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PERU

COUNTRY DEVELOPMENT STRATEGY STATEMENT

FY 82

January 1980

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
WASHINGTON, D.C. 20523

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USAID/PERU

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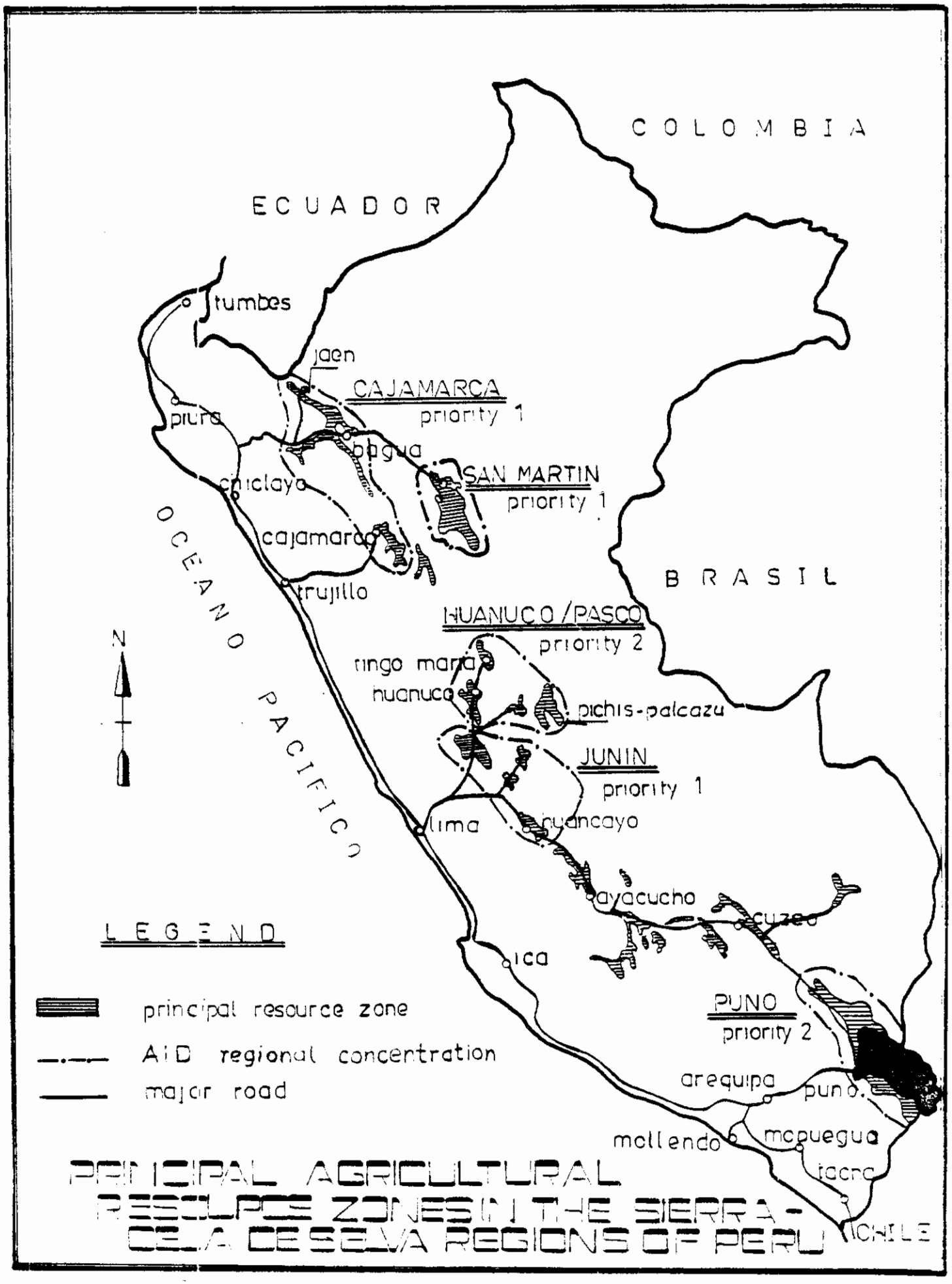

PRINCIPAL AGRICULTURAL RESOURCE ZONES IN THE SIERRA-CEJA DE SELVA REGIONS OF PERU

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A. ANALYTICAL DESCRIPTION OF THE POOR

1. The Magnitude of Poverty in Peru

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

A recent World Bank Study, based on 1971 consumption data, has concluded that, using the most conservative definition of poverty*, 28% of Peru's population, or 4.8 million people, cannot satisfy the most minimal food and non-food requirements to adequately sustain life needs. Broken down by the country's three principal regions, 59 percent, some 2.9 million, live in the Andean highlands (sierra); 12% on the coast, and 29% from the eastern slopes of the Andes (high jungle) to the low jungle (selva). In the southern sierra, almost 47% of the population is living in poverty, and the proportion of population who fall below the minimum poverty threshold for the entire rural sierra is 41%. The

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

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

2. The Geographic Distribution of Poverty

Income distribution patterns, based on a GOP national food consumption survey (1971-72), indicate an extremely skewed distribution in favor of the coastal region where Peru's principal cities are located. While metropolitan Lima comprised only 20.1% of the country's total population, its residents earned 46.2% of family income. The entire coastal region accounted for 40.6% of total population and 69.1% of total income. The sierra, with over half the country's population (50.8%) received 23.9% of income, while the distribution of population

and income in the selva was nearly equal (8.6% and 7.0% respectively). There is also a direct linear relationship between income and level of urbanization. Rural areas account for 54.4% of all families, but receive only 23.5% of all family income. Income per family becomes greater as one moves up the urban scale.

A geographical Profile of the Peruvian Poor, prepared by the Mission in 1976 confirms regional inbalances in income and access to public services. Using data gathered for twelve social, economic and cultural indicators to compare 23 departments and ten indicators to compare 150 provinces, it was found that the majority of poor reside in the sierra and the largest concentration of poor are located in: (1) the "mancha india", consisting of the contiguous southern sierra departments of Ayacucho, Apurimac, Huancavelica, Cuzco and Puno, and (2) in a northern sierra region consisting of Cajamarca, Ancash and San Martín. Highly significant disparities in access to services were found between the cities and modern agricultural enclaves of the coast, and the rest of the country.

3. Nutrition and Health Status

Peru's nutritional status manifests major deficiencies. GOP studies indicate that approximately one-half of all Peruvian children are malnourished. Seventy percent of all rural families are calcium - deficient; 56% register deficiencies in rhiboflavin and carotene, and 54% do not satisfy acceptable caloric intake levels. A diagnosis of Peru's nutrition situation points to two endemic problems:

Chronic Malnutrition - has always existed among the country's poorest population groups. This condition is due to: inadequate food consumption, because the poor are unable to produce and/or purchase a satisfactory nutrient intake; and poor biological utilization of food because of frequent infections, intestinal parasites and diarrheal diseases. These factors are common characteristics of poverty resulting from limited access to land, employment, education and basic health services. The areas suffering most from chronic malnutrition are the southern sierra, the low jungle, and the rural part of the central sierra, with a combined population of 4.5 million.

Acute Malnutrition - has become increasingly prevalent in the late 1970's as a result of soaring food prices, decreasing real incomes and austerity accompanying Peru's recent economic crisis. Available data indicate that the decline in food consumption by the urban poor has been so drastic during the past two years that it is no longer valid to consider malnutrition as an exclusive problem of the rural poor. One-half of the national population with caloric deficiencies lives in Lima. Government information and research undertaken by USAID/Peru reveal substantial decreases in the amount of both calories and proteins consumed by the middle and lower socio-economic strata of metropolitan Lima. By 1978, the caloric intake for the lowest socio-economic stratum in Lima was only 62% of daily requirements. Hunger is a current reality for an estimated 400,000 - 500,000 living in the Lima slums (pueblos jovenes). Since Peru's domestic economic recovery will be a slow and difficult process, malnutrition is expected to be extremely acute well into the decade of the 1980's.

Peru is characterized by high fertility, moderate mortality and significant rural-urban migration. The national population was estimated in 1979 at 17.3 million. The birth rate is estimated at 39.5% per thousand, mortality at 11.6 per thousand and the annual growth rate at 2.9%. The fertility rate averages 5.71 nationally -- 4.6 in the urban areas and a very high 8.5 births per woman in the rural areas. The high rate of population growth results in a relatively young population -- 43% of the population is now under 15 years of age, while only 4% are 65 or older. A demographic study done by the GOP presents alarming results; if present high fertility rates are kept constant, the population will more than double by the end of this century. High growth rates mean that each year Peru adds several hundred thousand persons to the group living in absolute poverty.

Peru's health problems are more severe than the Latin American average; child and infant mortality are high and result from a high incidence of malnutrition in the country's poorer regions. Nearly half (48.4%) of all deaths occur in children under 5 years of age and sixty percent of these are due to malnutrition-related diseases. Average infant mortality is 142 deaths per thousand live births, rising to an appalling 200 per thousand in the southern sierra. Nation-wide, 172 children out of every 1,00 die before the age of two. In the most deprived regions of the sierra that figure rises to 300/1000. Life expectancy is age 52. In 83 of Peru's 150 provinces it is less than 50 and, in 14, less than 40.

A rural/small town population of 6.2 million lies largely outside the reach of medical care. Although the Ministry of Health has some health infrastructure in the rural areas, providing para-medical attention, these facilities are ill-equipped and do not cover even one-half of all rural health districts. Even in cities, services are available primarily to the modern-sector workers (e.g. through social security) and not to slum residents. Access to potable water and sewerage systems also manifests urban/rural disparities. In 1972, 64.9% of the total population lacked access to potable water systems and 73.2% had no drainage or plumbing. In rural areas, only 6% of the population had access to potable water systems and a scant 1% had plumbing facilities.

Lack of access to public services imposes a double penalty on the poor, since alternatives are often very costly. The unit cost of a cylinder of water in a Lima pueblo joven is 16.7 times more than an equivalent unit of running water. The cost of a candle is three times higher than an equivalent unit of electricity, and kerosene is still higher. Thus, the lack of access to public goods and services works to drive significant numbers of the Peruvian population more deeply into poverty.

4. Educational and Cultural Status

While 85% of school age children in Peru have some access to basic education -- an impressive achievement -- again, highly significant disparities in access to and quality of education exist between the urban and rural areas. The literacy rate of the national population

over 14 years old, is 72.4%, 84% in the urban areas and 48.1% in the rural areas. The illiteracy rate among rural woman (67%) is much higher than that of rural men (42%). To the extent that the rural population has access to educational services, the education provided is almost exclusively primary, with secondary and technical schools virtually non-existent in all but a few district capitals in the rural regions.

Over three million Peruvians do not speak Spanish; most of these are Quechua - speakers with a smaller number speaking Aymara. These groups constitute a sizeable minority of citizens who live in the rural sierra in conditions of absolute poverty. Thus, the marginality of the rural poor in terms of income, lack of access to education and health facilities, etc., is reinforced by a real, although covert, ethnic order which has historically determined the political and social position of ethnic groups.

5. Role of Women

Problems which women face differ according to social class, and rural vs. urban location. In subsistence farming, where the male head of household frequently works away from home, women perform at certain times virtually all agricultural tasks from plowing and planting through harvest and marketing. The rural woman also engages in commercial and artisan activities. Within the family, rural women play an important decision-making role -- handling domestic finances and often making decisions on the sale of produce and purchase of farm inputs.

In urban Peru, opportunities for personal advancement outside the home are much greater than in the countryside. Women are represented

in the major urban professions. Thousands of working class girls and women are enrolled in a variety of formal and non-formal education programs, which the government strongly supports. Thus, the agenda for urban women includes greater attention to expanding legal rights (divorce, employment) than would typically be the concern of rural women. The problem of abandonment in the slums is especially severe and points to the need for a much stronger program of urban social services.

6. Target Sub-Groups

The Mission has attempted to define Peruvian poverty in terms of geography, health, nutrition and educational status; income distribution and the role of women. Each of these perspectives is a useful guide to AID programming. But each also lacks an important dimension -- the connection between the poor and their means of making a living. The following categorization attempts to make this connection:

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

-- Agrarian Reform Group Beneficiaries. 170,000 families belong to group farming entities set up during the Agrarian Reform. Most of these associative enterprises (AE's) cultivate common land (the old hacienda lands) which produces crops and livestock for

sale. Within most units, at least part of the family continues to individually possess and farm a small (generally under 5 has) plot for their own consumption. In the sierra, most AE's are neither productive nor profitable and living conditions are generally poor for the approxima 60,000 member families. Poverty has been reinforced by the insufficiency of technical assistance, agriculture inputs and unfavorable price policies In contrast, the enterprises on the coast are significantly more productive and the GOP has allocated more resources to them.

-- Campesino Community and Group Members (Comuneros). CC's are the remnants of pre-Columbian villages in which pastureland is communally owned, while cropland is subdivided for use by individual members. Although, there are more than a thousand CC's with over 420,000 families or 2.4 million people, only 415 CC's became legally recognized unde the Agrarian Reform. Only 2% of total CC holdings is cultivated land as opposed to pasture, and only one-half of all comunero families have agricult land for their own use. Most of the CC's are in the sierra and some in the high jungle. Campesino groups are composed of small subsistence plot holders who were renters prior to the agrarian reform. There are currently 798 group totalling 44,761 sierra families. The often-used figure of 325,000 agrarian reform beneficiary families combines the membership of associative enterprises campesino groups and legally-registered campesino communities.

-- Landless and Near Landless. There are an estimated 438,000 such families, with 79% living in the sierra. Many hold small plots of land, but are not considered statistically as farmers since their holdings are too small to provide even a subsistence living. Most rely on casual labor opportunities

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

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

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

	Millions
Independent, market oriented farmers (sierra and high jungle)	1.1
Agrarian reform beneficiaries (sierra)	.3
Campesino Communities and Groups (sierra)	2.6
Landless and near Landless (sierra)	2.0
Urban poor	2.5
	8.5

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

B. PROGRESS, COMMITMENT AND THE PERSISTENCE OF POVERTY

1. The Peruvian Revolutionary Experiment

The Phase I Government. The Velasco, or Phase I government (October 3, 1968-August 29, 1975), undertook the most sweeping reforms in Peruvian history to restructure the ownership of national wealth. A series of expropriations -- described in some detail in last year's CDSS -- led to a situation in which, by 1973, the State had assumed the role previously held by foreign capital in electricity, telephones, and railways, had taken over much of the mining sector and banking system, virtually all export marketing, and the entire fishing sector. Velasco's agrarian reform established many diverse types of enterprises owned and administered by the campesino themselves. An industrial reform permitted workers to share in profits and management, while a new education law sought to promote decentralization and local-level participation. The government organized urban squatter settlements as pueblos jóvenes (new towns) and gave them unprecedented legal rights and financial assistance. A "social property" sector was established to encourage worker-managed; market-oriented firms.

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

private sector's legitimacy. The Phase II government applied certain new policies to the greatly-expanded state enterprise sector--reprivatization of the fishing fleet and adoption of measures to maintain the profitability of state enterprises. The Industrial Communities were restructured into what is fundamentally a profit-sharing scheme with maximum ownership by workers set at one-third of share equity. Foreign exchange controls were eliminated, and social property enterprises deemphasized (relatively few were actually ever established); and food and petroleum subsidies have been greatly reduced.

Impact of the Revolution. Though it is too early to attempt a definitive summary, we feel that the strength of the Peruvian revolution to date lies in its reduction of the power of the oligarchy. The ability of this narrow, but economically powerful, group to block reforms needed for expanded participation of the poor in national economic development has been sharply reduced. The reforms implemented by the revolutionary government increase the possibility that the benefits of future growth in Peru will be more equitably distributed. Moreover, Peru has accomplished these reforms while demonstrating respect for human rights. On the other hand, economic growth has lagged and has eroded the ability of government to undertake programs to meet the basic human needs of the poor.

2. Poverty--Causes and Remedies

Rural Poverty. The persistence and gravity of poverty in the rural sierra derive from a combination of high fertility rates, a limited natural resource base, and isolation of various types--physical, economic, and

institutional, Peru's poor are poor partly because the region of the country they inhabit is poor. They are kept from becoming productive more from the fact they are not given needed public sector assistance than from high taxes, high rents, political repression, and various other forms of direct exploitation. Although one can not rule out persistently unfavorable terms of trade vis-a-vis domestic urban of foreign markets, it is doubtful that this, by itself, can explain fully the substantially lower incomes of the sierra rual poor.

Several Peruvian analysts identified the following factors in response to the question, "Why are they poor?": (1) small amounts of arable land; (2) use of traditional technologies; (3) isolation from large markets which is related to (4) non-existent or precarious condition of roads; (5) farm production oriented principally to family consumption (with a corresponding loss in output as compared with that which would exist with greater specialization); (6) lack of adequate public sector services of most types normal to Peru's principal urban areas, in particular, health and educational services; (7) differentially poor public services related to sierra agriculture, e.g. credit, availability of improved seed, and agricultural extension services. To this list we would add (8) constrained mobility arising from linguistic and ethnic differences,i.e. in the sierra region there is a high correlation between poverty and indigenous Indian culture.

Economic Dualism. Peru has a strongly dualistic economic structure. The modern sector is composed of the principal export related enterprises (CentroMin, MineroPeru, HierroPeru, Southern Peru Copper Corporation, 12

coastal sugar cooperatives, PescaPeru, medium mining enterprises, coastal agricultural in general and coffee growing areas), the Lima based manufacturing firms, related banking and import firms and government offices. The modern sector utilizes advanced and capital-intensive technology. Six percent of business firms (750 firms) account for two-thirds of GDP and control about 60% of invested capital. The traditional sector relies principally on subsistence agriculture and in the sierra and on casual opportunities in the urban labor market. Agriculture and services account for 61% of the labor force.

Dualism in Peru has both a sectoral and a geographic basis. Recent GOP initiatives in decentralization, particularly the establishment of regional planning entities, are first steps towards improving social and physical infrastructure in Peru's poorer regions. Improvements in highway, communication, and electric power facilities are needed but not necessarily feasible in all areas of the sierra. In much of the sierra, the agricultural land base does not suffice for both sharply increased living standards and substantial population increase; therefore, outmigration to the coastal and high jungle has been, and will continue to be, a principal mechanism for longer-term equalization of incomes.

Income Transfers. The Agrarian Reform transferred rural assets, and the industrial reforms increased worker participation in profits. These measures increase the chance that future growth in Peru will be more equitably distributed. Generally, the reform-related income transfers have been vertical rather than horizontal, i.e. income was redistributed within each economic sector rather than from the rich sector (urban modern) to the poor

sector (sierra agriculture). Though horizontal transfers would have been greater had the government not entered a period of economic crisis, the inability of a determinedly reformist government to effect such transfers points to the deep-rootness and persistence of dualism in the Peruvian economy. Income transfers via provision of public services (nutrition, education, health and housing) are obviously needed but can take place only in the context of a strong fiscal position, economic growth, and stability.

3. Economic Deterioration and Recovery

Severe Recession. Peru's estimated GDP for 1979 is 17% less than it would have been if the economy had grown by a 5% annual growth rate from 1970. Unfortunately the economy was in recession in 1977-1979, with per annum GDP growth of about zero, an absolute decline in manufacturing and construction output, severe declines in real wages and incomes in the urban sector, and increased unemployment and underemployment. As a result, GDP per capita in 1979 approximates the level of 1969/70. The recession was induced by severe external account deterioration, i.e. a decline of banking system net international reserves amounting to $1,718 million from 1974 to 1978 and growth of external debt from $5,569 million in 1974 to $8,839 million in 1978. The history of this recession included three attempted stabilization programs, near default on external debt (April-May 1978), widespread street riots (July 1977), and accelerating inflation (from 24% in 1975 to 67% in 1979).

Recovery in View. A stabilization program composed of the usual elements, i.e. substantial external financing and fiscal austerity, was

implemented in the second half of 1978. The GOP obtained an IMF stand-by agreement in September 1978 (which runs through 1980), negotiated a rescheduling of public sector debt amortization due in 1979 and 1980 from major creditor governments and foreign commercial banks. It has subsequently complied with the fiscally-austere quarterly targets established in the IMF stand-by. Sharply increased export earnings in 1979, estimated at $3.5 billion versus $1.9 billion in 1978 (arising from increasing petroleum and minerals prices), as well as debt relief are expected to produce a $1.5 billion increase in Peru's net international reserve position in 1979. Due to recent increases in reserves, the GOP announced its intention to waive part of the debt rescheduling obtained for 1979/1980 in order to lower debt service ratios for future years. This improved balance of payments position sets the stage for economic recovery -- imports will increase to about $2.66 billion in 1980 (as compared to $1.60 billion in 1978 and $2.06 billion in 1979). Even with substantial recovery of the urban-industrial economy, it is doubtful that growth over the next four years will permit Peru to achieve the size of GDP that it would have had in the absence of the economic difficulties of the 1970s. To overtake a hypothetical 5% GDP trend line from 1970 would require an annual growth rate of 9.5%

Causal Factors. The length and severity of Peru's recent recession suggests inadequacies of previous economic strategy and policies. In the FY 1981 CDSS we considered three principal causes of Peru's recession to be "living beyond means" (delay in undertaking appropriate policies to reduce demand), waste of capital (i.e. lowered productivity of investment), and

bad luck (lower world prices and lower-than-forecast volumes for Peru's principal exports.

Petroleum Policy. Under the Phase I government, private investment fell off substantially and public sector participation in the investment process increased. Many potential investors left Peru, and most of those who stayed adopted a "wait and see" attitude. Petroleum was a key element in the GOP strategy to maintain import capacity in the face of generally declining private investment. Beginning in 1972, contracts with foreign firms were let for petroleum exploration in the eastern jungle, and this exploration proceeded at an intensive pace until 1975. Faith in the availability of a large exportable surplus of petroleum was one of the factors which induced policymakers to undertake large external borrowing to finance expanded public investment without reducing private consumption. The failure of the strategy became apparent in 1975, when total proven reserves amounted to only 550 million barrels (about 7 months of Venezuelan production).

4. Prospects for Future Economic Growth with Equity

The Morales Bermudez government plans a return to civilian rule by means of elections in May 1980. The new government will have the task of constructing its own strategy for long-run economic growth and for reduction of poverty. It will face a number of "givens", as well as certain key policy issues.

Permanent Factors. Looking forward through the 1980s and beyond, Peru's natural resource base and demographic factors are the principal forces facilitating and limiting economic welfare. Rich unexploited

minerals, abundant hydroelectric potential, and moderate petroleum reserves are obvious strengths. Limited agricultural land and the high cost of expanding such land, limited availability of water for the coastal area, and demographic pressure are obvious limitations. The active labor force will be growing at a high rate for at least the next 15 years, and urban population will increase. Population growth will place increasing pressure on agricultural land, the provision of basic public services, and food and energy supplies.

The Near-Term Economic Task. The new government will have to focus initially upon policies to improve real incomes and employment in the urban sector, which are now far below historic norms. Even two to three years of vigorous economic growth, however, would not result in a recovery of these norms, especially for the urban and rural poor. At present, a major obstacle to increasing real demand is a high rate of inflation. Also, some 10-25% of Lima households have been enduring substantial nutritional inadequacy. In this context, accession of the new government to popular demands for price controls and subsidies (particularly on basic foodstuffs) and for urban employment programs of possibly low productivity would be understandable and would not necessarily signal a permanent retreat from price-directed resource allocation.

Medium-Term Policy Issues. Four important issues for Peruvian economic and social development are energy, external debt management, employment generation, and the allocation of public expenditures.

--Energy -- At present, Peru's proven reserves of petroleum amount to about 715 million barrels. This would suffice (without exports) for

about one decade of domestic consumption, PetroPeru's General Manager has stated that unless Peru carries out an aggressive exploratory program in all areas which have good possibilities, Peru will have to stop exporting and start importing petroleum by 1984. Cessation of petroleum exports would erode Peru's B/P severely. According to the latest available Central Bank B/P projection, for the four year period 1980-1983 petroleum will account for $6.1 billion of $18.1 billion in export earnings. The current account balance will be $1.6 billion, and the net B/P surplus will be about $0.5 billion. Obviously unless proven reserves and on-stream production increase during the next half-decade, Peru's future B/P prospects will be pessimistic. Not finding more petroleum would create the need for vigorous investments in alternative sources of export earnings, e.g. mining, to purchase imported petroleum. This would be more expensive per unit of investment than petroleum extraction facilities.

Development of Peru's large hydroelectric potential is also crucial, but entails high capital requirements. The Peru-U.S. 1979 Energy Study indicated a required annual investment in electric power facilities on the order of $385 million by 1985 (in terms of January 1978 U.S. dollars). This will entail investments with long pay-off periods. Therefore, more adequate funding and longer loan maturities by IFIs would be extremely useful.

-- External Debt Management -- At the end of 1978 Peru's external debt amounted to $8.9 billion--$6.7 billion of over-one-year term (of which $5.3 billion is public sector debt) and $2.1 billion of short term debt. Peru's total debt approximates 79% of GDP. The service of public

sector debt approximates 35% of expected 1980 commodity export earnings ($1.4 billion in debt service as compared with $4.0 billion export earnings). As export earnings grow, this ratio will decline to 29% in 1983. For the years 1981-1983 the Central Bank B/P projection presumes $970 million in annual disbursements of external credits to the public sector. The current IMF stand-by agreement includes limitations on external credits to the public sector of less than ten year term. Uncertain long term petroleum prospects (and previous experience) may make foreign commercial banks view Peru's creditworthiness more cautiously than they did in the mid-1970s. At present, disposable foreign exchange reserves provide adequate coverge for existing short term external debt. However, we recommend that the IFIs, major bilateral landers, and Peruvian policymakers cooperate to improve the structure of Peru's external debt, because the service burden during the next half-decade will be high.

-- Underemployment/Unemployment -- Peru's labor force has been growing by about 150,000 annually. The World Bank projects growth of the active labor force during the period 1972-1990 at 5.0 - 6.7% per annum, i.e. a 170,000 to 227,000 annual increase by 1990(depending on labor participation rates). Recovery from the recession will help, but this alone will not suffice. The World Bank study recommends labor subsidies to employ and train labor. Additional programs -- credits linked to employment-generating exports, expanded public employment to create urban and rural social infrastructure, etc. -- should also be explored. Non-traditional exports, some of which are high employment generators, have increased rapidly in recent

years due to more favorable exchange rates and fiscal subsidies. The need is for continued and more rigorous application of fiscal subsidies, banking sector credits, and training programs in favor of labor-intensive exports. Employment should also be encouraged in the agriculture sector through labor-absorptive growth of food production, through opening up of frontier areas, and through off-farm opportunities.

The Allocation of Public Expenditures -- A better distribution of public expenditures is needed both for maximization of economic growth and for funding basic human needs. The following criticisms have been levelled at the recent pattern of allocations: (1) Nearly all civilian political groups desire increased allocations for social services. (2) Military expenditures were publicly criticized as excessive (in 1978) by Peru's present Minister of Economy and Finance. (3) Several large scale projects were undertaken during the past decade without adequate attention to economic and social analyses (e.g. Majes, Tinajones). (4) The existing expenditure pattern in several sectors needs changing. E.g. in agriculture, for the period 1973-1982, about 70% of investment ($505 million or about $100 million per year) is devoted to four major coastal irrigation projects--Majes, Chira-Piura, Tinajones and Jequetepeque-Zaña. At the same time, current operating expenditures of the Ministry of Agriculture--for research, extension, et.al--were only $26 million (in 1979). (5) Resources devoted to diagnosis, project creation, and preparation of standard economic and social data have been too low.

GOP budget priorities in terms of actual expenditures (investment

and operating expenses) are represented for recent years (1976-1978) as follows:

Central Government Expenditures: 1976-1978 Averages

Category	Millions $U.S.	% of Total
Government Housekeeping	69.6	2.4
Economic Sectors	499.3	17.0
Agriculture & Food	204.4	7.0
Fishing	14.4	0.5
Industry and Tourism	34.7	1.2
Energy and Mining	78.4	2.7
Transportation & Communication	103.5	3.5
Housing & Construction	33.4	1.1
Earthquake Zone	18.0	0.6
Bayovar Complex	5.5	0.2
Regional	6.9	0.2
Human Resources	585.4	19.9
Education	432.1	14 7
Health	131 3	4.5
Social Mobilization	21.9	0.7
Police and Military	971.4	33.0
Interest, Amortization, Ministry of Finance	815.0	27.7
TOTAL	2,940.7	100.0

C. HOST COUNTRY DEVELOPMENT PLAN AND BUDGET

The GOP's 1980 budget conforms to a program of austerity in fiscal expenditures, with an overall deficit programmed at 1% of GDP (as compared with about 5% in 1978 and about 2% in 1979). It is consistent with the current IMF stand-by agreement (which runs through 1980). In real terms, growth of current expenditures is constrained, and an increase in tax revenues is utilized to expand capital expenditures (by about 10%), with high priority given employment-generating investments. The 1979 and 1980 budgets also included a number of encouraging planning concepts: de-emphasis of the least feasible of the large coastal irrigation projects (Majes), greater funding of small projects with more immediate impact on employment and small farm productivity, and regionally-focused development planning and administration.

The current public sector investment program, prepared by the National Planning Office, reveals aggregate investment for the five-year period 1978-1982 amounting to $4.6 billion (in 1978 prices). Approximately 48% of the total corresponds to external financing (an annual flow of $433 million) and 11% is investment of mixed-ownership enterprises. Economic infrastructure is a significant proportion of the total, with sectoral composition as follows: agriculture, 18.0%; mining, 14.1%; petroleum, 7.4%; electricity, 20.0%; transportation, 11.3% and communications, 2.5%. Social expenditures (housing, education, health and social security) amount to 7.3% of the total; regional and local projects, 5.8%; industry and tourism, 6.8%; and fishing, 2.0%. About $1.9 billion of the $4.6 billion public sector

investment program corresponds to the central government (i.e. excludes state enterprises and autonomous agencies). 80% of central government investment activity is in agriculture, transportation, housing, education, health, and regional development.

In terms of the next half-decade, the GOP's plan for economic and social development must be considered an unknown; no political party has revealed a comprehensive program for future economic and social development. Such a plan, we believe, should address the important medium term policy issues discussed previously, set forth attainable goals likely to be accepted by a majority of the people, and specify the utilization of principal instruments of economic policy (fiscal, monetary, wages, exchange rate, tariffs, treatment of foreign capital, management of state enterprises).

The new government will be faced by demands for increased social expenditures (particularly in health and education) and for employment generation. These demands will come at a time when Peru has barely recaptured a non-inflation-generating fiscal equilibrium. To finance these demands, Peru will not be able to rely on external borrowing from commercial sources to the extent that it did in the mid-1970s. Moreover, inflationary financing would only undo the patient work of stabilization. The government can reallocate fiscal expenditures to some extent, and increasing tax revenues is also possible. But sizeable adjustments along these lines will take time. Thus, the longer-term survival of the democratic experiment will depend on a fiscal program which conforms to near-term domestic revenue constraints, but also responds to obvious immediate human needs.

An integral reform of the tax system and improved tax administration are necessary components of a long term development strategy. Economic growth on the order of 6.5% annually for the next five years and expansion of the tax base on the order of 3% of GDP (from 1976-1978) could yield additional revenues of about $1.4 billion of which, we judge, about one third ($460 million) could be applied to programs impacting directly on the poor.

The principal constraint for the next few years on the expansion of programs in health, education, urban development, agriculture and transportation is central government financial resources. Increased donor activity in favor of these programs depends upon GOP fiscal performance to general counterpart to meet donor requirements. In this way the mobilization and allocation of domestic resources are linked to two problems described earlier -- improvement of the term structure of external debt and meeting an annual balance of payments gap of about $970 million in the early 1980's. Out of this $970 million, the GOP estimates that annual external financing of central government investment projects will be $150 million (in 1978 dollars). This assumes total central government investments of approximately $375 million annually. We think these investment levels are much too low, given the fact that virtually all programs impacting on the poor are included therein. A consultative group would be the proper forum for encouraging Peru to increase its central government investment allocations, particularly to social programs and sierra/high jungle economic growth activities. The

increases should be phased-in over the CDSS period -- to an annual level of perhaps $700 million for the central government investment budget, of which about $450 million would be for a poverty-related program. This $450 million would leverage perhaps $200 million in aid donor support. This seems realistic, given the possibility of roughly $360 m. in annual flows of concessional financing (100 from the IBRD; 100 from IDB; 85 from AID loans and HIG's and 75 from others). Of course, an important share of external assistance would be provided outside the central government sector (to the private sector or autonomous public sector activities).

D. OTHER DONORS

Peru has been receiving about $250 million annually in foreign assistance over the past few years, principally from AID, the IBRD and IDB, the UN, and other bilateral donors (especially the Netherlands, West Germany and Belgium). This amount should increase -- a stronger-than-ever possibility, we think, since the recent appointment of an IBRD resident representative here in Peru. Current other donor assistance touches virtually every economic sector to some degree, though the bulk of it is concentrated in agriculture, industry, transportation, energy, and mining. Coastal Peru has tended to benefit from this aid to a greater extent than the sierra or high jungle. This is understandable since the effective demand for investment capital has been much greater on the coast and in the modern sector. Growth in these areas is important to the overall development of the country. More recently, however, some of the key donors have been stressing that the

sierra and high jungle must get a bigger share of the country's growth and are actively developing sierra and high jungle projects. We believe this trend to be important. We see numerous possibilities for complementary assistance activity -- hydroelectric power and major trunk roads in the high jungle financed by the IFI's would give considerable impetus to our own strategy; also, there is plenty of room for other donors to finance rural infrastructure investments through newly-created Regional Development Organizations. Social programs also desperately need expanding.

Over the next half-decade, AID and other donors can through their project selection criteria influence Peruvian investment priorities in the direction of equity. This can occur in a variety of ways: as more projects are located in poverty target areas, the counterpart from the GOP budget assigned to these areas will increase; as donors discuss policies with the new government, the importance of insuring that Peru's poor areas (including the sierra and high jungle) get a larger share of expenditures must come through loud and clear. Thus, the AID program must not only finance new programs for the poor but also help to implement a stronger equity emphasis within the GOP budget.

E. AID ASSISTANCE STRATEGY

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

Looking at the longer-term objective of moving poor Peruvians out of absolute poverty, the role of AID during the years of the CDSS planning cycle must be -- along with other donors -- to fill the gap between Peru's commitment to the poor and its still-weak fiscal position. The actions Peru has taken to restore economic growth have, in the short-run, reduced the government's ability to carry out programs for the poor. If foreign aid donors do not respond generously during this period, the position of the poor will worsen and even the most promising of the reforms implemented in Peru over the past 12 years will not realize their equity potential. It is possible that the new government will wish to convene a consultative group -- which we would strongly support.

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

1. Social programs: sierra emphasis -- efforts in health, family planning, education, and nutrition directed primarily at the 6 million rural inhabitants of the poorest region of the country.

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

3. Coastal urban basic human needs -- the plight of the urban poor is serious during the current economic recovery, and our strategy includes sizable assistance to urban poor groups -- principally via food aid, housing investment guarantees and OPG's. Even after Peru's economy revives, urban poverty will remain as one of the toughest, most persistent problems facing a new civilian government.

The Mission also will provide a limited amount of technical assistance to the GOP in economic and social planning, which will encompass all three categories of Mission strategy. The planning function, particularly in the Planning Institute and the Ministry of Food and Agriculture is quite weak.

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

-- Dualism is largely a regional phenomenon. Peru must overcome the backwardness and isolation of the sierra.

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

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

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

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

2. Agrarian Reform Beneficiaries. Although AID will not focus primary attention on this group, it should benefit on a region-specific basis through increased agricultural inputs and rural infrastructure. The next few years will likely see some adjustment in the size and mode of operation of sierra associative enterprises.

3. Campesino Communities and Groups. These communities will benefit from health and family planning delivery programs, educational efforts, and rural public works -- all of which rely heavily on community cooperation. In some cases (but not all) members of communities or the community itself will be able to take advantage of agriculture credit and technology improvements. It would be misleading to say that five years of stepped-up AID assistance can lead Peru's campesino communities out of poverty, but it can meaningfully improve their quality of life and, in certain instances, open up new economic opportunities.

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

5. Urban Poor. What differences will AID's proposed urban assistance make in the lives of the urban poor? In the short-run the answer is obvious -- malnutrition and suffering will be alleviated.

Over the long run, AID inputs can help demonstrate a more viable pattern of urban development for Peru, through successful decentralization as well as more effective urban social services.

A more detailed discussion of Mission strategy follows:

Social Programs: Sierra Emphasis

1. Health and Family Planning -- In the FY 81 CDSS the Mission outlined a strategy which featured:

-- pilot activities to establish a workable, integrated maternal/child health and family planning program for Peru.

-- low cost rural health programs throughout the sierra region to alleviate a severely high incidence of child mortality.

Pilot activities for integrated health and family planning are proceeding in the Sur Medio Health Region of Peru, which has its headquarters in Ica. Although this is largely a rural coastal region, not generally afflicted by extremes of rural and urban poverty, the importance of establishing a precedence and momentum for public family planning programs justified the choice of Ica. The public health leadership of this region is strong and eager to implement family planning services.

With regard to overall health strategy, the Mission found it difficult to maintain an exclusively sierra focus. In September, the Mission signed its first major loan/grant project with the Ministry of Health. The project extends low-cost primary health care into rural areas on a nationwide basis. Although the program will impact most heavily in the sierra region, the Minister of Health felt that it

would be politically impossible for him to expand basic rural health care only in the sierra, while the rural coast was also deficient in health services. Health experts also pointed to the plight of scattered low-jungle population, which probably suffers the worst health conditions in the country.

The Mission would still describe its major emphasis as the extension of benefits of a low-cost delivery system to the sierra rural poor. The Mission plans to initiate a major program for potable water supply over the next year or two, and this program will be limited to the sierra and high jungle. It will focus on communities of less than 2,000 inhabitants and will draw on experience the Mission has gained through an OPG with CARE. The IDB has a similar program for communities over 2,000.

Future activities of the Mission in health and family planing will depend to a great extent on our experience under the loan/grant for primary health care and the Sur Medio Project. The former includes basic equipment, medicine, health and nutrition education, simple environmental sanitation activities and training at the community and health post level. The latter is a broader program which includes contraceptives, medicines, nutrition education, child feeding and general aspects of maternal/child health -- all coordinated at the regional level. The key to the success of both these programs is a core of para-professional promoters and empirical midwives working with community health committees to provide simple health services and to make referrals to health posts. The program of primary health care does not yet include contraceptive services. This reflects the caution of the Peruvian government in the face of considerable church

opposition to contraceptive provision by the state. However, there are indications that family planning services are beginning to be offered in many regions and will be added, region by region, to the primary health care concept. By FY 81, or 82, we should be ready for a follow-on loan/grant program which expands both family planning and nutrition elements as part of the primary health care concept. AID's assistance is expected to impact most heavily in the sierra and low jungle.

The urban pueblos jóvenes will also benefit selectively from integrated health/family service programs assisted by AID. By FY 82, the Mission will already have made some impact on health problems of urban slums through CARE and OFASA food-for-work activities -- 25 health posts will be constructed, staffed and equipped each year -- but much more will remain to be done.

Over the course of the next year the Mission plans to undertake a health sector study to define better the investment requirements of the sector and the likely result of specific investments on the health status of the Peruvian poor. Other donors (e.g. IBRD, UNFPA) are expected to become more active in the health sector over the next few years.

2. Nutrition -- The problem of malnutrition in Peru has become so critical that immediate and diverse actions are required to reduce its magnitude and severity.

The Mission's major response has been to expand PL 480 Title II feeding program rapidly, using OPGs to finance increased

administrative costs of PVOs. The value of Title II commodities has quadrupled over the past three years to a level of $20 million in 1980. This increase has had an impressive impact on the hunger problem. The Title II program should be expanded even further to a level of $30 million annually in the near future.

Feeding programs of the voluntary agencies serve the Peruvian poor on a nation-wide basis, though concentration is heavy in the sierra. OFASA (Seventh Day Adventists) provides rations to over 100,000 FFW participants and their families in Lima's slums. Catholic Relief Service/CARITAS reaches a total of 392,000 recipients in Food for Work and Maternal-Child Health projects nation-wide. SEPAS (Church World Service)recently began a Food for Work program for 100,000 beneficiaries in eight sierra departments. CARE and USAID are preparing a development-oriented food for work program in Lima's pueblos jóvenes. In addition, a government-to-government school feeding program reaches 500,000 children. In all, the Title II program in 1980 will reach an estimated 1.1 million people in Peru with a direct nutrition supplement.

The agriculture production dimension of the nutrition problem is being explored through an OPG project whose purpose is to increase food production of campesino communities in the sierra. In one project, part of the increased production will be channeled into nutrition programs for the children of these communities. The relationship of nutrition to health care is an integral part of the Sur Medio pilot project in health and family planning -- para-professional health promoters are trained to identify serious malnutrition and set up

appropriate supplemental feeding programs. Child feeding will also be an important part of the Mission's pre-school education program in Puno and Cuzco -- an estimated 36,000 children will benefit from this program over the next four years.

Other donors are helping Peru to expand production of protein-rich cereals of Andean origin, such as tarhui and lupino. The Germans have financed a mill for lupino, and the GOP is beginning to purchase this product for use in school feeding. AID's project in soybean production offers another possibility for improvement of the Peruvian diet through the introduction of new products.

The "nutrition sector" gives the impression of considerable activity which has yet to be adequately coordinated. Responsibilities for activities with nutrition impact are widely scattered among several GOP agencies; the GOP does not have a comprehensive food and nutrition policy. An AID nutrition planning project is scheduled for FY 1980 to improve the GOP's capacity to evaluate the diverse nutrition activities that are now being carried out, to establish priorities for the future, to implement and test pilot projects, and to develop large-scale replications of those nutrition interventions which are found to be most promising. During the CDSS cycle, this project may generate loan financing requirements which AID would stand ready to assist (e.g. food technology, targeted agriculture production inputs, use of mass communications to improve weaning practices, etc.).

The primarily focus of AID's activities in nutrition will remain in the sierra. However, over the past year the Mission, has become

acutely aware of the severity of urban malnutrition. This is a permanent rather than a transitory problem and will be an important target of AID nutrition strategy.

3. Education

The Mission's activities in the education sector are at a critical juncture. A number of technical assistance projects are coming to an end, and results have not been encouraging. With the exception of a new project for pre-school education in Puno and Cuzco and a project to test the concept of educational service centers at the primary level (itself in trouble due to cost over-runs), the Mission's education program is essentially inactive.

It has become evident over the past year that the number one problem of the education sector in Peru is the struggle between unionized teachers and the Ministry of Education headquarters in Lima. The government has permitted teachers' real wages to decline by 50% over the past three years (a greater decline than for other public sector employes). A protracted teachers' strike closed down Peruvian schools for nearly four months in each of the past two years. The Ministry's attention is absorbed to a large degree in labor problems.

Representatives of the AID Mission met recently with officials of the National Planning Institute, and the situation in the education sector was of great concern to both parties. INP was aware of the Mission's recent unfavorable experience in the sector and asked if we might finance a joint study of Peru's educational problems which could be made available to the new government. We agreed that this would be

an excellent opportunity to determine what AID might usefully do in the future. Certain possibilities for future programming clearly do exist. For example, a program to assist the impoverished southern sierra could: extend pre-school education more broadly, develop incentive programs for female education, as well as deal with some of the more conventional financial and technical requirements of the sector -- teacher training, job skills and vocational education, local production of teaching materials. Pre-school education is especially attractive, as it delivers nutrition and educational benefits to the most vulnerable sub-group in Peru. Another possibility is with the Catholic organization Fe y Alegría which has successfully carried out vocational training in the Lima pueblos jóvenes under an OPG.

Sierra and High Jungle Economic Growth

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

We wish to stress the unity of the sierra and the high jungle in USAID strategy. In the emerging context of decentralization, GOP planners are in the process of identifying sub-regions of sierra and adjacent high jungle, in which they want to generate a complementary process of economic growth and population adjustment. Surplus sierra zones, designated as "expellor" areas are linked with high jungle zones called "receptor" areas. This conceptual framework appeals strongly

to the Mission, for it joins economic growth potential with the basic human needs requirement of large numbers of people. As promised in last year's CDSS, the Mission has been attempting to specify in more detail those sierra and high jungle areas with the strongest agriculture and industrialization prospects. It is the Mission intention to direct the bulk of resources under the sierra/high jungle growth strategy to these selected areas. In this way, by the end of the CDSS period we will have something to show for our investment in terms of a self-sustaining growth process. We consider it unwise to dissipate resources in areas with little or no potential.

Areas within the Peruvian sierra and high jungle can be characterized as "transitional upward" areas, "transitional downward" areas, and "frontier" areas. The upward-bound areas have a better resource base, usually in the form of one or two valleys where crops can be grown, fair access to markets, and an agricultural export base which yields income from outside the region to break the poverty cycle. Downward-tending areas have more limited agricultural resources, export very little, and have difficult or non-existent access to markets. Frontier areas are essentially in the high jungle, which comprises the temperate zone along the eastern slope of the Andes.

The high jungle stretches the entire length of the Peruvian Andes and exhibits fairly uniform physical and climatic characteristics throughout. Some areas contain more potentially-arable, flat land than others, but there appears to be decent economic potential in most of the high jungle zone. What does vary a great deal is market access.

Major trunk roads have only penetrated several areas of the high jungle (Junin, San Martin, parts of Pasco). High jungle areas which appear to be large and have fairly good potential (for example, the high jungle of Ayacucho) do not have adequate penetration roads. In areas such as this one, and further south in Puno for example, the high jungle is fundamentally an extension of a sierra subsistence economy. There is some colonization in these non-accessible high jungle areas, with indigenous communities from the high sierra moving into these lower regions. But the full potential of these regions cannot be realized unless a broader trade in agricultural commodities is feasible.

The three major "upward transitional" areas of the Peruvian sierra appear to be Junin, Cajamarca and Puno -- in roughly that order of economic potential.

Junin, the key department of the central sierra, contains not only the largest and most productive sierra valley (the Mantaro), but also one of the best medium-sized valleys, that of Tarma. Junin is linked to the Lima market by good roads, and its high jungle portion (San Ramón, Satipo) also has adequate major trunk roads. Junin contains large pampas suitable for sheep and livestock production. As a result, its agriculture is fairly diversified, with Junin contributing nearly 5% of Peru's cattle production, 6% of its swine production, nearly 14% of its potatoes and 12% and 16% of its sheep and wool (respectively). Its total value of agricultural production is the second highest among sierra departments. In terms of value of production per cultivated hectare it is clearly the highest.

The population of Junin (600,000) presents the typical sociology of the sierra (see target group analysis), but it is somewhat more urbanized due to the vitality and growth of the capital city, Huancayo. The department of Junin also provides employment and services to poorer departments close by -- for example, farmers from nearby Huancavelica drive their cattle to slaughter houses near Huancayo, while landless and near-landless laborers from that department are frequently found working on the small coffee farms of Junin's high jungle.

Cajamarca contains one large valley with good agricultural crop land. Cajamarca's resource base should be defined to include the high jungle areas of two adjacent departments, San Martin and Amazonas. For purposes of Mission strategy, Cajamarca, San Martin and parts of Amazonas form a geographic unity. Cajamarca is linked by road to the urban coastal market of Chiclayo -- Trujillo. Adjacent high jungle areas (for example, Tarapoto in San Martin) also have access to the coast by road. Cajamarca itself contributes nearly 30% of the country's cattle and dairy production, 5% of its corn production and nearly 10% of its swine production. Potential for rice is also strong in the northern part of the department, which has good lands at lower elevation. Unfortunately, that area is poorly connected by road to major markets. The department has the top value of agricultural output in the sierra, though its output per cultivated area is lower than that of Junin. With one million people it is a heavily-populated department and one of Peru's poorest according to the Mission's geographic profile of poverty. Cajamarca agriculture is not as

diversified as that of Junin. It is only specialized enough in cattle and pigs to permit significant exports. As Cajamarca's neighboring high jungle areas begin to produce more food, the agricultural economy of the entire zone will become more diversified. There is already considerable migration of people from Cajamarca to these nearby lands.

Puno is clearly at a somewhat lower level of potential among sierra regions. However, it can still be described as upwardly-transitional due to its strong position in the production and export of livestock. Puno produces 8% of Peru's cattle, 25% of its sheep and 44% of its wool production. 10% of Peru's potato production also comes from Puno. The department is sufficiently specialized in the production of these commodities to permit vigorous exports. The department is connected by road and rail to Peru's second largest city, Arequipa, and it has an outlet to the sea in the port of Mollendo. Although the department of Puno is quite poor, it is one of the few areas of the sierra that has experienced some in-migration over the past decade. The department has excellent pasture land but is not a prime area for the production of most crops. Is poorly connected by road to its adjacent high jungle area. Puno is third among sierra departments in agricultural production and second in output/cultivated area (just slightly ahead of Cajamarca).

A fourth area made up of the Departments of Cerro de Pasco and Huanuco is also worth considering. The sierra portions of these departments have little going for them -- their livestock production is much less significant than that of Puno and Junin, for example.

Rather, they are interesting for their high jungle regions. A road which AID is helping to build with Title I local currencies is being constructed into the Puerto Bermudez region of Pasco, and the Mission intends to study this area as a possible site for replication of a sub-tropical lands development project now under way in Tarapoto (San Martin). The high jungle of Huanuco is, of course, a major coca growing area and the source of the raw material for much of the illicit narcotics trade. A major U.S. objective is to reduce significantly the illicit excess coca crop, bearing in mind that AID development projects in such areas can be important in reducing production of narcotics and in promoting alternate development. In this regard, the Embassy and AID are planning to undertake shortly a rural development study of the region based on the groundwork already done in a previous, shorter report, so that a detailed plan for coca transition/rural development combined with increased enforcement and control measures can be presented to the new civilian government when it takes office in mid-1980. This could entail a significant rural development loan for the area sometime during the CDSS period.

During the CDSS planning cycle the Mission will continue to stress the priority regions of Junin and Cajamarca-San Martin, especially as regards physical infrastructure investment. At some point in the cycle, however, we should move toward an expansion of program focus by beginning to work with the regional development committees of Puno and/or Pasco-Huanuco. To some extent, the choice of regions depends on the actions of other donors. The IBRD has shown some interest in Puno and

is developing an integrated rural development project for Lampa Province (possibly the highest-potential area of Puno). The German program is quite active in Ayacucho, and the Dutch tend to concentrate in the large department of Cuzco.

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

1. Rural Infrastructure

a. Market town investments such as marketplaces, slaughterhouses, and municipal services would be chosen on the basis of regional economic impact. We anticipate substantial investment requirements undertaken in the Regional Development Committee context and planned for maximum strengthening of rural-urban linkages. The HIG program can also help supply capital for housing and urban public services that many of the more important market towns require.

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

c. Rural public works - in looking closely at the development requirements of the sierra/high jungle, one is struck by the availability of surplus labor, the willingness of communities to donate their labor, and the need for small-scale infrastructure in rural communities. In 1978 the GOP initiated a program of "local interest projects by deparment," under which rural communities propose local

public works activities at the regional or departmental level -- small bridges, road improvement, conservation, etc. Allocations were $11 m. in 1978 and are budgeted at $48 m. in 1980. AID will support expansion of this program through PL 480 local currency, Title II food-for-work, and loan funds provided for this purpose to regional development committees in priority departments.

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

3. Research and Extension - During the past 10 years considerable deterioration has taken place in the agricultural training, research and extension sub-system. Since 1977 the GOP has reversed this trend in terms of policy, but lacks the resources to effect the desired revitalization. A Title XII comprehensive baseline study of the training, research and extension system, completed in 1979, forms the basis for a major program of assistance in five of Peru's most important food crops. This loan/grant project will begin in FY 80. By FY 82 or 83 we will be ready for the recommended second phase dealing with livestock, especially aimed at sheep, llama and alpaca -- the principal income source for the sierra farmer.

4. On-Farm Agricultural Inputs - types of investments needed to increase productivity include provision of fertilizer, land preparation (leveling, drainage, fencing, etc.), improved breeding stock (cattle, sheep, llama, alpaca), and seed multiplication. Substantial institutional

constraints exists to the successful provision of inputs to target group farmers. This is true especially of the independent farmers and campesino communities. The creation of economically-viable small farmer organizations is made difficult in Peru by the diversity of micro-regions in the sierra and high Jungle, the lack of clear government policy toward farmers who are not associated with agrarian reform units, and the cultural isolation of certain groups (especially the campesino Communities). AID's TA project with a cooperative bank may prove to be an effective channel for reaching small farmers in the Junin region. The Mission also intends to explore intensively during FY 1980 (with assistance from a local PVO) the prospects for a member-owned marketing enterprise in the Central sierra. A loan for expansion of food production in the sierra is scheduled for FY 1981. The Mission plans to work with development committees in priority regions and with the Agrarian Bank in formulating programs for inputs delivery.

5. Rural Enterprises - the ability of the sierra and the high jungle to generate off-farm employment depends fundamentally on the growth performance of agriculture. However, the process of small enterprises formation (under both coooperative and single-entrepreneur ownership) can be stimulated through timely input of credit and technical assistance. A highly successful credit channel created by the Industrial Bank with AID support will be expanded. Another loan -- for private sector agribusiness development channeled through the Central Bank -- has also proven successful and will be replicated in FY 80 or 81.

6. Natural Resource Preservation and Renewal - an inventory of Peru's agricultural resource base (land and water) has been completed for the coast and some selected areas of the selva and sierra. However, large areas of these latter two regions remain to be inventoried. Many of these areas are of key importance in the design of development programs targeted to the poorest rural segments of the Peruvian population and to the opening up of new agricultural lands. Inventories are also needed to plan the prevention of resource deterioration already taking place -- especially stream pollution from mining and soil erosion through inadequate conservation practices on cultivated land. A project to assist the GOP obtain resource information will begin in FY 80.

To increase agriculture production and small farmer income, as well as to address environmental problems, the Mission plans to finance programs of soil and water conservation, water-shed management, and reforestation. These efforts will draw on Mission experience in small-scale sierra irrigation projects (by 1982, some 1,200 hectares will have been completed) and in reforestation (an OPG/Title II program through the local affiliate of Church World Service will have planted 31,000 hectares in five sierra departments by 1982). Community based-conservation programs in the sierra will also be encouraged through OPG's to local private voluntary organizations.

7. Appropriate Rural Technology - The Mission is exploring unconventional technologies of potential benefit to the rural poor. These include: the use of treated sewage for on-farm irrigation,

improved farm implements and intermediate technology applications in rural small industry. At present, their potential for replication is not yet known; however, results are almost in for the treated sewage project in Tacna. The beneficiaries in Tacna are clearly the poorest of the urban low-income groups (living in urban-fringe desert areas which can be irrigated for small-scale agriculture). Therefore the project would fit under AID's urban basic human needs program or could be made available to an IFI for replication.

8. Energy - As indicated previously, Peru's most crucial issue with respect to energy is how to manage a transition from petroleum to hydroelectric power. At current appropriation levels, AID has no possibility of becoming involved in major hydroelectric investments. However, IFI's can and should provide funding for high-priority hydro projects. U.S. private sector financial institutions and Eximbank could participate constructively with the IFI's in the creation of financial packages for these projects. Therefore, IDCA should work with OPIC and Exim to help bring about such financing arrangements.

AID's strategy with respect to energy will be to: (1) finance small-scale "minihydro" plants in key areas of the sierra and high jungle, and (2) strengthen the GOP's capability to test and evaluate alternative energy sources. A loan/grant program for FY 1980 will finance minihydro plants in those regions of the sierra and high jungle which are of top priority to AID. At the same time technical assistance will be provided to the Ministry of Energy and Mines in alternative energy sources --wind and solar power, geo-thermal resources, and

technical alternatives within the general field of minihydro itself. The German aid program will continue to supply Peru with technical assistance (engineering, macro-planning) in the field of electric power. The Germans are also considering assistance to construct mini-hydro plants, primarily in Ayacucho and Cuzco.

The Mission's continuing efforts in reforestation will be another way of addressing the energy problems of the poor -- much of Peru's sierra has suffered from deforestation, particularly in over-populated, poor valleys such as Cajamarca, and the resulting loss of firewood deprives the poor of their major energy resource.

Urban Basic Human Needs

There are two fundamental concerns addressed by Mission strategy: one is urban poverty (documented in the first part of the CDSS), and the other is urban development, the optimal role of cities and towns in the Peruvian development process. Urban poverty can be alleviated through short-term emergency programs (e.g. Food for Work), but cannot be solved until the economy is sufficiently vigorous to absorb under-employed and unemployed labor. We anticipate a continuing severe problem of urban poverty in Peru. Urban development, on the other hand, considers the contribution of cities to the economic life of the country and attempts to devise policies which will serve a pattern of balanced urban-rural growth. The Mission's strategy attempts both to alleviate urban poverty, and to establish an improved policy and planning framework to stimulate urban development. The Mission's strategy is divided into four parts:

1. Social programs: To combat urban malnutrition the Mission has

organized urban food-for-work programs for maximum short-term impact. A new program, to be carried out in Lima by CARE, will utilize Title II food to pay workers, local currency from PL 480 sales to purchase materials, and grant funds for program administration -- some 45,000 persons will benefit in the first year (with expansion ancitipated in subsequent years). This program will establish a variety of essential services in the pueblos jóvenes as well as employ and feed the urban poor at a time of great need. The goal is to institutionalize this program within the GOP. To that end, we also intend to apply DSB (Office of Housing) grant funds to the improvement of planning capability in the Ministry of Housing. Thus, the CARE program has both short-term emergency and long-term development characteristics.

We expect that the new civilian government will face such serious political demands (pent-up after several years of declining real incomes) that we will be asked to continue all of our Title II programs in urban areas for some time. We believe that such continuation will be justified. In the short-run, one cannot expect the revival of the modern sector urban economy to provide a great deal of relief on the employment side.

In addition to food programs, the Mission intends to selectively fund health and family planning activities among the most needy urban residents (as explained previously) and to help expand opportunities for vocational education in the poverty-impacted slums.

2. Urban Services in the Shelter Sector: USAID's Housing Investment Guarantee Program has benefitted an estimated 55 thousand low-income persons to date. The program stresses provision of services (water,

sewerage, electricity hookup) and preparing urban land for settlement (sites and services). Housing itself is effectively excluded from the program, since even the cheapest unit is beyond the reach of AID's target group. Peru's Housing Bank is currently suffering from decapitalization due to high rates of inflation. GOP subsidies are keeping the Bank's programs (including the HIG program) afloat during a difficult period. This is solid evidence of GOP commitment. In last year's CDSS the Mission proposed an increase of HIG authority in Peru to $25 million annually. We remain convinced that these levels are realistic, and that institutions other than the Peruvian Housing Bank can be developed as channels for HIG funds. In FY 80 for example, the savings and loan system will be used. Over the next several years we also intend to channel a greater portion of the HIG program to secondary cities, in conjunction with loan and grant financing for Regional Development Committee programs. Toward the end of the CDSS period, it will be possible to finance some low-cost housing units, as real incomes of the target group increase. It might also be possible to extend the coverage of the HIG program to housing-related community projects (for example, a community center) and we intend to work with a local PVO to organize communities for this purpose.

3. Decentralization: Much of AID's overall strategy in Peru is aimed at building up provincial areas in which sizable numbers of poor people live, creating economic growth in these areas so that they can serve as alternatives to Lima and other urban coastal cities. It is not so much a question of solving the problem of massive migration to

Lima as it is of alleviating enough of this tremendous burden so that the position of the poor in Lima and other coastal cities stands a chance of improvement. It is also in the interest of the country to foster a more balanced industrial and population location policy. Most of these points have been covered previously under the sierra and high jungle economic growth section of the CDSS. Peru's decentralized investment policies should show significant results during the CDSS period. The city of Huancayo for example is already close to 200,000 in population and shows all the signs of becoming a major sierra growth pole. Businesses of the kind which used to be located only in Lima (e.g. meat butchering and packing) are appearing in Huancayo, providing value-added which previously would have gone to Lima. The GOP appears eager to foster this kind of development -- this is manifested not only in the creation of regional development committees but also in the application of tax exonerations for investors in non-coastal areas.

4. Credit for Small Business in the Urban Slums: An urban slum in Peru does not present the picture of an undifferentiated mass of poverty. Considerable entreprenuerial activity occurs, and many of these "informal" business ventures are important to meeting the basic human needs of the urban poor -- materials for home construction, food marketing, provision of households supplies, etc. The Missions intends to develop programs for small business in the pueblos jovenes on a pilot basis. We would use our successful experience of assisting rural enterprises in the sierra, although a great deal of modification is likely to be required in the urban setting. Two possible institutional channels are: the Industrial Bank of Peru and the Caja Municipal of Lima (Municipal Pawnshop).

F. ASSISTANCE PLANNING LEVEL

PAPL - by Program Emphasis

	82	83	84	85	86	TOTALS
Social Programs: Sierra Emphasis	37	47	36	60	36	216
Health/Family Planning	5	25	5	24	15	74
Nutrition	30	20	20	35	20	125
Education	2	2	11	1	1	17
Sierra and High Jungle Economic Growth	71.0	71.0	87.0	73.0	80.0	322
Rural Infrastructure	42.3	31.3	34.3	43.3	18.3	169.5
Agr. Research/Extension	5.5	21.5	6.5	5.5	5.5	44.5
On-Farm Agr. Inputs	2.5	2.5	1.5	21.5	1.5	29.5
Rural Enterprises/ Agribusiness	15	10	-	-	15	40.0
Natural Resource Preservation and Renewal	2.5	2.5	17.5	1.5	17.5	41.5
Appropriate Technology	.2	.2	10.2	.2	.2	11.0
Energy	3	3	11	1	22	46
Urban Basic Human Needs	37	32	32	32	45	178
GRAND TOTAL	145	150	155	165	161	776

PAPL - by Funding Category

	82	83	84	85	86	TOTALS
Social Programs: Sierra Emphasis	37	47	36	60	36	216
Grants	5	5	5	5	5	25
Loans	10	20	10	35	10	85

	82	83	84	85	86	TOTALS
HIG	-	-	-	-	-	-
Title II	18	18	18	18	18	90
Title I	4	4	3	2	3	16
Sierra and High Jungle Economic Growth	71	71	87	73	80	382
Grants	3	3	3	3	3	15
Loans	35	35	55	45	50	220
HIG	10	10	10	10	10	50
Title II*	-	-	-	-	-	-
Title I	23	23	19	15	17	97
Urban Basic Human Needs	37	32	32	32	45	178
Grants	2	2	2	2	2	10
Loans	5	-	-	-	20	25
HIG	15	15	15	15	15	75
Title II	12	12	12	12	8	56
Title I	3	3	3	3	-	12
GRAND TOTAL	145	150	155	165	161	776
Grants	10	10	10	10	10	50
Loans	50	55	65	80	80	330
HIG	25	25	25	25	25	125
Title II	30	30	30	30	26	146
Title I	30	30	25	20	20	125

* Food for Work portion (Social Programs: Sierra emphasis) also relates to growth goals.

USAID/Peru emerged from last year's CDSS Review with an approved planning level of $90 m for FY 85. This year the Mission's IPA was $43 million (loans and grants for FY 86). This is less than half the level approved last year, and it is only slightly higher than the actual FY 79 level (about $35 m). Obviously, the most recent IPA is deeply troubling to the Mission. Is it realistic to assign a loan/grant level this low to a poor, and relatively important, country such as Peru during a period of presumed rapid growth in AID appropriations (FY 82 - 86)? If the PAPL were achieved, Peru would receive about $200 million more in loans and grants than is implied in the most recent Indicative Planning Allocation, as follows:

	82	83	84	85	85
	($ Millions)				
PAPL	60	65	75	90	90
IPA (est.)	25	30	34	40	43
Difference	35	35	41	50	47 + 208

The effect of not achieving the PAPL (i.e. of losing out on the additional $200 million) would depend, of course, on the priorities assigned within the strategy. At lower levels, the Mission would recommend primary concentration on social programs, especially health - nutrition - family planning, and the agriculture research/extension and on-farm inputs portions of the sierra and high jungle economic growth strategy. Obviously, rural infrastructure and energy represent the largest demand for financing and at aid levels

below the PAPL, we would be constrained in contributing to these vital programs.

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

Grants - A modestly rising grant level is needed to provide technical assistance elements for major programs in all sectors and for pilot work in preparation for these programs. The Mission views the grant component of major programs (e.g. Agriculture Research and Extension, which will be financed using both loan and grant funds) as one way the Mission can manage a larger AID effort while keeping down direct hire staff levels. Joining grants and loans also permits a more concentrated effort toward reaching the goals of USAID strategy.

OPG projects will continue to play an important role in Mission strategy --to support an expanding Title II program, to encourage grass-roots voluntary organizations in carrying out community action programs, to provide economic opportunities for rural and urban poor women, and to experiment with new approaches to development in agriculture, education and health. AID has been instrumental in the emergence of two women's organizations: one directed at rural-poor programs and the other interested in legal and social services for the urban poor. The OPG program has moved up from about $400,000 in FY 78 to $1.4 m in FY 80 and is expected to continue at about that level. It is one of the most effective programs that exists in Peru to encourage poverty-directed work by local organizations.

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

HIG - This highly successful urban program should increase to an annual $25 million level -- shelter sector institutions can handle $15 million in coastal slums and up to $10 million in other urban centers and market towns.

PL 480 Title I - Peru continues to be close to the prescribed per capita income out-off for Title III, but not near enough. However, if the per capita income rules for the program were to change, we are convinced that an excellent program, strongly supportive of poverty reduction could be devised. We urge the AID Administrator and the Administrator of IDCA to work vigorously to change the language of PL 480 legislation to introduce greater flexibility so that cases such as Peru could be included.

In the meantime, we are using Title I for its maximum development impact. We have developed with the Government of Peru detailed plans for the use of local currency generations. These funds are used to finance projects which are complementary to our own -- for example major penetration roads into the high jungle. They are also used to finance counterpart for AID projects. Local currencies from the FY 78 and 79 agreements have already helped considerably to institutionalize the poverty - focus which the Mission seeks to realize in

its development strategy. The development impact of $123 million in Title I sales proposed during the CDSS period would be very powerful, given continued fiscal tightness in Peru.

A program of concessional food sales would utilize US wheat, soybean oil and (especially) rice. It is difficult to predict the supply and distribution of these commodities for the first half of the 1980's. For example, in the FY 1981 ABS (May 1979) we estimated a rice import requirement for FY 80 of 105 thousand MT. Latest unofficial estimates, only 9 months later, call for 210 thousand MT of imports due to continued drought conditions in northern Peru and also to the fact that many coastal farmers are getting out of low-value rice and into high-value cotton. Edible oil requirements will depend heavily on the fluctuations of domestic fishoil production. The potential for increased wheat consumption between now and the mid 1980's appears to be strong given the rapidgrowth of Peru's coastal urban population.

We wish to stress the importance of Title I imports during the early years of the new civilian government and especially in the period immediately upon taking office. That government will be hard-preseed to acceed to the demands of an urban population which has been financially squeezed. Moreover, agricultural production is not going to take off overnight, no matter what the agricultural policy innovations of the government may be. Timely imports of basic food-grains under PL 480 will, therefore, constitute a crucial pillar of support. As to funding levels, it is likely that annual Title I Programs in the range of $30 m during the early years and $ 20 m

during the later years of the CDSS cycle will be fully justifiable on grounds of support to the new Peruvian government and to its development budget.

PL 480 Title II - Further increases are needed (1) to combat serious malnutrition in urban areas, (2) expand school feeding (as GOP administration of the program improves), and (3) to fit a nutrition component into the primary health care program. Thus, we are less sanguine than last year that Title II levels can diminish over the CDSS period. Because Title II is such an integral part of each strategy component (sierra social programs, economic growth, and urban basic needs) it is highly desirable to keep this development resource flowing at constant, high annual levels (est. $30 million).

Staffing Implications

The Mission's current U.S. direct hire ceiling is 23, and its foreign national ceiling is 60. In last year's CDSS the Mission suggested that some increase in direct hire staff (mainly in project management) would be needed before the end of the CDSS period. We intended, however, to keep increases to a minimum by continuing to pursue the kind of management policies which have enabled the Mission to carry out a vigorous, growing program with a very lean direct-hire staff. Some of these measures are: financing grant projects as companions to major loans (thereby shifting some of the project management burden to US or Peruvian contract technicians) and using OPGs (e.g. under the Title II program) to substantially shift management responsibilities to private voluntary organizations.

Since last year, we have noted the agency's intention to cut staff by 10% by the year 1985. One of the Mission techniques -- using PVO's more heavily -- figures prominently in the communications we have received from AID/W. The Mission's experience on this point is interesting -- we have expanded the Title II program fourfold over the past 2 1/2 years while holding staff levels constant in the Food for Peace office. This expansion has been made possible through the provision of OPGs to four principal PVOs which handle food in Peru. While this technique has worked well in terms of keeping down direct hire levels, it has also proven to be rather costly. We obligate about $800,000 per year for the four OPGs, and of that $332,000 goes for personnel and related costs in the PVO organizations. In time these amounts will decline as the GOP is able to contribute more to administration of the expanded programs. However, $332,000 is quite a large sum, especially if one compares it to the Mission's overall operating expense budget (1.2 million dollars) and the portion of operating expenses going to salaries of 60 USAID local employes ($400,000).

The loan which we are developing for agricultural research and extension was handled under Title XII auspices at the project development stage. A consulting group recruited and approved by Title XII conducted the preliminary studies. We presume that a consortium of US universities, again under Title XII auspices, will provide technical assistance under the project once it is approved. The Mission's management burden may be diminished by virtue of the Title XII connection. We plan to shift procurement, training and other functions to the contractor. But four or five additional AID

contract employees in Peru will also mean more work for the Mission in some areas, e.g. controller operations, executive office functions and, of course, project management.

We see two ways to "do more with less people". One is to rely more heavily on foreign nationals -- making better use of Mission direct hire positions, expanding local contracts, and (where possible) shifting more responsibility to counterpart organizations. In Peru local employees fill key professional jobs within the Mission (e.g. Chief engineer, assistant program officer, financial analyst, deputy executive officer). Local contracts have also proven to be helpful in expanding the Mission's capacity to perform in-depth project evaluations. The second is simply to do more of the kinds of projects which require less staff -- larger projects, relatively simple in design, and (in many cases) channelled through intermediate credit institutions. Larger construction projects for rural infrastructure would be stressed; for example, financing of major trunk roads as opposed to numerous farm-to-market roads. Sector-type financing is also an option. Projects of this kind are extremely important to the success of development programs aimed at reducing poverty, but they are not terribly innovative and are quite similar to typical IFI projects. More extensive replication of successful AID projects can also reduce the management burden. But even a replication project needs to be managed, and the replication is never as straight-forward and simple as is might look from the CDSS vantage point. A different region may be involved, with special sociological and administrative

characteristics. Modifications based on previous experience are often necessary.

To sum up, it would be possible for this Mission to manage an FY 86 program at the PAPL with the same number of staff we have now. The program itself would be consistent with the strategy proposed in the CDSS. However, we would have to rely heavily on Peruvian intermediate credit institutions to move the money, and we would have less time to devote to pilot projects which might pay off in the creation of new approaches to persistent poverty problems.