the collection of tolls. The study will develop new traffic and income projections and will provide a clear and precise explanation of the data considered and its level of support, and will also include an analysis that will provide future investors and finance experts with additional background information that will enable them to adequately assess the risks associated with the project. This study is scheduled to be completed in early January of 2005.

Financial Structuring. The following activities were carried out:

Simulation of Long-Term Financing. In order to finance the investment for the rehabilitation and improvement activities, the issuance of a Bond called “Amazonas Centro Bond” for US \$60 million was simulated. Toll collections will be the source of payment for the coupons.

Shadow Rating. The risk rating agency “Apoyo & Asociados”, an affiliate of Fitch Ratings, was asked to evaluate the Amazonas Centro Bond and provide a Shadow Rating on the risk of the instrument to be issued in order to fund the maintenance and rehabilitation projects of the AC Corridor.

Loan Guarantee. A concept paper was prepared that examines the possibility of structuring a loan guarantee with the *Development Credit Authority* (DCA) of USAID.

Bid Documents. Support was provided to Proinversión in the preparation and updating of all documents included in the bid process. The following activities were carried out:

Terms of Reference and Clarification Notices. The Terms of Reference were made available in November, 2003. Since that time, we have worked together with Proinversión on the preparation of five (5) clarification notices that have modified both terms and bid calendar.

Concession Contract. The first version of the concession contract was prepared. Modifications to this document will be made as the process progresses.

C4. Promotional Activities

In order to achieve highly competitive bidding processes, the PPP team of PRA, together with Proinversión, has launched an aggressive promotional campaign for the Amazonas Norte and Amazonas Centro road concession projects at the national and international levels. The main activities of this campaign are described below:

Definition of the Market. Identified and contacted over 80 firms in 14 countries (Peru, Chile, Colombia, Mexico, Brazil, Ecuador, France, Spain, Sweden, Italy, Belgium, the United States and Canada).

Publications. An advertisement was published in the March 6, 2004 edition of *The Economist* magazine. A “teaser” was prepared and published along with a detailed description of the technical, financial and legal characteristics of the two projects.

Roadshows and follow-up meetings

- *Santiago, April 19 – 23, 2004.* Individual meetings were held with: OHL, SACYR, AZVI, and Ferrovial Agroman of Spain, VINCI of France, Impregilo and Torno of Italy, SKANSKA of Sweden, Besalco and Constructora Fe Grande of Chile.
- *Lima, April 30, 2004.* A seminar co-sponsored with the Peruvian Chamber of Construction (CAPECO) was held with the objective of disseminating the project among Peruvian construction firms. The ministers of MEF and the MTC participated in this event.

- *Sao Paulo and Rio de Janeiro, June 14 – 17, 2004.* Meetings were held with: Andrade Gutierrez, Companhia de Concessões Rodoviária (CCR), C.R. Almeida (Ecorodovias), Grupo Triunfo S.A., Construcoes Queiroz Galvao, TCM Engenharia (Caminos del Pacífico Consortium), Constructora Norberto Odebrecht S.A.
- *Santiago, July 9, 2004.* The Executive Director of Proinversión traveled to Santiago in order to follow-up with the companies contacted during the road show held in April and met with the following companies: Vinci, Ohl, Besalco and Ferrovial-Agroman.
- *Santiago, September 1, 2004.* During a trip, the Vice Minister of Economy held meetings with Besalco, Ferrovial – Agroman, and Vinci.
- *Paris and Madrid, October 13 – 16, 2004.* Meetings were held with directors from the following companies: Vincy and Bouyges in Paris, OHL, FCC, Nexo and Ferrovial in Madrid.

Results of the Promotional Activities:

Amazonas Norte Road Concession – Pre-Qualified Firms	
Tcm Engenharia e Empreedimentos (Caminos del Pacifico)	Brazil
Obrascon Huarte Lain S.A. (OHL)	Spain
Construtora Queiroz Galvao S.A.	Brazil
Consortio Skanska BOT – Ocacsa	Sweden– Mexico
Constructora Graña Y Montero	Peru
Construtora Norberto Odebrecht S.A.	Brazil
Construtora Andrade Gutierrez S.A.	Brazil
Consortio Besalco	Chile
Camargo Correa	Brazil
Amazonas Centro Road Concession – Registered Firms	
Constructora Malaga Hnos. S.A.	Peru
Concar S.A.	Peru
Hidalgo E Hidalgo S.A. - Construcción Y Administración S.A.C, Asociados	Ecuador – Peru
Translei S.A.	Peru / Portugal

D. Main problem areas and how they are being addressed

Problem. The GOP officially opened the AN and AC international bidding processes without having completed the minimum required feasibility analysis nor the detailed preparation of bidding documents. As a result, the original bid schedules have had to be modified on several different occasions. This has led to a series of problems in the implementation process and, more importantly, the uncertainty generated by the frequent changes in the bidding calendar has caused potential investors to hold back from participating in either or both the AN and AC bidding process. *How this problem is being addressed:* We have established a direct and ongoing dialogue with Proinversión where these issues have been discussed in-depth, particularly with regard to the recent developments in the AN process, and we believe that this dialogue will have a positive effect on the AC concession process. We are recommending that a final bidding calendar for the AC concession not be published until the time periods required for finalizing all of the technical and financial feasibility studies for the concession have been definitively established.

Problem. We have perceived serious conflicts of interest between sector ministry officials who do not believe in the PPP processes, since the concessions would mean a reduction in their sphere of influence and possible reductions in ministry staff and budget allocations. This has been manifested in the form of delays in the delivery of information or delivery of outdated or conflicting information, overly elaborate designs, and demands for increased initial investments that could negatively affect the PPP bidding process. *How this problem is*

being addressed. We have held meetings with the involved institutions and stressed to them the negative repercussions caused by delays in the delivery of information. As a result, it was determined that Chemonics could request information directly from *Provias Nacional* to streamline the process.

Problem. Continual changes in the officials appointed to coordinate the concession processes in Proinversión, MTC and MEF have delayed transaction implementation due to the fact that many of the agreements that were reached with a given office have had to be re-negotiated upon the arrival of a new official. *How this problem is being addressed.* To the extent possible, our team has made an effort to involve the greatest possible number of government officials in the implementation of these projects, especially middle management personnel, who have lower turnover rates in their respective institutions.

MAP 4.1: EJE AMAZONAS NORTE – CENTRO



Cuadro 4.1: Resumen del Avance del Componente PPP - Concesión Eje Amazonas Norte

Indicadores finales	Tipo de Infraestructura	Indicadores Intermedios	Metas	Avance	Avance (%)	Medios de verificación	Riesgos posibles *	
Concesión Eje Amazonas Norte	Carreteras	A. Evaluación Previa de Posible PPP						
		Evaluación de Posible PPP	01	01	100	Estudio Definicional	0	
		B. Preparación de Estudios y Recopilación de Información para los Postores						
		B.1. Evaluación de los Esquemas de Financiamiento	01	01	100%	Informe	0	
		B.2. Implementación de la Sala de Información	100%		90%	Cartas enviadas a Proinversión	1	
		B.3. Estudio de Tráfico	01	01	100%	Informe	0	
		B.4. Evaluación Socioeconómica del Corredor	01	01	100%	Informe	0	
		B.5. Estudio de Evaluación Ambiental Estratégica (EAE) del Corredor	01		50%	Informe	2	
		B.6. Estudio de Impacto Ambiental Olmos-Piura	01		50%	Informe	1	
		B.7. Actualización de Estudios de Impacto Ambiental (EIA)	05		0%	Informe	1	
		B.8. Shadow Rating	01	01	100%	Informe	0	
		C. Garantía Financiera						
		C.1. Aprobación del inicio de negociaciones de la garantía financiera	01	01	100%	Comunicación del MEF	0	
		C.2. Obtención de la Garantía Financiera por parte de un Organismo Multilateral	01			Garantía firmada entre el MEF y el Org. Mult.	3	
		D. Diseño del Contrato						
		Diseño de la versión final del contrato	01		67%	Circular de Proinversión	1	
		E. Inversionistas para la Concesión						
		E.1. N° de Postores Inscritos	05	11	100%	Comunicación de Proinversión	0	
		E.2. N° de Postores Pre Calificados	05	02	40%	Comunicación de Proinversión	2	
		E.3. N° de Postores Pre Calificados que presentaron propuesta técnica	03	0	0%	Comunicación de Proinversión	3	
		E.4. N° de Postores que aprobaron la propuesta técnica	03	0	0%	Comunicación de Proinversión	3	
		E.5. N° de Postores que presentaron Propuesta Económica	03	0	0%	Comunicación de Proinversión	3	
		E.6. Adjudicación de la Buena Pro	01	0	0%	Comunicación de Proinversión	3	

Cuadro 4.2: Resumen del Avance del Componente PPP - Concesión Eje Amazonas Centro

Indicadores finales	Tipo de Infraestructura	Indicadores Intermedios	Metas	Avance	Avance (%)	Medios de verificación	Riesgos posibles *
Concesión Eje Amazonas Centro	Carreteras	A.1. Evaluación Previa de Posible PPP					
		Evaluación de Posible PPP	01	01	100	Estudio Definicional	0
		B. Preparación de Estudios y Recopilación de Información para los Postores					
		B.1. Evaluación del Esquema de Financiamiento	01	01	50%	Informe	0
		B.2. Implementación de la Sala de Información	100%		50%	Cartas enviadas a Proinversión	1
		B.3. Estudio de Tráfico	01		30%	Informe	0
		B.4 Estudio de Demanda	01		20%	Informe	0
		B.5 Actualización de Estudios de Impacto Ambiental (EIA)	03		0%	Informes	3
		C. Diseño del Contrato					
		Diseño de la versión final del contrato	01		17%	Circular de Proinversión	1
		D. Inversionistas para la Concesión					
		D.1. N° de Postores Inscritos	05	3	100%	Comunicación de Proinversión	1
		D.2. N° de Postores Pre Calificados	05	0	0%	Comunicación de Proinversión	1
		D.3. N° de Postores Pre Calificados que presentaron propuesta técnica	03	0	0%	Comunicación de Proinversión	2
		D.4. N° de Postores que aprobaron la propuesta técnica	03	0	0%	Comunicación de Proinversión	2
		D.5. N° de Postores que presentaron Propuesta Económica	03	0	0%	Comunicación de Proinversión	2
D.6 Adjudicación de la Buena Pro	01	0	0%	Comunicación de Proinversión	1		

Riesgos de no cumplir con la meta establecida:

Ninguno = 0 Bajo = 1 Medio = 2 Alto = 3