

CDSS

FY 92 - 96

USAID/Peru

May, 1991

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I. OVERVIEW OF THE ENVIRONMENT FOR DEVELOPMENT AND DEMOCRACY

A. Economic and Social Highlights

Peru's size, topography, and tropical location endow it with a variety of environments and natural resources. It comprises three broad natural regions: the coast, the Andean Sierra and the Amazonian Selva. Nearly one half of Peru's 22 million people lives in the coastal region, 40% in the Sierra and the remainder in the Selva, which comprises 67% of Peru's area. These physical divisions are reflected in marked social contrasts which have slowed Peru's integration as a society, and in recent years have inhibited efforts to control the violence that threatens the country's fragile democracy.

Peru has a relatively open economy, with merchandise trade representing about one-fourth of GDP. Principal economic activities are manufacturing, mining, agriculture, and services. Manufacturing produces mostly consumer goods for the domestic market, intermediate goods, and to a lesser extent capital goods. Manufacturing contributed 21% to GDP in 1990 and about 12% to exports. The manufacturing sector emerged behind a complex web of trade barriers and regulations that protected it against external competition, and fostered a dependence on imported inputs and technologically outmoded and capital intensive production processes.

Mining is Peru's largest source of export earnings, and it remains an enclave sector with few linkages to the rest of the economy. The principal minerals are copper, zinc, lead, and silver. Mining contributed 12% to GDP in 1990 and generated 44% of export earnings. In the 60's and 70's, fisheries were a major export, but later declined to around 15% of export earnings due to over-exploitation, and the nationalization of private fleets.

Peruvian agriculture reflects the country's varied ecological regions, with irrigated

farming in some 52 coastal valleys, and a combination of rainfed and irrigated farming in the highlands. Forestry and some agricultural activities, which are poorly linked to the national market, are the principal legitimate economic forms of land-use in the Selva. The services sector employs about 26% of the economically active population and generates about 52% of GDP. This sector is comprised mainly of commerce, government, insurance and other activities.

Peru's diverse topography constitutes a major constraint to balanced economic development. It restricts the development of a transport network, limiting the possibilities of economic integration and trade within the country. The road network has disintegrated in the past decade because of insufficient public investment. Other infrastructure facilities including ports, railways and power generation and transmission networks have declined because of lack of maintenance as well as terrorist actions.

Governmental intervention in the Peruvian economy has been ubiquitous. A number of public enterprises created in the 60's and 70's attempted to control production and infrastructure in strategic sectors. The growth of the state reduced its efficiency and the private sector's contribution to the economy. Currently, there are about 180 state-owned enterprises, most of which have been operating at a loss owing to poor management practices.

Since 1968 there have been abrupt fluctuations in Peru's economic growth, with repeated balance of payments crises and growing inflation. The main causes have been inappropriate economic policies that distorted the functioning of the economy, discouraged savings and investment, and fostered resource misallocation. By mid-1990, inflation was running at over 3,000% per year, while the economy was in a deep recession. The public sector was operating at a deficit with barely enough resources to pay for salaries. Large-scale corruption, generalized subsidies and price controls severely distorted relative prices. A

unilateral moratorium on most external debt service isolated Peru from its traditional creditors; arrears reached about \$12.9 billion, or 65% of external debt. As a consequence, economic and social infrastructure, normally financed with external funds, deteriorated to unprecedented levels.

Peru's population has doubled since 1961, with a mean annual growth rate of 2.5% adding almost 600,000 people per year. Income distribution in Peru is one of the most regressive and uneven in Latin America. Over 70% of Peru's economically active population is unemployed or underemployed. The lack of jobs and government restrictions have contributed to the generation of an informal underground economy as an alternative to the formal sector. Chronic poverty is a pervasive problem, primarily in rural areas, and especially the highlands. However, because of poor economic performance and extensive migration of rural poor to squatter slums in metropolitan areas, poverty has increased in urban areas as well.

In 1984, 38% of children under six suffered from severe chronic malnutrition, and the situation has deteriorated significantly since then. The infant mortality rate of 81 per 1,000 is one of the highest in Latin America. A recent cholera epidemic further weakened Peru's health status and highlighted the tremendous deficiencies in safe water supply and sanitary waste disposal.

B. Political Setting

Peru's democratic institutions are fragile; the country has been ruled by de facto regimes for much longer periods than by constitutional and democratic governments. Throughout most of Peru's history only a small minority exercised political power in alliance with a narrow class of economically powerful industrialists, importers, and land owners. They used their access to government to secure special privileges and concessions that frustrated competition, efficiency, and access to economic opportunity by most Peruvians. While freely-elected democratic governments have ruled since 1980, serious and deep-rooted economic

and social ills have frustrated the growth of democratic institutions. Informality, corruption, political violence and the infringement of human rights have reached serious levels.

Most government activities lack transparency, public feedback and accountability. After elections, Peru's citizens rarely dialogue openly with their representatives. The executive branch exercises disproportionate power compared to the judiciary and legislature, and the system of checks and balances is weak. The Congress often abets executive branch pre-eminence by giving the President wide powers to legislate by executive decree. The judicial branch is notoriously inefficient, under-funded, corrupt, and saddled with poorly motivated personnel in dilapidated facilities. Other components of a democratic society that could stimulate a free interchange of ideas and the incorporation of considerations important to all elements of Peruvian society are weak or fragmented. Political parties, the media, unions, pressure groups, regional and municipal governments and think tanks are often unstable, highly partisan, personalistic or single-issue oriented. They lack the broad base of support needed to mobilize a consensus on issues of interest to a majority of Peruvians.

The 1990 presidential elections marked a major change in Peru's approach to politics. Alberto Fujimori became the first Peruvian President of non-European origin, and to a large extent, a new group of congressman was elected. The Presidential election represented a rejection of traditional political parties and leaders, and a victory for a new coalition of interests with little previous government experience. It also resulted in a fragmented Congress, susceptible to Presidential manipulation. Concurrent with the Presidential elections the country embarked on a regionalization process with the creation of regional assemblies and naming of new authorities to carry out government responsibilities on a decentralized basis. Sharing power with the regional governments and establishing an equitable division of limited government resources with them represent new problems for Peru's political institutions.

The past decade has seen the growth of Sendero Luminoso (SL), the most violent and nihilistic terrorist movement in Latin America. Between Sendero and the government's efforts to eliminate it, more than 19,000 Peruvians have been killed, and some \$20 billion in material damages or lost production has been incurred. While SL has less than 5,000 partisans under arms, it operates with impunity in many highland areas, the Upper Huallaga Valley, and many coastal cities. SL has threatened any development activity that demonstrates the state's interest in improving the welfare of its citizens and their support for the country's democratic institutions. More recently the Movimiento Revolucionario Tupac Amaru (MRTA), a more traditional Marxist terrorist group with less than 500 armed supporters primarily in urban areas, has become an increasing problem.

Neither of these terrorist groups is likely to come to power over the next five years. However, the consequences of their violent activities include the progressive retreat of the state as an effective authority from many rural areas, massive migration to the cities, an increase in human rights abuses, the destruction of physical infrastructure, decreased investor confidence, and an inability to carry out development activities in areas where they are most needed. Future prospects for democracy depend on the government's ability to carry through its economic stabilization and growth program while avoiding the disintegration of society through subversive violence.

C. Narcotics

For centuries Peru's coca production was oriented towards domestic demand. But, as cocaine consumption expanded abroad, narcotics traffickers found Peru's Upper Huallaga valley to be an ideal environment for the production of high-quality coca. Peru now supplies over 60% of the world's production of coca leaf, and is rapidly becoming a major coca base producer. Some 120,000 farmers are engaged in coca cultivation throughout the country, with

perhaps 5,000 more involved in related processing, trafficking and financial operations. The industry brings at least \$600-700 million in foreign exchange into the country each year.

The expansion of illicit coca growing and trafficking has done serious social, economic, political and environmental harm to Peru. Narcodollar liquidity has distorted exchange rates to the detriment of legitimate exports and driven less profitable crops out of extensive areas that formerly supplied food to internal markets. The narcotics industry undermines Peru's legitimate authorities and has established a symbiotic relationship with both Sendero Luminoso and the MRTA, while its power of corruption is felt throughout the government.

D. The New Government's Political and Economic Agenda

President Alberto Fujimori assumed office in July 1990, and immediately took action to address Peru's unprecedented hyperinflation and deep economic recession. His government initiated a bold and comprehensive economic stabilization program which includes drastic cuts in public spending together with tax reforms and the elimination of subsidies. Results achieved to date are encouraging, with a substantial reduction in inflation, and the government proceeding with negotiations on a medium term economic program with the IMF and the World Bank, aimed at restoring macroeconomic equilibrium and sustained growth. An IMF agreement should enable Peru to reschedule its bilateral and multilateral debt.

The Fujimori administration's policy agenda is consistent with many U.S. foreign policy concerns. The President has assigned high priority to ending terrorist violence, improving human rights performance, making the justice system more efficient, and addressing the country's endemic problem of corruption. Efforts to promote democratic decision-making and administrative simplification should strengthen public support for democratic institutions. Fujimori has also emphasized the importance of family planning and improving Peru's agricultural technology generation and extension system.

President Fujimori is interested in cooperating with the United States in controlling narcotics production and trafficking. After initially rejecting proposed U.S. counternarcotics military assistance, he called for an integrated approach to the drug problem involving military, police, and economic assistance. The U.S. Mission has recently concluded an overall framework agreement for a comprehensive anti-narcotics program. The GOP is setting up an Autonomous Authority for Alternative Development (ADA) to coordinate all GOP anti-narcotics efforts and to interface with U.S. assistance efforts. Initial discussions with GOP authorities on the economic measures needed to address the country's narcotics problems indicate their approach largely parallels our own.

USAID has good access to and a productive dialogue with the new authorities. Because our own priorities coincide with many of the new administration's, and because of the additional resources we anticipate becoming available, we should be able to impact positively on Peru's economic and democratic development over the CDSS period.

II. PROBLEM ANALYSIS AND DESCRIPTION

A. Achievement of Broadly-Based, Sustainable Economic Growth

1. Economic Policies that Promote Investment, Employment and Export-led Economic Diversification

Over the last two decades, Peru's economic policies changed from one administration to the next. The erratic economic frameworks contributed to a sustained deterioration in production, income levels, income distribution, and inflation. The Garcia administration (1985-1990) inherited an economy with a strong international reserves position, a competitive real exchange rate, and public sector prices and tariffs that roughly covered operating and capital costs. But, growth rates were low, reflecting exogenous shocks and low investor confidence. The Garcia administration initiated a "heterodox" economic program,

which was based on the belief that sustained real GDP growth, employment and wages could be achieved by expansionary fiscal and monetary policies combined with administrative controls on key prices and foreign trade, the financing of deficits through forced savings, and subsidies on basic goods and services. Garcia introduced a sustained wage increase program aided by expansionary fiscal policies to stimulate demand. Subsidized credit, lower taxes, price subsidies on agricultural inputs and outputs, and import restrictions on goods competing with domestic industry stimulated production. Inflation and the maintenance of real incomes were addressed by widespread price controls. The Garcia administration also unilaterally limited the amount of external debt servicing payments to 10% of export receipts, and arrears jumped from \$1.3 to \$12.7 billion between 1984 and mid-1990.

While the Garcia program initially cut inflation and generated economic growth, it faltered when foreign reserves and excess capacity in key sectors were exhausted, and when inflation accelerated. By 1990, the country was clearly worse off than in 1985. Garcia's expropriation of a U.S. oil company and his attempt at nationalizing the banking system eroded investor confidence. Net international reserves declined from \$1.4 billion to minus \$189 million. Tax revenue as a percentage of GDP dropped sharply from 13% to 5%. Inflation was running about 32% per month, real GDP had dropped 21% since 1987, and real wages were equivalent to 43% of their 1988 level. With the accumulation of external arrears and Garcia's confrontational debt policy, external creditors, including the IFI'S, suspended further lending. Most new U.S. economic assistance except for food aid, resources channelled through NGOs, and counternarcotics assistance ceased because of payments arrears.

Personal income and its distribution worsened. GDP per capita in 1985 was about equal to that of 1968, while current levels are even lower than the levels reached at the end of the 1950s. The ratio of income earned by the highest 20% of the population

compared to the lowest 20% is 32 to 1. In 1981, wage earners received 37% of national income, independent workers received 22%, while businesses received 36%. By 1989, the wage earners' share dropped to 20% and the independent workers' share declined to 17%, while the business share increased to 61%.

A coca production industry emerged in partial response to and abetted by the policy environment. Narcotics production and processing preempted resources for economic development, and further hindered the functioning of the economy. It enlarged the fiscal deficit by requiring additional expenditures to fight drug trafficking while generating few tax revenues. The Central Bank lost control over a significant portion of the money supply as coca-dollars entered through the parallel banking system. These inflows aggravated inflation and maintained artificial exchange rates that progressively eroded the competitiveness of legal Peruvian exports.

The newly elected Fujimori administration immediately implemented major, controversial, and politically painful reforms, to reduce price distortions, improve tax collection, narrow the fiscal deficit and stop hyperinflation. The actions included: (1) unification and floating of the exchange rate; (2) substantial foreign trade liberalization; (3) large overnight increases in a number of previously subsidized prices, including fuels, foodstuffs, and public utilities; and (4) the liberalization of interest rates. In March 1991, the GOP supplemented the adjustment program with a comprehensive series of structural reforms aimed at strengthening stabilization and laying the basis for sustained growth. These measures are having a profound impact on the structure of the economy by reducing the extent of government participation in and control of it. They have removed decades of government attempts to control economic factors, and offer unprecedented growth opportunities for the private sector in response to newly deregulated market forces.

Reforms adopted include the liberalization of the trade regime by further

lowering tariffs and reducing their dispersion. The Government simplified temporary admission procedures to facilitate the import of inputs used by the export sector, liberalized ports and customs operations, and eliminated profit and capital repatriation constraints. It established an export drawback mechanism to reimburse exporters for indirect taxes and liberalized the foreign exchange market by allowing residents to hold foreign currency deposits at home and abroad. And, interest rate controls were further reduced.

The functioning of the labor market was improved by making short-term employment less subject to litigation and reducing the costs associated with seniority benefits. Legal causes for worker dismissal have been more precisely defined.

A framework to carry out the privatization and rationalization of public enterprises has been established. And, the GOP identified the first 23 state firms to be privatized and is moving to divest them.

Public sector monopolies in the agricultural and insurance sectors were eliminated, and they must now compete with the private sector. The GOP has established the basis for the functioning of a relatively unimpeded land market, and it will now permit farm land to be mortgaged.

The GOP program is beginning to produce solid results. Inflation has been reduced dramatically, the enormous distortions in relative prices have been eliminated, and fiscal accounts are roughly balanced. U.S. food assistance has been critical to containing potential social unrest that could have been generated by the reforms. However, the economic stabilization program needs to be complemented by renewed growth and expanded employment opportunities in the short term to ensure continued commitment to it.

The GOP is coordinating its economic stabilization program with the IFIs in order to reinsert Peru into the international financial community and obtain financial support

for the program. The IIs are supportive of the program, and the GOP now has a draft agreement with the IMF, which will be concluded upon securing additional resources through a Support Group.

2. Private Sector Response to the Policy Environment

a. International Trade and the Private Sector

Private sector development in Peru reflects decades of public sector attempts to direct the functioning of the economy and to participate in it directly. The result has been the development of a thinly linked bipolar private sector. Rent-seekers in vertically-integrated import substitution industries, protected by trade barriers and other government regulations that impede competition, exist alongside the informal sector. The informal sector is the antithesis to government regulation, and emerged as an alternative to entrepreneurship and employment in the formal economy. Between these poles are the traditional exporters who, since colonial times, have utilized Peru's agricultural and mineral resource endowment to generate foreign exchange and employment. A relatively small non-traditional export sector dedicated to the transformation of Peruvian raw materials has emerged in the past two decades.

This pattern of private sector development has not utilized Peru's resources efficiently. Rent seekers rely on outmoded capital-intensive technologies. The informals rely on rudimentary labor-intensive technologies that generate inadequate levels of income. The export sector is competitively weak since its cost structure and modus operandi have been subject to excessive government regulation and inadequate economic policies.

The bipolar nature of private sector development in Peru is reflected in employment patterns. In Lima, about 1 million people are employed in the informal sector, or about 42% of total employment in the city. During the 1988-89 hyperinflationary crisis,

informal employment grew by 4.5% annually in response to the decline in formal economic activity. Informal employment growth was led by retail commerce (ambulantes) whose share of total employment rose from 55% in 1987 to 61% in 1989.

While informal employment rose, the income levels earned in the sector were grossly inadequate to meet basic needs. In early 1990, the average salary paid in the informal sector was only enough to purchase 10% of a basic consumption basket. Micro-entrepreneurs earned enough to cover 25% of the same basket and self-employed informal workers 13%. But, the informal sector is not a significant vehicle for increased productivity, savings and investment. Only about 15% of the informal urban sector labor force is employed in activities that have potential for growth.

The GOP's comprehensive reform program freeing up the principal markets in the economy, such as labor, financial and international trade, provides a powerful stimulus to revitalize private enterprise. But further efforts to reduce governmental interference are needed. And, public investment in infrastructure is needed for Peru to capitalize on its comparative advantage. Most importantly, the government must ensure that its policies are developed through an open dialogue with the private sector and are free of the arbitrary treatment that discouraged investment in the past.

The private sector has great potential to lead Peru's economic reactivation and its insertion into world business and commerce. It has a relatively large and sophisticated light industrial base. Peruvian businessmen are creative and adaptable, and quick to respond to new growth opportunities. The country has many microclimates that allow cultivation of a wide variety of agricultural products, a seasonal "window" on the U.S. and European fresh produce markets and a large labor force, skilled in a wide range of export-related disciplines.

A.I.D.-supported efforts have developed the country's capacity to train entrepreneurs and skilled labor as well. A.I.D. has helped establish a private sector confederation and exporter community that vigorously communicate their concerns to the government. The new Investment and Export Promotion project will address a number of the more fundamental credit, technological and marketing constraints to rapid private sector led export growth. Efforts through ILD are decreasing the administrative burden in establishing new formal sector enterprises. And, implementation of the Andean Trade Preference Act should greatly improve Peru's access to the U.S. market.

b. The Agricultural Sector

Peru's agricultural sector employs 35% of the economically active population and produces 13% of GDP. It has significant potential for earning foreign exchange, generating income, and creating viable employment. However, agricultural production has not kept pace with population growth. Inadequate performance is due to excessive government intervention in the economy including a hastily implemented land reform program that established inefficient collective enterprises, import substitution policies that turned the terms of trade against agriculture, and the steady deterioration of research and extension services.

These trends climaxed under the Garcia Administration, which attempted to reactivate the sector by increasing agricultural farmgate prices and lowering farmer costs while ensuring the supply of basic foodstuffs at reasonable prices. A low exchange rate for food imports allowed the GOP to generate a surplus from domestic sales. The surplus was used to fund farmer subsidies. Price controls kept consumer prices down, while subsidized credit and price supports promoted agricultural expansion. The strategy unraveled as the international prices of agricultural imports increased but the corresponding exchange rate and domestic prices were kept repressed. This helped exhaust international reserves and led to a

rapid monetary expansion. Other detrimental effects included the erosion of agricultural export competitiveness and a decline in the production of domestic substitutes. While agricultural consumers and producers gained at first from these policies, in the end, both lost.

Agricultural productivity remains very low, with per hectare yields in Peru being among the lowest on the continent. Little has been done to develop new export products; policies did not favor non-traditional exports. Few investments have been made in improving productivity and encouraging the productive use of comparative advantage.

The stultifying and meddlesome presence of the government permeates the sector, limiting competition and hindering private sector growth. Until recently public marketing monopolies discouraged domestic production and distorted factor costs. Government intervention in transport pricing, crop storage, labor, and food marketing all limit the growth of the private sector in agriculture.

The agricultural credit system is a major barrier to growth. The amount of credit is sharply limited by the economic stabilization program. The traditional source of agricultural credit, the public sector Agrarian Bank, is decapitalized and poorly staffed. While private banks are also affected by the credit shortage, their increased lending to agriculture will depend on the effectiveness of current GOP efforts to liberalize land markets toward the unimpeded use of land as collateral.

Peru's inadequate and deteriorated infrastructure is a major constraint to agricultural development. Poor transportation linkages isolate many producing areas from inputs and markets. Large irrigation projects ignored the needs of Sierra producers and were poorly managed. These projects were not accompanied by cost recovery policies or technical assistance and salinization has become an increasing problem. The system for generating and disseminating new technology and production packages is weak, is not demand driven, and lacks

public-private sector cooperation. The extension service has sharply deteriorated and is not coordinated with research.

The new government has abolished one grain marketing agency, eliminated monopolies, and compelled government food suppliers to compete with the private sector. A.I.D.'s Policy Analysis and Institutional Development project helped provide the analytical justification for these actions. The Fujimori administration apparently intends to dissolve the Agrarian Bank and establish a new credit system, and is committed to a larger role for the private sector in the generation of agricultural technology. And, it is now focusing research efforts on priority crops with high demand as well as adding its own resources to support the research agenda under AID's Technology Transfer Project.

3. Accelerated Opportunities for Increased Participation in the Economy by the Historically Disadvantaged

Poverty is pervasive in Peru, and most Peruvians lack adequate food, housing, education and health services. While chronic poverty has been traditionally concentrated in the Sierra, in recent years it has extended to the urban coastal areas. The number of people living at poverty risk rose from 5.5 million in 1986 to 8.8 million in 1989. The number of people living in households with critically malnourished children rose from 2.7 to 6.6 million over the corresponding period, with further serious deterioration in nutrition status during 1990.

Some 40% of all deaths occur among children under age six. Acute respiratory infections (ARI) and acute diarrheal diseases (ADD) together account for 55 percent of all child deaths and for over 82 percent of all illnesses in Peru. Overall immunization coverage has reached barely 65-70% of children under six. ADD is closely related to water and sanitation problems and is also the second cause of adult morbidity. However, access to safe

drinking water and appropriate waste disposal facilities are very limited, particularly in the Sierra and Selva. Only 60% of all Peruvians, including 24% of rural inhabitants, have access to potable water, with 45% of the total population having access to sanitary sewage disposal, including 18% of the rural population. Inadequate water and waste disposal systems are major transmission modes for the current cholera epidemic, which has affected nearly 200,000 Peruvians to date, and will likely become endemic in the country.

Reproductive problems, including complications from spontaneous and illegally-induced abortions cause an estimated 30 maternal deaths per 10,000 live births each year. High maternal mortality rates are due to malnutrition, inadequate prenatal care, unassisted delivery, high levels of fertility and inadequate birth spacing. Currently, only 60 percent of Peruvian women receive prenatal care and less than half of all births are assisted by trained birth attendants.

Peru's fertility rate fell from over 6 births per woman in 1977 to 4.1 in 1990, but is still high in relation to economic resources and carrying capacity. Peru has a very young population, of which 39% is under the age of fifteen. There is a large unmet demand for family planning services, with approximately 60% of Peru's couples of fertile age expressing a desire for no more children or to limit births in the near future. Yet, only 23% of couples have access to modern family planning services.

The Ministry of Health (MOH) and the Peruvian Institute of Social Security (IPSS) are responsible for providing health care to 85% of the population, but more than six million Peruvians have little or no access to modern health services. The 1991 MOH budget of \$350 million is only 68% of the amount invested in real terms in 1984, and only 10% is targeted on priority primary health care and preventive programs. Provision of adequate health care is adversely affected by inefficient management, continuous strikes of health workers,

and high turnover of personnel.

Public sector health financing is not oriented toward critical priorities. Hospital based curative care in urban areas receives more resources than preventive care and services in rural areas where the needs are greatest. Public institutions are overly centralized, bureaucratic and politicized. New IPSS management is considering decentralization and some privatization of services. There is great interest and promise in the mobilization of the private sector to enhance and extend access to public sector services. However, at present, public, PVO and private sector services and institutions are poorly coordinated.

Peru's major support for child survival comes from USAID, and resources are focused on expanding coverage of services and strengthening management capabilities in the public sector. Efforts have significantly increased immunization coverage, use of oral rehydration therapy, and the development of epidemiological surveillance and health/management information systems, which have contributed to managing the current cholera epidemic. Combined Title II PVO supplementary feeding and maternal child health activities have been critical in moderating severe malnutrition among targeted women and children. USAID is Peru's major population and family planning donor, financing contraceptives and services in the public and PVO sectors. Ongoing activities support sustainable PVO family planning programs, improved management, and contraceptive supplies with a logistics and information system to track their use.

4. Preservation and Sustainable Use of the Natural Resource Base

Peru has an extremely varied number of environments and an exceptional diversity of flora and fauna. Many of its ecosystems are fragile, and some have already suffered serious deterioration due to long-term population pressure. Others are threatened by the effects of migration from neighboring, overpopulated areas and these problems are particularly severe

in the Sierra and Selva. In the Selva, tropical forests are threatened by colonization. Selective logging, often followed by slash-and-burn agriculture, destroys annually more than 300,000 hectares of prime tropical forest. Coca cultivation has caused wholesale destruction of tropical forests, erosion of hillsides and serious pollution due to toxic waste disposal. In the coastal region poor water management and resulting salinity in irrigated areas has led to the loss of more than 300,000 hectares of agricultural land. Fragile dry forests have suffered deforestation, and several coastal habitats are threatened by over-exploitation. Watersheds rising in the Sierra and providing irrigation water for the coast need integrated management to regulate water supplies and protect property and supply routes.

Recognition of the threats to natural resources and biological diversity is growing, with increased activity on the part of public and private organizations. The GOP recently published an environmental code, and it has established a number of national parks and protection areas. Nevertheless, the problems are so immense that most efforts have not been adequate to provide the needed conservation and protection. Also, the current economic situation and policies encourage short-term, depredatory resource use rather than long-term, sustainable management.

Recent advances in the development of techniques for sustained-yield management of tropical forests, notably in the A.I.D.-supported Central Selva Resource Management Project, offer prospects for placing extensive areas under sustainable development. Legal changes are being discussed which would establish user rights over land in addition to the forest crop to encourage investment in longer term forest management and preservation, and increased Peruvian participation in world markets.

Policies and incentives for private sector involvement in natural resource and biological diversity preservation need to be developed. These should be tied to activities

to generate income and employment to ensure their sustainability and wider acceptance over time by private entrepreneurs.

B. Fragile Democratic Institutions

1. The Status of Competent, Civilian Government Institutions, Pluralism, and Democratic Values

Peru's government has been democratic since 1980. Earlier governments restricted elections to literates, thereby excluding participation of most of the indigenous population. Government instability has been endemic in Peru. Nevertheless, there is a general consensus that democratic institutions are the most appropriate means to recognize and achieve the country's national aspirations. Some Peruvians argue for more authoritarian rule to deal with terrorist threats and economic stagnation. But, the country's recent experience of more than a decade of autocratic, de facto government reinforces the commitment of most Peruvians to popular participation.

The activities of the executive, judiciary and legislature branches lack transparency, feedback and accountability. Equal access to the law and government decision-making does not exist. Respect for individual rights and the enforcement of contracts is uneven. Human rights abuses are common and rarely punished. Economic and social discrimination limits access by many to decision-making levels.

The concept of checks and balances is weak in Peru. The executive power is stronger and more active than the legislative or judicial branches. The overextended executive branch encroaches on the private sector's productive functions and does not effectively discharge its own obligation to provide efficient regulatory and supporting services. A cumbersome public administration hinders private creativity and investment, forcing citizens to resort to corruption or to informality to conduct normal business.

While Peru's legislature is frequently critical of executive authority, the Congress nonetheless often defers to it to enact laws that it is incapable of preparing. Between July 1985 and January 1991, Congress approved 2,087 laws while the executive approved 2,114 supreme decrees issued under its "extraordinary measures" authority. The current Congress is fragmented into four principal parties or coalitions, none of which comprises over 34% of the membership of either house. Many members are poorly informed about major economic, political and social issues as well as specific legislation. No institution systematically keeps them informed on issues on the agenda.

Communication between Peru's citizens and elected representatives is weak. There are few ties between individual legislators and their constituents. Senators are elected at large in national elections, and deputies are in essence at large representatives of extensive, heterogeneous districts.

The judicial system does not work for most Peruvians. It is notorious for corruption, inefficiency, apparent arbitrariness, high transaction costs, and virtual inaccessibility to mainstream society. Little dignity is accorded to most court personnel, and the poor image of the courts and low salaries attract judicial personnel with mediocre talent and questionable moral standards. Legal procedures are abstruse, antiquated, and unequipped to strengthen the hand of law enforcement officials in the battle against terrorism and narcotics trafficking.

The judicial system consists of three overlapping and uncoordinated functions which diffuse responsibility. Judges carry out investigative functions that often conflict with those of law enforcement and prosecuting officials. Annual changes in the Supreme Court President and the lack of a planning and management office do not permit any coherent improvements to germinate. The Public Ministry, an autonomous executive branch entity, carries out the prosecutorial function. The Ministry of Justice administers the prison system and

codifies laws and provides this information to other judicial system personnel. The Ministry is highly politicized, with the Minister having changed 9 times in the past five years.

Judicial inefficiency includes the failure to hear and resolve disputes in a timely manner; there are too few judges for the population. The number of trial judges per 100,000 Peruvians declined from 2.8 in 1960 to 1.2 in 1989. Because of judicial overload, judges delegate functions to court clerks, adding further delays and opportunities for corruption. Clerks retain a percentage of fees collected for processing documents, and the consequent proliferation of documentation further clogs the system.

Peru's government is highly centralized, with most decision-making authority confined to Lima. Regional and municipal governments lack authority, are overly dependent on the central government, have few resources and lack the power to mobilize local financing. Expenditures of sub-national governments are very low, amounting to only about 5% of total government expenditures, compared to an average of 20-40% in other countries. The regionalization process started in 1989 continues to go forward, and 1991 is the first year that the regions have budget authority.

It is not clear whether the regionalization process will strengthen Peru's democracy by developing governments that are more participatory and responsive to local needs and aspirations. So far the process has been highly partisan. Individual regions have been established based on geographic propinquity rather than common and uniting features. And, the regional governments are not entirely democratic as they are based on a combination of both elected and appointed members.

Corruption is a serious problem that permeates all levels and sectors of government. More recently narcotics trafficking has greatly expanded corruption's scope and level, especially in the military and police. Bribes from individuals or corporate interests are

common to acquire special privileges, contracts, or to have government officials perform their public duties. President Fujimori announced the creation of an Anti-Corruption Commission at the beginning of his administration, but no action has yet been taken to operationalize it.

Human rights abuses abound in Peru, and are committed both by government as well as terrorist organizations. Continued abuses threaten approval of U.S. economic development resources.

Peru is a remarkably open society. The media represents a broad spectrum of political values, and open political debate of opposing perspectives is common and tolerated. The country has carried out three fair and open elections in the past two years even though Sendero Luminoso attempted to disrupt them by killing elected officials and threatening anyone participating in them. The GOP's ability to organize and carry out the electoral process -- and the public's interest in participating in them in spite of extreme difficulties--demonstrates the country's commitment to the most fundamental precepts of democracy.

Local community organizations have demonstrated great strength and resourcefulness in responding to the hardships caused by the economic adjustment program. But, their capacity to articulate common political concerns, and the willingness of higher level institutions to respond to them are limited. Their continuing input to political decision-making needs to be assured. This includes greater grass roots access to and contact with the legislature, promoting greater efficiency and responsiveness to them by the judicial branch, and better recognition of their needs by the executive branch in terms of economic and social policies and decisions.

2. Opportunities for Strengthening Democratic Institutions

Notwithstanding the President's autocratic management style, there are significant opportunities for Peru's democratic institutions to mature and for broader public

commitment to them. The Fujimori administration's economic policies entail reducing the government's activities, privatizing many enterprises and functions, and improving those remaining. These policies should help foster allegiance to democracy as the government better fulfills its role in areas where it can concentrate. Recent initiatives including administrative simplification and the democratization of decision-making manifest the President's interest in making the government more responsive to the average citizen's concerns. The new administration is committed to overcoming the corruption that exists in all state activities. It is interested in major systemic changes in the judicial system, and, it has given mild support to the process of regionalization.

Through A.I.D.'s leadership in the identification of problems threatening Peru's democratic institutions the Administration of Justice project has defined activities that could be implemented quickly to accelerate judicial processing. This project has also defined a series of issues that require policy-level attention. A.I.D. has supported anti-corruption activities, the democratization of decision-making, administrative simplification and the strengthening of regional authorities through the Institute of Liberty and Democracy. And, we have been critical in the development of local community organizations.

The administration's concerns regarding strengthening democracy coincide to a large extent with our own. Yet, the administration has developed no coherent strategic approach to address the problems. Thus, we have a challenging opportunity with the new government and other political forces to establish areas of cooperation to strengthen democratic institutions.

C. The Challenge of Narcotics to Democracy and Development

Peru supplies over 60% of the world's coca leaf and is a major coca base producer. Illicit coca farming employs about 60,000 farmers in the Upper Huallaga Valley

(UEIV) and almost the same number in other areas of Peru. There are about 121,300 hectares in coca production. We estimate foreign exchange earnings from coca actually entering Peru at \$600-700 million annually.

The expansion of coca production and trafficking has done serious economic, political, social and environmental harm to Peru. Narcodollar liquidity has distorted exchange rates and has swung the cost/returns structure against legitimate crop and other productive activities. A symbiotic relationship between narcotraffickers and terrorists has virtually eliminated civil governmental authority in the coca growing areas, making control and alternative development efforts highly risky. Deforestation, erosion and the disposal of toxic chemicals associated with narcotics are causing incalculable ecological damage in these areas.

The new administration has proposed an integrated approach to the narcotics problem. It is establishing an Autonomous Authority for Alternative Development (ADA) to coordinate activities and administer resources in the counter narcotics effort. It will probably coordinate and monitor alternative development programs like USAID's Upper Huallaga Area Development Project, as well as administering future economic assistance resources. On May 14, 1991 the United States signed an umbrella agreement with the GOP, which committed us to helping Peru carry out a comprehensive anti narcotics program.

Constraints to the reduction of illicit coca in Peru include persistent market distortions caused by faulty economic policies, making legal crops unprofitable. The deterioration of infrastructure and government services restricts the marketing of legal crops from coca-growing areas. The management and level of police and military resources currently engaged in counter-narcotics enforcement efforts are inadequate to disrupt narcotics trafficking and keep the price of coca down over time, a sine qua non for alternative development programs. And, the lack of security inhibits legitimate private sector investment in the region.

A.I.D. has been involved in the Upper Huallaga Valley since 1981, and we have substantial information concerning alternative income earning programs that could function in the area. We are supporting one of the few civilian authorities in the Valley through the PEAH project. If security is restored in the area and the price of coca driven down over time, we will be able to assist in the provision of legal and self-sustaining employment for current coca producers and processors.

III. STRATEGY

A. Strategic Objectives

Peru's complex development agenda includes maintaining the economic stabilization program and placing the economy on a path of steady growth. Conditions must be created under which the poor can find viable employment and services that help meet their basic needs. Structural reforms must be accomplished to strengthen support for democracy and to reduce barriers to individuals exercising their entrepreneurial and creative skills and contribution to economic growth. Narcotics production and subversion with debilitating effects on the economy must be suppressed.

To help Peru address its development agenda the Mission will pursue five specific objectives. They are consistent with the LAC Bureau objectives of broadly-based, sustainable economic growth; the evolution of a stable, democratic society; and, responding to specific challenges of direct interest to the United States. In descending order of priority our objectives are

- An overall policy framework and structural reforms that promote economic stability and sustained growth;
- Reactivated private productive sectors generating employment, foreign exchange and increased productivity, while preserving natural resources;

- Replacement of coca-based employment and foreign exchange earnings with legal alternatives;

- Strong, democratic institutions that reinforce economic freedom; and,

- Improved health status through access to quality primary health care.

These objectives are inter-related, cross-cutting and mutually supportive. For example, greater access to quality primary health services should improve the productivity of the workforce reactivating the private productive sectors. Increased legal income-earning alternatives for Peruvians now engaged in narcotics production should reduce the corrosive impact this industry has on democratic institutions. Similarly, open and transparent political institutions, including equal access to law, inhibit special interest regulations that distort balanced economic growth benefitting large numbers over time.

USAID has worked on activities related to these objectives. They involve sectors where we have substantial background knowledge and experience, and where the Peruvians seek our participation. A.I.D. currently is the only significant donor in these sectors, which are development priorities for the new administration. To a large extent private entrepreneurs are prepared to collaborate with the government in these areas. In addition, they are areas where Peru has rapid growth potential and untapped productive capacity.

1. Policy Framework and Structural Reforms

Our highest priority is to maintain and strengthen Peru's commitment and efforts to establish a sound economic policy framework and to carry out structural reforms that serve as the foundation for economic stability with sustained growth. Peru's lack of progress in the past two decades can be traced to fundamentally flawed policies that led to increasing distortions, inefficiencies and disinvestment. These policies stultified economic growth, contributed to a civic culture that questions the capacity of democratic institutions to solve

national problems, and enabled the narcotics industry to flourish.

The importance attached to an adequate policy framework rests on other strategic factors. It is directly relevant to vital U.S. narcotics interests because sound policies must be in place for alternative coca income programs to be effective. USAID maintains a productive dialogue with senior decision-making officials in the public and private sectors who seek our counsel on policy matters. We have the capacity to provide culturally and politically sensitive policy analyses and options. The amount of A.I.D. program assistance proposed over the CDSS period should leverage further changes in coordination with other donor assistance.

The structural reform agenda we will support is wide ranging, but achievable. The tax system and its administration should be reformed to distribute the tax burden more evenly, promote efficiency, and generate sustained revenues. Customs administration needs to be simplified to facilitate trade. The scope of public sector activities should be reduced, and the government's regulatory role streamlined. Public investment should be increased while the number of public sector enterprises must be reduced. Ongoing financial sector reforms need to be sustained, including judicious management of the money supply, strengthening banking system regulation, restructuring or privatizing public development banks, and promoting private sector lending to the agricultural sector. The GOP's commitment to modifying labor laws to permit the free negotiation of wages should be assured. And, we must ensure that the GOP maintains a market determined exchange rate, gradually reduces tariffs to a flat targeted 15% rate, substantially reduces non-tariffs barriers to trade, and encourages foreign direct investment. We will need to direct our resources to ensure that these structural changes are carried out and sustained.

The Peruvian economic development strategy is evolving, and the authorities will have to make refinements to the overall agenda. This will require an approach

that reflects a judicious blend of technical analysis, an understanding of the social and political context that surrounds them, and continued political commitment. USAID's Policy Analysis, Planning and Implementation (PAPI) project, directly tied to the highest economic policy making levels of the country, already has become essential to providing guidance to make the stabilization and structural adjustment program succeed.

2. Reactivated Private Productive Sectors

The second Mission objective is to support a rapid and sustainable private sector-led economic reactivation that generates foreign exchange, employment and boosts productivity while preserving Peru's natural resources. Our emphasis will be on labor-intensive small business, the non-traditional export sector, and commercial agriculture. We will also include natural resource preservation activities that are self-sustaining and that generate new jobs. This objective is complementary to a sound market-oriented macroeconomic policy framework that should facilitate private sector growth. It also coincides with GOP priorities and the LAC Bureau objective of encouraging a vigorous response by the private sector to a favorable policy environment. Improved welfare through economic growth is urgently needed after years of recession and high unemployment and underemployment and a generation of decay. And, increased incomes will enable the poor to secure needed social services. Moreover, the private sector is prepared to collaborate with the government and external donors.

We have selected small business, non-traditional exports and agriculture because they have the greatest potential for rapid expansion and should involve large numbers of underemployed Peruvians. Significant growth is possible without major new investments through the utilization of existing productive capacity. Relatively low cost interventions in such areas as marketing, quality control, basic management and accounting training, and limited technical upgrading will enable non-traditional exporters and small entrepreneurs to take

advantage of Peru's comparative advantages. Our involvement also is supportive of USAID's other objectives of providing increased alternative income-earning opportunities for coca farmers and accelerated participation of the poor in the growth process. And, resources available through the Andean Free Trade and Enterprise of the Americas Initiatives will provide further incentives to private productive sector growth.

The Mission's objective also is to stimulate investments that balance the use of natural resources with their preservation while creating viable, self-sustaining employment. Entrepreneurs, banking on short term gains, particularly in the Selva, will be prone to give low priority to conservation. Peru's resource conservation needs are immense, but our involvement will be focused on investments that impinge upon tropical areas. Our objective includes mobilizing financing from other sources including the private sector and GOP investments in resource conservation. Debt for nature swaps could be an important component of our involvement toward the out years of the CDSS if the GOP resolves its commercial debt problem.

3. Replace Coca-Based Employment and Foreign Exchange Earnings with Legal Alternatives

Reducing the amount of drugs produced and processed in Peru is a key U.S. foreign policy objective. Our commitment has materialized in the recent signing of a comprehensive U.S.-Peru narcotics agreement that lays out a framework for joint economic, military and law enforcement cooperation. To fulfill this U.S. foreign policy priority requires an integrated Country Team approach within which A.I.D.'s participation is critical. Police and military activities must restore a reasonable amount of security for the legitimate private sector to become involved and for A.I.D. activities to go forward in coca-growing areas. And, law enforcement and interdiction efforts must drive the price of coca down over a sustained period

so that coca growers will be compelled to look to other sources of income. This is a cross cutting issue, affecting three of the Mission's other objectives. We will achieve the counternarcotics objective by helping establish a proper macro economic policy framework, enabling legal alternatives to become profitable. Reactivated private productive sector should provide jobs for those now engaged in coca production and we will give particular attention to creating alternative crop and income earning opportunities in coca growing areas. We will focus on helping forge a national consensus on the need to attack Peru's drug production, processing and consumption problem while strengthening democratic institutions such as the justice system, which can help address the narcotics problem.

4. Democratic Institutions that Reinforce Economic Freedom

We will support the evolution of selected Peruvian governmental structures so that they become more open, accessible to all citizens, accountable to the people, and stimulate responsiveness and feedback. This will contribute to the development of a better system of checks and balances among the three branches of government. Our efforts will focus first on strengthening the judicial system, making it more efficient, enabling it to process narcotics cases effectively, and ensuring equal access to the law. Second, we will concentrate on enhanced popular participation in key public institutions to ensure their transparency, accountability and feedback. This will involve increased participation in the executive decision making process to enhance the framework for promoting economic freedom. It will also include assisting the Parliament to be responsive to constituency concern, helping to reduce corrupt practices in public institutions, and making community organizations better promoters of civic education.

Beyond some interest on the part of other donors in the issue of human rights, A.I.D. is the only external participant helping strengthen Peru's democratic institutions.

We have been involved in administration of justice activities for the past five years, have considerable knowledge of the constraints, and solid working relations with Peruvian leaders in the sector. The issues of corruption, justice administration, regionalization and development of representative grassroots organizations are high priorities for the Fujimori administration, and our collaboration is sought. Widespread discontent with the efficiency of Peru's democratic institutions, and a climate of change reflected in the recent elections, expand the likelihood of successful interventions in this area.

5. Improved Health Status Through Access to Quality Primary Health Care

Peru's unprecedented economic adjustment process is causing transitory economic displacement and further hardships in low income sectors, resulting in a reduction of basic health care services and access to adequate food supplies. These disruptions threaten already depressed levels of well being prevalent among the poor, which require improvements if economic growth is to be revived. The accelerated participation of the poor in the growth process must be given special emphasis. We will do this through priority attention to improving health status and access to quality health care, including feeding and nutrition services, child survival, reproductive health, and water and sanitation needs.

This objective will be achieved by A.I.D. involvement in two areas. First, we will strengthen preventive health care systems, promoting partnerships and effective collaboration between the private, PVO and public sectors. Our objective is to ensure that scarce resources are targeted so that all children are immunized; that oral rehydration technology and salts are available nationwide; that reproductive health services including family planning achieve national coverage; that consumers pay for the health care they can afford; and that access to potable water and sanitation facilities based on cost recovery grows by 2.65% and 3.2% respectively per year in peri-urban and marginal urban areas. A.I.D.-financed food

assistance programs, now enabling the GOP to move forward on macroeconomic policy reforms, will continue to be targeted on the reduction of malnutrition and provide temporary feeding support to those in greatest economic need.

Second, we will increase the coverage of family planning services so that at-risk couples or individuals have access to family planning information and contraceptive supplies on a timely and affordable basis. This will involve increasing the sustainability of PVO family planning programs, more vigorous participation by the private commercial sector, better coordination between the public and private sector, and a strengthened public sector capacity to deliver services along with increased GOP resources.

Preventive health care, child survival and family planning are areas in which we have a comparative advantage, considerable experience, and knowledge of constraints and opportunities. They are fields in which USAID is currently the leading donor. Our resources should be complemented over the CDSS period by increased and better GOP investments as well as other donor programs, particularly in the areas of health facility rehabilitation and the expansion of urban water and sanitation systems. A.I.D.'s food assistance program will continue to play a vital role in averting further malnutrition, especially through the first three years of the CDSS period.

B. Implementation Strategy

1. Policy Framework and Structural Reforms

The economic stabilization and liberalization program initiated by the new administration is the most ambitious in modern Peruvian history. But, it is only the beginning of a long and complicated economic transformation process. Political consensus on the policy framework is weak, and social unrest, exploited by terrorist groups, could force the administration to back down from its pursuit of a radical change in Peru's approach to

development. The GOP must confront the implementation problems and political repercussions associated with far reaching reforms, and make corrections and adjustments as circumstances require. In a number of areas the administration has signalled its intentions, but concrete plans to execute them have not been developed, and the GOP will need assistance in translating its free market inclinations into specific action plans. These include discrete areas where A.I.D. can play a leading role, such as in privatization, financial sector reform, and savings mobilization.

A.I.D.'s strategy to help Peru sustain and refine its policy framework and structural reform program will be implemented through an integrated program combining diplomacy, policy dialogue and conditionality, technical assistance, balance of payments support, and food resources to help mitigate the impact of economic adjustment. A.I.D. should show diplomatic leadership in facilitating Peru's reinsertion into the international financial and economic community. This will require working with the IMF, World Bank and IDB to develop more imaginative and flexible instruments to relieve Peru's arrears problems with these organizations and enable them to resume net lending in the shortest possible time. A.I.D. should assume a leading role in bringing together a Support Group of bilateral donors to mobilize resources for Peru. The Mission's analysis of critical development issues and capacity to provide feasibility and background information on potential projects for other donor assistance is a powerful resource to enable bilateral donors to provide early assistance to Peru. In addition, the United States will need to exercise leadership to ensure that the Paris Club extends the most concessional terms available to Peru in rescheduling its official debt. Finally, the Enterprise of the Americas Initiative and the Andean Trade Preference Act will provide concrete evidence of U.S. commitment to Peru's full participation in the international economic community.

Our strategy entails strengthening the dialogue we have with Peru's economic policy makers through advisory services, studies and training financed with project

assistance. Our support for public and private sector access to critical analyses of developmental issues and public consideration of these studies will help build a consensus on further policy changes needed. Our eventual leadership of a Support Group should ensure that our policy concerns are addressed.

Balance of payments support is another integral part of our strategy to ensure that the GOP continues implementing appropriate macroeconomic policies. We will condition the use of balance of payments resources as appropriate to ensure that needed policy changes are effected or sustained. Furthermore, balance of payments support will also be conditioned on the GOP's meeting specific narcotics control and/or human rights performance criteria.

A.I.D.'s food assistance program supports the proper policy framework. The Title III program will help finance the country's balance of payments deficit as growth resumes as well as meeting urgent nutrition needs. It will be conditioned on the implementation and maintenance of macro-economic and agricultural sector reforms as determined on an annual basis. The Title II and Section 416 programs will continue to provide a safety net of food, employment and health activities that help the poor adjust to the dislocations caused by economic stabilization.

We will require approximately \$178 million each year over the FY 1992-1994 period to achieve our policy framework and structural reform agenda, and some \$150 million per year thereafter. Each year of the first period we need \$70 million in ESF balance of payments support, an average of \$1.5 million in ESF project funding for policy analyses and technical assistance, \$30 million in Title III resources, and \$77 million in Section 416 and Title II food resources (including transportation). After FY 1994 ESF levels should remain constant, but the humanitarian assistance level of food resources should drop to around \$50 million

annually. This assumes that the economy will experience significant growth by FY 94, thus the GOP will be increasingly able to import food needs with its own resources, and that emergency feeding, employment and health programs can be reduced from current levels.

2. Reactivated Private Productive Sectors

We will concentrate on the reactivation of labor-intensive small businesses, non-traditional exporters, commercial agriculture, and employment-intensive self-sustaining natural resource preservation activities. Major barriers to export, small business and agricultural sector growth have been eliminated with the government's new economic policies. Nevertheless, years of deteriorating infrastructure, excessive government interference, the failure to explore new crop and industrial opportunities, high levels of protection, distortions caused by government monopolies, and inadequate financial sector mediation will retard the private productive sectors from taking advantage of the more favorable environment.

a. Export Promotion and Small Business Development

Our strategy is to provide technical assistance in export promotion, training and seminars, and credit while strengthening Peruvian export promotion organizations to provide sustained services to non traditional private sector companies. This includes developing production technologies suitable for Peruvian exporters and small entrepreneurs, and establishing linkages so that they will have access to them on a continuing basis. This is most important in the export area, where Peruvians have not exploited their comparative advantage. We will furnish assistance in areas such as product design, processing, quality control, packaging and labeling and grading and standards. We will look for appropriate U.S. business investment opportunities, consistent with the Administrator's Business and Development Partnership Initiative.

We will help develop the marketing skills and information systems

needed by the small business and export sectors through project-specific interventions. This includes stimulating contact between larger enterprises and potential small business suppliers, and facilitating exporters' contact with external buyers. We will also promote the development of managerial skills. Current A.I.D. activities are strengthening the Peruvian institutional capacity to provide management training for larger entrepreneurs and exporters. One institution is deepening its commitment to small businessmen with training in management, accounting, inventory and quality control, and marketing. We will broaden these efforts particularly to focus on women, who add a dynamic element to the small business sector.

We will help reduce the intrusive role that the state exercises over entrepreneurial activity. For the informal and small business sector we will continue efforts at administrative simplification and removing barriers to the sector's full integration into the formal economy. We will expand the activities that ILD has pioneered to reduce administrative barriers, and spin off successful programs to local organizations in other areas of the country. To promote exports we will support efforts to remove bureaucratic obstacles to international trade. This will require reforms in customs and air and sea port administration to improve efficiency and reduce import and export processing and time. In addition, private sector investment in port level transport, marketing, and cold chain storage facilities will be encouraged. The Export Council to be created under the Investment and Export Promotion project will identify major administrative constraints, and will bring together the public and private sectors to support practical means of eliminating them. Technical studies under the PAPI project will also highlight constraints as well as focus public attention on addressing them.

Our strategy also envisions correcting financial sector regulations and practices that inhibit medium and long term lending and limit small entrepreneurs' access to credit. Policy studies under the PAPI project will identify the major problems and suggest

alternatives to ensuring the availability of investment resources. We are prepared to address financial sector concerns, either through a discrete project, or as an element of broader project activities to promote small enterprise and export development.

We will make available local currency associated with the balance of payments program through credit lines to private commercial banks for on-lending to specifically-targeted small businesses and exporters to ensure that they can finance expanded operations. Credit will be provided on commercial terms and at real positive rates of interest. And, as Peru rejoins the international financial community we will help expand the private sector's capital base by promoting external investment in specific production lines.

Finally, our strategy will support privatization. We are currently analyzing possible support for an effort to set up a temporary organization to manage Peru's privatization program, and we are financing assistance in valuing state enterprises that will be sold. We will continue providing technical assistance to this program, and may expand it in the future to link it to investment promotion activities as well as efforts to identify external sources of capital for companies to be divested.

We do not anticipate significant A.I.D. dollar resources for infrastructure, but we will influence investments in physical facilities. Under the counternarcotics objective we will finance the rehabilitation of the road from the Selva coca growing region to the Coast. This will establish a vital lifeline between legal production activities in the valley and markets on the coast. We will help create a Donor Coordination Unit within the Office of the Secretary of the Presidency, which will develop background and pre-feasibility information on proposed projects that can be used to pursue other donor financing. Local currency associated with A.I.D. balance of payments assistance may be used to help finance the counterpart needs of other donor funded infrastructure projects complementary to our

strategy.

It is unlikely that the GOP will resolve its commercial bank arrears problem in the near future. Thus, Peru will not be eligible for investment fund resources under the Enterprise for the Americas Initiative (EAI). We will urge that the EAI contain sufficient flexibility to enable Peru to benefit from the EAI'S investment fund program so long as it continues to implement sound macro-economic policies that would permit a future settlement of the commercial debt issue.

b. Agriculture and Natural Resources

Our strategy to reactivate agricultural sector growth will focus first on addressing the GOP's continuing need for ongoing policy analysis. In the past the analytical basis for decision-making has been largely financed externally, and the GOP's analytical capacity has not been institutionalized. The government now appears prepared to revise its salary schedule to recruit and retain the highly skilled professionals to carry out this function, a mayor shortcoming in the past. If this salary policy change is effected, A.I.D. will assist the GOP in institutionalizing a policy analysis function.

Second, we will direct technical assistance and policy expertise on several fundamental institutional constraints. Title III assistance will provide us with the leverage to ensure that concrete measures to overcome them are adopted. Changes needed include legislative modifications in land tenure practices and the mortgaging of agricultural land. These reforms should enable commercial agriculture to achieve economies of scale, particularly in the area of non-traditional exports. Cost recovery schemes and user fees must be implemented for costly irrigation systems. Further removal of market barriers, including transport pricing, labor, and input supply is needed. We anticipate that the policy analysis unit to be created in the Ministry will give priority to reviewing these impediments to the exercise

of free market forces in the agricultural sector.

We will also foster the development of an agricultural credit system that provides resources in a timely manner and at positive real rates of interest. We will meet part of the credit needs of non-traditional agribusiness exporters through ESF generated local currency channeled through commercial banks. But, a better system to target credit on small commercial producers is needed. The GOP is in the process of establishing an agricultural foundation, partially capitalized from surcharges on food imports, that may replace the Agrarian Bank. Once the government's plans are clearer we will be able to define our involvement more precisely. Support for the sector's policy analysis function should define the options that the country has to resolve the agricultural credit problem, and develop an action plan to address it. We anticipate, however, supporting a rural savings effort that mobilizes resources for local investment.

We will continue to help resolve the technological problems that result in low per hectare yields. We will further develop a demand-driven agricultural technology generation system in which the private sector plays an increasingly important part. The indiscriminate use of water and loss of land to salinization will be addressed. In addition, we will help strengthen the system for disseminating technology through private farmer organizations and commercial firms. We will also examine the possibility of supporting extension efforts carried out by new regional authorities. The availability of certified seed will remain a major need, and we will expand support for programs to establish successful private seed producer associations.

A complementary aspect of our strategy to reactivate the productive private sector will be to generate employment and foreign exchange in activities that make use of Peru's diverse resource base while protecting and replacing it. The conservation of the

Peruvian Amazon for sustainable contribution to the economy will be the cornerstone of this effort. We will focus on the achievement of public and private cooperation on integrated resource management activities that involve long term, sustainable yield management of tropical forests. Technological practices and experience developed under earlier A.I.D. activities will be promoted, which will yield significant short and long term profits while sustaining Peru's resources.

To implement our strategy to reactivate the private productive sectors we will require approximately \$31 million per year throughout the CDSS period. This includes both DA and ESF dollar funding for specific projects. ESF and PL 480 generated local currency will supplement dollar resources. Local currency will be used for credit funds connected with A.I.D. export promotion and small business development projects, to help finance the GOP contribution to A.I.D. project activities, and to finance the GOP counterpart to infrastructure and other donor-financed projects that are consistent with our strategic objectives.

3. Replace Coca-Based Employment and Foreign Exchange Earnings with Legal Alternatives

Our counternarcotics strategy depends heavily on actions over which A.I.D. has minimal control. First, security must be restored within the coca growing areas so that development activities can go forward and the legitimate private sector will make medium and long term investments in the area. Civil authority must be re-established in the Upper Huallaga Valley (UHV), and the presence of civilian operating ministries restored. Second, law enforcement and interdiction activities must drive the price of coca down in order to make legitimate alternative crops and occupations competitive.

Our strategy to provide legitimate income-earning alternatives to coca

growers is closely related to and fully integrated into three of the Mission's other primary objectives. First, the country must have appropriate macro-economic policies in place that provide incentives, reward investment and stimulate legal growth in a non-distorted manner. Our strategy of providing technical assistance and balance of payments support under the policy framework and structural reform objective should ensure that the economic conditions are established and maintained that facilitate the participation of farmers and others in licit activities that generate reasonable returns.

Second, new sources of foreign exchange and employment generation must be developed to replace those that will be lost by a sustained and aggressive GOP attack on drugs. Our efforts to reactivate the productive private sectors should help achieve this. The growth of small and micro enterprises within the formal sector and the promotion of investments and non-traditional exports will earn foreign exchange while creating new labor force opportunities. We will give priority attention to identifying export opportunities for products that can be grown or processed in the coca-growing regions. Further, buoyant agricultural sector growth should reduce the tendency to migrate to coca growing areas.

The third component of our strategy is to promote legitimate growth, jobs and private sector investments in the coca-growing regions. This element of our strategy is also supportive of our objective of reactivating the private productive sectors. To do this we will continue efforts on adaptive research and dissemination of production packages to farmers. Agricultural credit will be resuscitated to stimulate the growth of legal crops. And, we will provide incentives for private sector involvement in crop collection, storage, transport and marketing. We will cooperate to secure the privatization of a government palm oil facility in the UHV, which could absorb large numbers of coca growers. Reforestation of coca-growing areas also will further natural resource preservation goals. And, complementary off-farm

employment opportunities will be created, and our small business development efforts should provide guidance on successful approaches. In addition, the rehabilitation of the Selva-Coastal road should greatly lower the cost of goods produced in the UHV while expanding the export competitiveness of the area's output.

The final component of our counternarcotics strategy is to strengthen democratic institutions that will help address the narcotics problem, another of USAID's priority objectives. We will direct Administration of Justice activities so that they focus more closely on drug crimes specifically, while expediting the judicial process more generally in areas that could affect narcotics cases. We will also continue to build a constituency that recognizes the drug danger to Peru and demands that the government confront it. Drug awareness activities will be extended, and we will ensure that recognition of the narcotics danger is built into our participant training program.

Resources to achieve the objective of replacing coca-based employment and foreign exchange earnings with legal alternatives also will support other priority Mission objectives. We will need approximately \$197 million each year, including \$167 million in ESF balance of payments and project assistance, PL 480, and Section 416 to ensure that the appropriate policy framework is sustained. We will need \$25 million in ESF project assistance plus additional local currency for projects to generate foreign exchange and employment and to address the special needs of the coca growing areas. And, \$5 million will be needed in ESF project funding to finance drug education and administration of justice activities that strengthen democratic institutions and serve counternarcotics objectives.

4. Democratic Institutions that Reinforce Economic Freedom

Many activities carried out by the Peruvian state stifle economic freedom, creativity, risk-taking, and legitimate entrepreneurial activities. The justice system is inefficient,

lacks credibility, and impedes investment and growth by its inability to enforce fundamental contractual rights. Legislators are poorly informed on issues of national importance. Corruption, which is increasingly associated with narcotics trafficking, weakens popular support for democratic values. New regional governments may not even have the financial independence to become strong autonomous democratic institutions. Many grassroots organizations are poorly equipped to mobilize popular support for actions that will benefit large numbers of Peruvians or serve as incubators of democratic ideals.

Our strategy to promote strong democratic institutions that reinforce economic freedom includes a complex, but interrelated series of interventions, but with two major themes. The first element of our strategy will be to strengthen the judicial system and make it more efficient. We will develop a consensus on reforms needed within the judicial sector and on practical measures to carry them out. Expanded policy dialogue and political consensus will help achieve this, and we will support the development of a private sector advocacy group to help forge greater commitment to action. The reform process must then be institutionalized so that major structural changes are achieved over time in such areas as the organic laws of the Judicial Power and the Public Ministry, and simplified procedures for enforcement of arbitral awards.

We will also help to improve the quality of judicial performance in the courts. We will support GOP efforts to reduce the amount of time to hear cases and resolve controversies, and increase public access to dispute resolution institutions. Activities to advance this strategy include the development and promotion of alternative dispute resolution venues, such as arbitration, and standardizing and simplifying legal procedures and rules of court. We will also support the Supreme Court President's request for geographic expansion of the successful court management program, which is streamlining case processing, providing judges

with skills to adjudicate cases more rapidly, and maintaining records and case information uniformly to provide greater judicial oversight and accountability. We will also continue efforts to develop a compendium of Peru's laws and legal precedents.

The second element of our democratic strengthening strategy is to secure wider public participation in selected political institutions and practices to ensure their openness and transparency, public accountability, and responsiveness to popular concerns. To achieve this we will help reduce executive branch interference in political and financial decisions so that market forces may guide economic agents by strengthening support for an effective democratic decision making process. Executive branch decisions and regulations should take into account feedback from groups that may be affected by them. We will also broaden the administrative simplification program, which will increase opportunities for small businesses to participate in the formal economy. Finally, we will help privatize state-owned or managed enterprises and reinforce the GOP's recent decision to eliminate all government monopolies. This will be implemented through external advisors to assist in privatization, the promotion of external investment in companies to be sold, and assistance in the valuation of assets. ESF and PL 480 conditionality will be the primary vehicle to support the GOP's decision to eliminate government monopolies.

Existing project activities to disseminate policy studies and analyses of major development issues to Peru's legislators should increase their understanding of the country's options to stimulate growth. But, more timely information on specific legislation, practical information translating development theory into law, and an appreciation of the complex downstream effects of proposed laws are needed. We will develop an independent and non-partisan information resource that is available to parliamentarians to provide them with up to date analyses of the implications and impact of specific proposed laws. This institution should

also keep track of proposed laws as they advance through the Congress, thus helping legislators establish their agendas so that they can be better informed and more effective representatives of their constituents.

The new government has not yet defined an approach to confront corruption, and our own strategy may be modified as GOP plans become more precise. We will continue our efforts to promote democratic decision making, including helping the Peruvians develop systems so that they can make information available to the public that may otherwise mask improper behavior. We will promote the adoption of a rigorous criminal code governing standards of ethical behavior as well as the creation of a strong enforcement unit with widespread authority and public credibility. We will be prepared to support the Anti Corruption Committee, which President Fujimori has announced but not yet made operational. Existing ILD activities may be expanded which focus on the use of public forums for the identification of improper practices, research and investigation into their nature, and the formulation of new systems to ensure that the problem is corrected. Narcotics awareness activities will also develop a consensus on to address a fundamental source of corruption.

The degree of our involvement with regional and local governments will depend upon the results of a study regarding their financial viability. If they can become reasonably self-sufficient over time we will explore helping develop a well-trained and competent cadre of regional officials with increased authority to mobilize local resources. This would also include support to develop operating systems for these officials that ensure that constituents are consulted about government decisions, and the design of procedures that safeguard against corruption. And, discrete projects could be focused to strengthen local and regional authorities, such as local agricultural extension agents or health personnel.

We will strengthen the capacity of Peru's grassroots organizations to serve

as representatives of their communities as well as to promote democratic principles and aspirations among their members. Our training program, which is concentrated on local organizations, will be the major vehicle to implement this strategy. We will also add a civic education component to our work with community organizations through the large Title II feeding program, which relies heavily on the organizational and management skills of local private institutions primarily organized by women.

Many activities that strengthen democratic institutions will be financed under other key Mission objectives. For example, one project supporting the policy framework and structural reforms objective also will help create a more informed legislature. Local currency funded activities focused on the same objective will be used for civic education for community organizations. We will need only approximately \$7 million in ESF project financing over the CDSS period to finance directly the strengthening of democratic institutions. However, resources supporting other policy objectives including ESF project funds and ESF, PL 480 and Section 416 monetization program local currencies must be assured.

5. Improved Health Status Through Access to Quality Primary Health Care

The quality of life of Peru's poor has not improved in the past two decades. Access to modern contraceptive services and supplies remains far below demand, and primary health services are not available to all Peruvians in need. Infant mortality rates are among the highest in this hemisphere. Malnutrition has grown sharply, and may well increase in the short run as the GOP continues its economic stabilization and adjustment program. Access to safe water and sanitation services is limited to less than half of Peru's citizens. While these problems are related to some extent to a lack of investment in basic health and family planning services, they are based more directly on inappropriate sectoral policies and institutional practices that require fundamental structural reform.

To increase coverage of family planning services we will promote and strengthen a vigorous private sector role in the production and provision of contraceptives. This includes the elimination of tariff and licensing barriers and growth of a strong commercial sector contraceptive marketing and manufacturing capacity. We will also expand the inclusion of family planning services under private sector health care plans.

We will support more efficient and self-sustaining private and non-governmental family planning programs. This includes the adoption of a cost-recovery ethos and management systems within family planning PVOs to reduce their reliance on external funding. We will promote greater coordination between the public and private sectors both in preventive health and family planning so that the private sector can make use of under-utilized public sector facilities or the public sector may contract out services to private firms. In addition, we will foster the role of women as community leaders, educators, and first-line health promoters, utilizing staff training programs, basic health education, the promotion of effective breastfeeding and weaning foods, and encouraging innovative approaches to addressing child survival and maternal health issues.

Presidential support for vigorous family planning programs must be sustained and channelled into practical and effective initiatives. We will finance further operations research and collection of data on the impact of Peru's population growth on development to strengthen the empirical basis for priority to population programs. In addition, we will ensure that adequate contraceptive supplies, and a logistics system are available for public, private and PVO programs with a decreasing reliance on A.I.D. as the primary source of supplies.

The public sector will continue to be the major provider of long lasting contraceptive methods and we will expand its capacity to provide them. We will encourage the

development of protocols to use promising new methods, such as NORPLANT or extended use IUDs. This will require further training of family planning personnel and limited equipment and supplies for modern long lasting contraception. We will also work with the Ministry of Health (MOH) and Social Security Institute (IPSS) so that they devote an increasing proportion of their resources to family planning services, establishing a cost recovery criterion for efforts in curative care.

Our strategy to strengthen preventive health care systems, primarily within the private and nonprofit PVO sectors, involves encouraging collaborative efforts among PVOs, and between them and the public sector. We will promote new mechanisms for supporting innovative efforts in self-financing primary health care, the application of proven child survival technologies, and regional efforts to develop new efficiencies in the provision of services. We will provide incentives for a better division of labor in the provision of primary health care and hospital-based services between the MOH and IPSS. We will also assist tentative IPSS efforts to privatize and commercialize health insurance and other services.

USAID will encourage a reorientation of the MOH away from the direct provision of curative services to the establishment of norms and quality criteria that the private sector should increasingly fulfill. We will work with the public sector so that it targets its resources on those groups that can least afford health care, while stimulating the private and PVO sectors increasingly to absorb the relatively more affluent Peruvians who can pay for part or all of their health needs while the MOH ensures that service criteria and norms are followed.

The MOH and IPSS appear predisposed to a closer working relationship with the private sector, and we will condition assistance to the public sector on the contracting out of services and facilities and the employment of new procedures to generate additional resources through user fees. We expect that lowered costs and quality improvements will

stimulate the GOP to replicate pilot models to additional areas. We will also build a cost-recovery component into public sector programs that are carried out by community organizations and private contractors. In this regard, with local currency we will finance an expansion of urban and peri-urban small water and sewerage systems with an educational component, which can increase over time through the creation of a user-financed revolving fund.

The public sector will retain a major role in prevention programs to promote child survival and we will condition further support to refocused MOH and IPSS programs. Assistance will be tied to incentives to improve the quality of preventive health programs, a cost recovery basis for curative facilities and interventions, and new mechanisms to improve the quality and management of personnel. In addition, we expect to extend our involvement in the area of child survival by financing vaccine preventable disease programs, diarrheal disease control, upper respiratory infection control measures, and strengthened support systems including health and management information systems and active epidemiological surveillance.

We will continue supplementary feeding programs using PL 480 Title II resources as an integral part of child survival activities. These programs will be increasingly targeted and determined according to child survival and nutrition indicators to focus assistance on those in greatest need. While these programs are to a large extent concentrated on the nutritionally vulnerable, by FY 95 there should be sufficient growth in the economy so that our financing of the safety net can be reduced. As the Title II program begins to decline we will ensure that remaining resources are targeted on those children at greatest nutrition risk.

To implement the proposed quality health care program we will need approximately \$13 million each year in Development Assistance resources over the 1992-1996 period. In addition, \$77 million in PL 480 Title II and Section 416 resources for FYs 92-94,

which will decline to approximately \$50 annually in the out years, also will support this objective. While resources will be projectized, we are considering the use of Non Project Assistance to strengthen public sector child survival programs if we secure needed policy changes with respect to a greater role for the private sector and a reorientation toward preventive services directed at the appropriate target.

C. Monitoring and Evaluation

Annex A contains selected program performance indicators appropriate to each Mission strategic objective along with appropriate targets to be achieved over the CDSS period.

IV. RESOURCES

A. Program Funding

The proposed program is inter-related and self-reinforcing; resources will frequently support several objectives. For example, humanitarian food assistance will provide a safety net to enable the GOP to sustain the proper macroeconomic policy framework while helping meet nutrition objectives. Similarly, improvements in judicial administration will help achieve the narcotics objective while strengthening democratic institutions.

Our highest priority is for ESF program and project funding. ESF balance of payments support will strengthen the GOP's commitment to appropriate macroeconomic policies without which most other objectives cannot be attained. These resources are also important because they will signal the priority we attach to Peru's reform program, thereby leveraging other donor resources. In addition, local currency associated with ESF support is critical to private sector growth and narcotics control. ESF project funding will also support an appropriate policy framework and needed structural reforms through policy advice and analyses. Further, ESF project funding will help reactivate the private productive sectors including the coca growing areas, while strengthening democratic institutions.

The second priority is for PL 480 Title II and Section 416 humanitarian food assistance. This reflects the urgency of alleviating the heavy burden that the poor are bearing under the economic stabilization program combined with already existing severe chronic malnutrition. In FY 1995 and beyond the direct food assistance program will be reduced, in expectation of renewed economic growth, greater domestic food production and increased income levels.

The third resource priority is for Development Assistance, with the greatest need being for family planning services, an area where A.I.D. has a history of successful involvement. This is also a priority of the new administration. After population needs are met our priority is for Development Assistance funding for primary health care programs in response to critically low child survival indicators. Subsequent priorities for Development funding are for agricultural programs, participant training and for natural resource development and preservation activities. These areas are ranked lower because other requested resources can be used to achieve related elements of the same Mission objective or because other donors over time will become involved in these areas.

Our final priority is for PL 480 Title III food assistance. While the balance of payments effect of Title III will contribute to the most fundamental objective of continuing the proper policy framework and structural reforms, because of its nature it is not as flexible as other higher resource priorities. Local currency generated by the Title III program will be used in part to help finance GOP counterpart requirements for A.I.D. Development Assistance funded projects as well as other donor funded activities complementary to A.I.D.'s.

The table at Annex B provides details of resources to be used for each objective over the FY 1992-1997 period.

B. Staffing and Operating Expense Levels

The table at Annex C summarizes USAID/Peru's organizational structure and Operating Expense funded work force as of mid-1991. We have a total of 166 OE-funded employees on board, organized within six Mission offices.

In addition to the OE funded personnel, there are an additional nine project funded professional personnel working in the USAID building who spend part of their time on non project-related matters.

USAID management has just participated in an NSDD-38 review of all U.S. positions, and we believe that the OE funded workforce detailed above should be adequate to manage and implement our strategy. We anticipate no significant changes in OE funded personnel over the CDSS time frame. There will be, however, an increase of project funded personnel as counter-narcotics resources come on stream.

In addition to handling USAID/Peru matters, the Executive and Controller Offices have administrative and financial management responsibilities for the ADC programs in Colombia, Brazil and Chile. We have urged for some time that these responsibilities be taken over by A.I.D./W or another Mission. While this would not result in significant personnel reductions, it would enable us to better manage USAID/Peru's rapidly expanding portfolio.

USAID's Executive Office and the Embassy Administrative Section have agreed to a fifteen point cooperative program to achieve a more efficient use of U.S. Government resources. This has led to the expansion of collaboration in a number of areas including shared building space, combined shuttle service, joint non-expendable property disposal, and possibly shared warehouse space. The Embassy is completing plans for the construction of a new office building facility, but it is not clear at this time if space will be provided for A.I.D. If so, we will give greater priority to a consolidation of our administrative functions with the Embassy.

We anticipate establishing a Trust Fund by FY 1992 to cover 25% of our local currency operating expenses in accordance with LAC Bureau guidance. Overall OE costs average slightly less than \$6 million per year. OE costs are high in Peru. This is due to some extent to economic distortions and narcotics earnings, which keep exchange rate depreciation from paralleling inflation. OE needs also are large due to high FSN salary and severance payment levels. Furthermore, the lack of U.S. Resident Hire or qualified Peruvians has frequently required the employment of more expensive USPSCs.

PROGRAM PERFORMANCE

Annex A

I. Support the Achievement of Broadly-Based Economic Growth

| L A C Sub-objectives | Mission Strategic Objectives | Performance Indicators | Baseline 1990 | 1995 |
|---|---|--|---------------|----------|
| Promote Investment, Employment and Export-led Diversification | An Overall Policy Framework and Structural Reforms that promote economic stability and sustained growth | Decrease in the average monthly inflation rate | 43.4% | .8% |
| | | Increase in Real Per-capita GNP Base=1989 | \$1,010 | \$1,140 |
| | | Increase in Real Wages (1989=100) | 80 | 120 |
| | | Underemployment as a % of economically active population (base 1989 in Lima) | 73.8% | 50.0% |
| | | Central Government budget surplus as % of GDP | -3.3% | -1.4% |
| | | % of Central Government deficit financed by the Central Bank | 70% | 72% |
| | | Central Government domestic borrowing as a % of GDP | 2.3% | 2.3% |
| | | Net International Reserve Level (equivalency in monthly imports) | 3 months | 5 months |
| | | Tax revenues as a % of GDP | 7.5% | 13.2% |

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Vigorous response
by the Private
Sector to a
favorable policy
environment

Reactivated
private sector
generating
employment,
foreign exchange
and increased
productivity

| | | |
|--|--------|----------------------|
| Private sector investment as a % of GDP | 11.8% | 18.7% |
| Domestic savings as a % of GDP | 13.4% | 22.4% |
| External savings as a % of GDP | 0.7% | 2.1% |
| Foreign direct investment (million US\$) | 29.0 | 700.0 |
| Agricultural borrowing from the banking system as a % of GDP | 2% | 5% |
| Spread between annual borrowing and lending interest rates | 380% | 8% |
| Real interest rates: | | |
| lending | -6.4% | International levels |
| borrowing | -14.3% | |
| Agricultural GDP (million US\$) | 4,866 | 6,500 |
| Production of the principal agricultural crops: (MT) | | |
| Wheat | 76.4 | 182.0 |
| Corn | 487.2 | 810.0 |
| Potato | 1028.8 | 1,883.0 |
| Cotton | 242.0 | 333.0 |
| Agricultural wholesale price Index | 100.0 | 220.9 |

| | | | | |
|--|--|---|---------|-----------|
| Accelerated Opportunities for increased participation in the economy by the historically disadvantaged | Improved health status through access to quality primary health care | Decreased infant mortality rate | 81/1000 | 65/100 |
| | | Increased share of MOH budget for preventive activities | 10% | 40% |
| | | Increased % of target population immunized | 65% | 85% |
| | | Increased MOH distribution of ORS packets per year | 500,000 | 6,000,000 |
| | | Decrease in infant diarrhea (episodes per year per infant) | 10 | 5 |
| | | Increase in % of MOH operating costs recovered from hospitals and health care centers | 5% | 40% |
| | | Increased access to potable water (% of population) | 46% | 60% |
| | | Increased access to sanitary disposal of wastes (% of population) | 18% | 35% |
| | | Increased modern contraceptive prevalence (% of WIF) | 23% | 40% |
| | | % of operating costs recovered in PVO family planning services | 10% | 50% |

| | | |
|--|---------|-----------|
| Increase # of commercial FP outlets | 3,500 | 6,500 |
| Increase in Couple-Years-Protection | 620,000 | 1,000,000 |
| Decrease in acute child malnutrition rates | 8% | 3% |
| Decrease in chronic child malnutrition rates | 60% | 40% |

II. Support the Evolution of stable democratic societies

| LAC Sub-objective | Mission Strategic Objective | Performance Indicators | Baseline 1990 | 1995 |
|---|---|---|---------------|-------------|
| Encourage the strengthening of competent civilian institutions that will merit the confidence of political and military leaders, citizens and investors | Encourage strong democratic institutions that reinforce economic freedom <u>Sub-objectives</u> Judicial Branch strengthened | # of courts using case management systems | 10 | 193 |
| | | # of attorney offices using case management systems | 0 | 193 |
| | | MOJ budget as a % of total Central Gov. budget | 0.75% | 5% |
| | | Anti-corruption committee established | Non-existent | Established |

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| | | | |
|---|---|--------------|-------------|
| | Non-partisan institution supporting judicial reform | Non-existent | Established |
| Increased popular participation in key public institutions to assure new accountability, transparency, and feedback | adoption rate (%) of administrative simplification programs in public sector institutions | 50% | 85% |
| | # of property titles granted | 30,000 | 800,000 |
| | Non-partisan institution providing analysis of legislation | Non-existent | Established |
| | Number of organizations involved in civic education | about 100 | about 1,000 |

III. Respond to needs for international cooperation in addressing specific challenges to the attainment of broadly based sustainable economic growth and the evolution of stable democratic societies.

| L A C Sub-objective | Mission Strategic (Objective) | Performance Indicators | Baseline 1990 | 1995 |
|---|---|---|---------------|-------|
| Contribute to the formulation and implementation of USG strategies for dealing with issues of special concern such as the production, trafficking and consumption of drugs, terrorism and environmental degradation | Replace coca based employment and foreign exchange earnings with legal alternatives | Decrease in foreign exchange earnings from coca/cocaine (millions US\$) | 800 | 400 |
| | | Increase in foreign exchange earnings from legal exports | 3,276 | 4,000 |
| | | Foreign exchange earnings from non-traditional exports (millions US\$) | 974 | 1,400 |

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| | | |
|---|---------|---------|
| Decrease in coca farmer employment | 120,000 | 70,000 |
| Increased area in production of legal marketable crops in the Hualaga Valley (Haa.) | 100,000 | 160,000 |
| Increased new investment in legal production activities in the Hualaga Valley (million US\$) (absolute investment) | -0- | 100 |
| # of institutions involved in narcotics awareness and prevention activities | 1980 | 3,200 |

Program Funding

(\$000)

| <u>Mission Objective</u> | <u>FY 92</u> | <u>FY 93</u> | <u>FY 94</u> | <u>FY 95</u> | <u>FY 96</u> |
|--|------------------|------------------|------------------|------------------|------------------|
| <u>Policy Framework</u> | <u>179,000</u> | <u>180,254</u> | <u>175,000</u> | <u>150,000</u> | <u>150,000</u> |
| Policy Analysis (ESF Project) | 3,000 | 254 | - | - | - |
| Balance of Payments (ESF Program) | 70,000 | 70,000 | 70,000 | 70,000 | 70,000 |
| Balance of Payments (Title III) | 30,000 | 30,000 | 30,000 | 30,000 | 30,000 |
| Safety Net (Title II and Section 416) | 76,000 | 80,000 | 75,000 | 50,000 | 50,000 |
| <u>Private Productive Sectors</u> | <u>27,391</u> | <u>29,869</u> | <u>28,343</u> | <u>33,296</u> | <u>37,600</u> |
| Exports and Small Business (ESF/DA Projects) | 24,321 | 24,246 | 23,000 | 25,000 | 27,000 |
| Agriculture (DA) | 3,070 | 5,623 | 5,343 | 8,296 | 10,600 |
| <u>Counter-Narcotics</u> | <u>(207,800)</u> | <u>(211,800)</u> | <u>(206,213)</u> | <u>(180,000)</u> | <u>(180,000)</u> |
| Policy Framework (ESF Program and Project, Title III, Title II and Section 416) | (179,000) | (180,254) | (175,000) | (150,000) | (150,000) |
| Private Productive Sectors (ESF projects) | (24,000) | (24,246) | (23,000) | (25,000) | (27,000) |
| Democratic Institutions (ESF/DA projects) | (4,800) | (7,300) | (8,213) | (5,000) | (3,000) |
| <u>Democratic Institutions</u> | <u>6,639</u> | <u>9,400</u> | <u>10,143</u> | <u>6,331</u> | <u>3,100</u> |
| AOJ/Anti Corruption, etc. (ESF/DA projects) | 4,800 | 7,300 | 8,213 | 5,000 | 3,000 |
| Participant Training/Special Activities (DA) | 1,839 | 2,100 | 1,930 | 1,331 | 100 |
| <u>Quality Health Care</u> | <u>10,450</u> | <u>15,542</u> | <u>18,033</u> | <u>11,467</u> | <u>10,000</u> |
| Family Planning (DA) | 3,170 | 2,600 | - | 2,330 | 4,000 |
| Preventive Health (DA) | 7,280 | 12,942 | 18,033 | 9,137 | 6,000 |
| Total* | 223,480 | 235,065 | 231,519 | 201,094 | 200,700 |

* Excludes PD&S.

OE-Funded Staff as of Mid-1991

| <u>Office</u> | <u>USDH</u> | <u>USPSC</u> | <u>USRH</u> | <u>ESNDH</u> | <u>ESNPSC</u> | <u>Total</u> |
|-----------------------------------|-------------|--------------|-------------|--------------|---------------|--------------|
| Director | 3 | - | 1 | 1 | 3 | 8 |
| Private Sector and Trade | 4 | - | - | 6 | 1 | 11 |
| Health and Democratic Development | 3 | - | - | 6 | 9 | 18 |
| Agriculture and Natural Resources | 3 | 1 | - | 3 | 4 | 11 |
| Project Development and Program | 2 | - | - | 2 | 3 | 7 |
| Controller | 2 | 1 | - | 10 | 18 | 31 |
| Executive | 1 | = | = | 14 | 65 | 80 |
| Total | 18 | 2 | 1 | 42 | 103 | 166 |