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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

PERU

PROJECT PAPER

DISASTER B/P SUPPORT

AID/LAC/P-177

Loan Number:527-F-093
Project Number:527-0278

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AID 1120-1

PAAD

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO.: Project No. 527-0278 527-F-093
2. COUNTRY: PERU
3. CATEGORY: PROGRAM ASSISTANCE LOAN
4. DATE: January 31, 1984
5. TO: M. Peter McPherson, A/AID
6. OYB CHANGE NO.:
7. FROM: Marshall Brown, AA/LAC (Acting) SS
8. OYB INCREASE: $60 million
TO BE TAKEN FROM:
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 60 million
10. APPROPRIATION - BUDGET PLAN CODE

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
[X] LOAN [ ] GRANT	[ ] INFORMAL [X] FORMAL [ ] NONE	FY 84	of authorization

15. COMMODITIES FINANCED

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.: $60 million
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: $60 million	Other:

18. SUMMARY DESCRIPTION

As a result of the floods, landslides and drought of 1983, the already acute balance of payments and budgetary crises facing Peru were made even worse. These natural disasters caused over half a billion dollars in foreign exchange losses. As a consequence, the country has experienced an even greater decline in economic activity and employment nationwide than otherwise would have been the case without the disasters.

The purspose of the proposed program is to make available $60 million in foreign exchange to help relieve balance of payments pressure resulting from the disasters. Local currency counterpart will be used to support productive employment activities to counteract the direct and indirect effects of the disasters.

The term of the loan will be 25 years with a ten year grace period with interest on the unpaid balance of the loan of 2 percent during the grace period and 3 percent thereafter.

19. CLEARANCES	DATE
LAC/SA:FAlmaguer FA	3/1/84
LAC/DP:JOleson	3/1/84
LAC/DR:DJohnson	
AA/PPC:RDerham, Acting	5/1/84
GC:MFry	5/1/84
M/FM/CONT:CChristensen	5/1/84

20. ACTION

[X] APPROVED [ ] DISAPPROVED

M. Peter McPherson — AUTHORIZED SIGNATURE — DATE: May 1, 1984

Administrator
Agency for International Development
TITLE

CLASSIFICATION:

BEST AVAILABLE COPY

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I. SUMMARY AND RECOMMENDATIONS

A. Economic Background

During the course of 1983, Peru has suffered a combination of natural disasters of unprecedented ferocity including extensive flooding all along the northern coast, severe drought in the southern highlands, and the disappearance of the anchovy which provide the basis for the country's fishmeal and fishoil industry. This, added to the persistent effects of the worldwide recession which have severely depressed the prices of Peru's major exports, has produced a 10.6 percent decline in real GDP. This decline was more than twice the average experienced in Latin American countries in 1983. As a result, Peruvian per capita incomes have been forced down to 1965 levels.

Of the 10.6 percent decline in GDP experienced in 1983, 5.5 percentage points were attributable to the direct and indirect effects of natural disasters. These included not only the losses of crops, petroleum, and fish, but also the decline in manufacturing, transportation, and commerce which resulted from the losses in production inputs and the disruption of productive activities generally. Thus, the effects of the disasters were felt throughout the country.

The disasters had a particularly heavy impact on the balance of payments and the level of foreign exchange reserves. The 1983 balance of payments is estimated to have declined by over two hundred million dollars as a direct result of "el Nino," and the unfinanced 1984 balance of payments gap will be at least 80 million dollars greater than it would have been without the disaster. The largest part of this loss resulted from decreased exports of petroleum, fish products, cotton, and sugar. This loss in foreign exchange resulting from the disaster further aggravated Peru's ability to finance imported inputs necessary for a partial restoration of the loss in GDP caused by the disaster. In addition, increased imports of rice, sugar, soy oil, and potatoes were required as a result of the disaster. These enormous foreign exchange losses came at a time when Peru's reserves were already at minimum levels as a result of the prolonged world recession.

The sharp deterioration in the balance of payments forced the GOP to undertake significant austerity measures to prevent a further loss of reserves. Chief among these measures was a significant tightening of the Central Bank's monetary policy. In addition to the balance of payments effect, the disasters also brought about a substantial deterioration in the GOP's fiscal situation. Lost tax revenue of the central government, increased expenditures to cope with the disasters, and losses by state enterprises because of the disasters equaled 3.8 percent of GDP. Thus, as a result of the disasters, the GOP was required to tighten credit precisely at a time when the disasters were substantially increasing the public sector's own borrowing requirement.

The inevitable result of this set of circumstances was that the burden of austerity has fallen heavily on private sector employment. Not only were many firms in acute financial distress as a direct or indirect result of the natural disasters, but their ability to finance their requirements through the domestic financial market was substantially reduced. As of December 7, 1983, total private sector credit from the financial system had declined 15.8 percent, the equivalent of $619 million. The combination of the disasters, the decline in business activity generally, and the credit crunch has led to business closings, low rates of capacity utilization, the failure of three major financial institutions, and rates of unemployment and underemployment of more than 60 percent. Real wages have declined by 19.3 percent since late 1982. These conditions, in turn, have produced a perceptible worsening of Peru's already serious poverty and malnutrition problems. Moreover, there is little prospect of significant improvement in 1984. As a result of the need for continued austerity to deal with the weak foreign exchange situation, current projections are for a recovery of only 3 to 4 percent in output from the very depressed levels of 1983. On a per capita basis, this represents only a 0.4 to 1.4 percent increase.

The substantial worsening of the GOP's fiscal position has also seriously undermined the prospects for long-term recovery. With increases in interest payments on foreign debts and political and institutional obstacles to major cuts in current spending, the burden of fiscal austerity has fallen heavily on the investment budget. For the first ten months of 1983, real central government investment expenditures were 40 percent lower than in the corresponding period of 1982. In addition, the 1984 budget calls for a further slowing down of development projects, even donor-funded projects. Thus a major effect of the 1983 disasters has been the postponement of the essential development projects which would provide the basis for recovery and renewed growth.

Therefore, at a critical time in Peru's history, when the fundamental future orientation of the nation's economic structure will be debated, Peru is faced with further relative stagnation in per capita incomes and a stretching out of ongoing investment as a result of the macroeconomic effects of 1983's disasters. If Peru's fundamental private sector development strategy is to continue, it is imperative that ways be found to restore confidence in the basic approach of the present government. To do this, it is essential that foreign exchange resources be provided in order to permit a more expansionary policy which will make possible a perceptible improvement in living standards in 1984.

B. Program Summary

1. Dollar Resources

In order to deal with the balance of payments and employment aspects of the disaster, the Mission proposes to make available to the GOP $60 million in freely available foreign exchange, one-eighth of the estimated loss due to the disasters. The amount proposed will enable Peru to recover a significant portion of the foreign exchange loss resulting from the disasters, permitting the Central Bank to follow a more expansionary path in monetary policy consistent with targets established under the IMF program. These additional resources, combined with other donor resources, a significantly reduced public sector deficit, and improvement in savings mobilization by the financial system, should enable the financial system to recover a significant part of the decline in lending volumes experienced in 1983 and allow the economy to recover faster than the 3-4 percent growth rate which would otherwise be possible in 1984 if additional external resources were not to be made available. Three percent growth represents a per capita increase of only 0.4 percent while even 4 percent growth would produce only 1.4 percent increase in output per capita. The additional 0.8 percent growth that will be made possible by this program on top of the 0.4 to 1.4 per capita growth which would otherwise be possible will help overcome the widespread impression that Peru's current free-market policies have failed and head off measures which would return the country to the counterproductive interventionist and protectionist policies of the past.

The program would be conditioned on GOP signing an agreement with the IMF and an agreement with the Mission on a series of administrative improvements required to facilitate the implementation of disaster recovery activities.

The AID resources would be disbursed in two tranches. The first tranche, $30 million, would be disbursed on signing of the agreement or shortly thereafter. As a condition precedent to initial disbursement, AID will require that the GOP furnish evidence of the IMF Board approval of the Standby Agreement and a statement of GOP intention to establish improved administrative arrangements that will accelerate implementation of the disaster rehabilitation and reconstruction program and other high priority projects. The second tranche of $30 million would be disbursed approximately six months after the first disbursement if the GOP continued to be eligible for drawings under the IMF program and if the GOP is satisfactorily carrying out the improved administrative arrangements described in its statement of intention submitted with respect to initial disbursement.

2. Local Currency Uses

Local currency resources associated with the program will be used to: provide funds on a priority basis to promote productive employment-creating activities in areas directly or indirectly affected by the disaster. To achieve these objectives, the GOP will establish a special account in the Banco Industrial del Peru (BIP) or other appropriate financial institution with the local currency equivalent of the first $30 million of loan proceeds. The account will be used to address the immediate need to create and maintain productive employment. The fund will be used to provide credit to firms in financial distress as a result of the disaster-worsened recession. Given the apparent reluctance of many commercial banks to increase lending in the current environment, it is likely that the major part of such funds will be disbursed through the BIP. Prior to the disbursement of the second $30 million, the Mission will evaluate the BIP local currency loan program and will explore the feasibility of establishing a mechanism to rediscount local currency funds through commercial intermediaries. If it is determined that a rediscount mechanism is feasible, the second tranche of local currency will be provided through commercial banks.

The disasters also produced a serious decline in public sector revenues. This has forced a severe curtailment in the implementation of public sector investments including the implementation of high priority donor assisted projects. We would plan to leave open the option of utilizing some portion (about 25%) of the local currency resources to accelerate the implementation of high-impact, employment-generating disaster and development projects, including projects funded by other donors.

C. Loan Terms

The borrower will be the Government of Peru, represented by the Ministry of Economy, Finance, and Commerce. The term of the loan will be 25 years with a ten year grace period with interest on the unpaid balance of the loan of 2 percent during the grace period and 3 percent thereafter. The improved administrative arrangements referred to in the conditions precedent to initial disbursement (described above) will be negotiated with the GOP, as will understandings about the details of the monetary program. In these negotiations, USAID/Peru will seek agreements that the GOP will make special arrangements which will exempt disaster activities from existing ceilings and restrictions on hiring and contracting and implement other arrangements which will improve disaster project implementation. The Mission only expects to proceed with the loan subsequent to the signing of an IMF Standby Agreement.

D. Recommendation

USAID/Peru recommends authorization of a loan of $60 million from Disaster Assistance Funds.

II. CURRENT ECONOMIC SITUATION

A. Basic Trends in Production

The Peruvian economy has suffered serious reverses during calendar year 1983 as a result of natural disasters which, combined with the adverse effects of the world recession, have gravely imperiled the prospects for economic recovery.

1. Aggregate Output by Sector

Table 1 summarizes recent trends in aggregate output by sector. Between 1978 and 1982, the Peruvian economy experienced modest real growth. Although real output growth never exceeded 3.8 percent (in a period when population was increasing at 2.6 percent), it was an improvement over the previous period of economic decline under the military government.

Agricultural production has been extremely erratic during recent years. Having increased modestly in 1979, agricultural production fell by 5.4 percent in a continuation of a long-standing pattern of stagnating agricultural production due to a combination of lack of production incentives and adverse climatic conditions. In 1981, as a result of good rainfall, increased producer prices, and increased availability of agricultural credit, overall agricultural production increased by 12.8 percent. Although the 1981 production gains were led by a 70 percent increase in rice production, output gains were widespread and included significant increases in livestock and poultry production. In 1982, the growth in agricultural production slowed markedly to 3.7 percent as drought conditions in the north of the country reduced production of corn, rice, and wheat. In addition, cotton output declined by 15.9 percent in response to low world prices, while further gains in poultry and livestock were impeded by market saturation.

In the manufacturing sector, developments have been complicated by a number of factors. These include the significant opening of the economy to international trade which was initiated by the previous government in 1978-79 and intensified by the present government. This opening consisted of a significant reduction in the levels of many tariffs to an average level of about 30 percent and the elimination of most non-tariff barriers. These measures have had an adverse initial impact on a number of formerly protected industries. In addition, the prolonged world recession has depressed demand for manufactured exports. Finally, the imposition by the U.S. Government of countervailing duties on Peruvian textile exports has had some depressing effect on the output of that industry but apparently less than had been anticipated.

Trends in manufacturing sector output are indicated on Table 2. Among major subsectors of manufacturing, the fish processing subsector has exhibited wide swings in output due to year-to-year swings in the availability of the catch. Other food, beverage, and tobacco production, the single most important subsector showed essentially stagnant real output since 1980 after modest growth in the two previous years. Petroleum products and chemicals exhibited modest growth of 2.2 and 2.4 percent, respectively in 1981 and 1982 after a strong 10.6 percent increase in 1980. The basic metal and metallic products and machinery subsectors have experienced major output declines recently as a consequence of external competition and weak domestic demand, particularly for investment goods. Textile production, which had already declined by 2.0 percent in 1980, fell by 3.7 percent in 1981 and 7.8 percent in 1982.

Overall, the manufacturing sector, which tends to be most sensitive to the business cycle in any case, and which was previously highly protected, has been particularly adversely affected by the opening of the domestic market to foreign competition. A new general law for industry was promulgated in mid-1982 to stimulate the manufacturing sector. The new law continues the system of tax incentives which promote reinvestment in existing firms and which provide additional incentives--up to a 90 percent tax credit--for investment outside of Lima as well as special incentives for small enterprises and for export-oriented firms. Nonetheless, the manufacturing sector continues to operate under a number of disabilities. Among these are a provision of the labor code which makes it difficult for a firm to lay off workers during a business downturn, and an existing capacity, installed under a regime of substantial tariff and non-tariff production, which is not appropriate to the pattern of costs and prices prevailing now in the Peruvian market.

2. Functional Distribution Output

The previous section discussed recent developments in the major sectors of the Peruvian economy. A somewhat different perspective can be obtained by looking at the trends in the functional distribution of output, that is, the distribution between consumption and investment, between public and private sectors, and between domestic activity and the external sector.

Table 3, which summarizes recent trends in the functional distribution of dommestic output, provides useful information about the source of demand for output and some indication of the future level of aggregate supply. The consumption share in total output declined sharply in 1979 to 79.3% of total output from 83.2% the previous year then partly rebounded to 81.5% in 1981, held constant in 1982, then fell still further to 78.9% of the total in 1982. This pattern is the product of a number of trends. Public sector consumption jumped sharply in 1980 partly as a result of a significant increase in public sector revenues resulting from buoyant export prices. Public sector consumption subsequently declined following a sharp fall in export prices and a significant worsening of the fiscal situation.

The overall share of investment in total output increased sharply between 1978 and 1980, on the strength of increases in both public and private fixed investment. In 1981, domestic investment increased still further, to 20.1 percent of GDP, primarily as a result of strong performance of private fixed investment and a substantial increase in inventories. Despite the deteriorating domestic and international economic situation, the level of private investment held up remarkably well in 1982 with a decline in fixed investment of only 0.8 percent of GDP.

The buoyancy of Peru's investment performance despite the disappointing levels of output growth is surprising. On the other hand, it is also surprising that output growth year after year has been so low (averaging 3.7 percent growth from 1978 to 1982), despite the levels of investment that have been undertaken in recent years. The explanation for the latter lies in a combination of a poor prioritization of public sector investment projects, an inappropriate set of private investment incentives (e.g., subsidized interest rates, taxes on labor), and structural constraints such as the labor stability law which encourage investment in excessively capital intensive activities.

The third major functional category of final demand is the external sector. From a position of moderate stimulus in 1978-1979, the influence of net external demand weakened considerably up to 1981, recovering only slightly in 1982. To some extent, this pattern reflects the decline in export receipts associated with the fall in primary commodity prices after the boom of 1979-80. More important, however, has been the influence of the opening of the domestic economy which began in 1978-79 and culminated in the removal of virtually all administrative controls on imports in 1981. It was probably inevitable that this opening of the domestic economy to external competition should have had a depressing effect on domestic output (even if it had been accompanied by a real depreciation of the exchange rate which it was not) because the domestic production of importables would decline immediately while the capacity to supply increased levels of exportables and non-traded goods would appear only after some lag. It was particularly unfortunate that this opening coincided with the onset of the world recession which reduced international demand for goods which Peru could potentially export. Nonetheless, the depressing effect of reducing trade barriers appears to have been accentuated in 1981 and early 1982 by a seriously overvalued exchange rate which encouraged imports. In 1983, following a significant real depreciation of the sol, the current account balance improved significantly. During 1983, net external demand was a source of some stimulus to the economy, equal to 3.8 percent of GDP.

B. Production Effects of the Natural Disasters

The natural disasters of 1983 had a devastating effect on an economy which was in any case contracting due to the effects of external market conditions. These losses in current production are in addition to the destruction of infrastructure (which is being addressed by the Disaster Relief, Rehabilitation and Reconstruction Project 527-0277). In addition to causing a decline in current consumption, these losses in current output have had a particularly severe impact on the balance of payments with critical implications for 1984 and beyond.

Losses resulting from natural disasters can be divided broadly into direct losses in agricultural and livestock production, either from the destruction of output itself or from an inability to market crops due to infrastructure damage, declines in fishing production resulting from the warming of ocean waters, declines in petroleum production resulting from damage to the transandean pipeline and some direct disruption of production in the Talara area, and manufacturing, transportation, and service output declines due to an absence of production inputs. The total effect of the natural disasters on output during 1983 was the subject of a recent study by the Central Bank. The conclusions of this study are summarized briefly on Table 4 and below.

Of the losses in agricultural production, the most important was the destruction of most of the potato crop, amounting to some 650 thousand metric tons. Other major agricultural losses resulting from the flooding and drought were sugar cane (200 thousand metric tons), rice (131 thousand metric tons), corn (109 thousand metric tons), and cotton (710.7 quintales of fiber). In total, direct agricultural losses, including declines in the quality of output due to water damage, measured at farm gate prices, amounted to 1.5 percent of 1982 GDP.

In the case of petroleum and mining production, the disaster related losses were equal to 4.6 percent of 1982 production. In addition to the direct losses in this sector, there were also declines in the manufacturing sector, due to the decline in refining and in the transportation sector.

In the fishing sector, total output declined by 26.1 percent due to the almost total disappearance of the anchovies which are the primary input into the production of fishmeal and fishoil. Again, in addition to the losses in the fishing sector itself, significant losses were attributable to the manufacturing sector.

In total, manufacturing output declined by 5 percent as a result of the disasters. In addition to petroleum refining and fish processing, a variety of productive activities were disrupted as a result of damage to the transportation system. Textile production was also interrupted as a result of damage to the cotton crop.

In addition to the previously mentioned sectors, significant losses were sustained by the transportation sector and by a variety of service sectors including wholesale and retail trade. In total, these "other" sectors sustained losses equal to 5.4 percent of 1982 output.

Overall losses in all sectors due to the direct and indirect effects of climatic disasters were calculated by the Central Bank study at 5.5 percent of 1982 GDP. GDP in 1982, measured at current prices was 13,813 billion soles or, at the average rate of exchange for the year of 697.57 soles per dollar, $19.8 billion. Therefore, the dollar value of the loss in current output during 1983 was $1,089 million.

The losses in output were heavily concentrated in export industries, including petroleum, fishing, and cotton and sugar production. As a result, the 1983 disasters had a particularly heavy impact on the balance of payments which is estimated to have worsened by over two hundred million. This will be considered in detail below.

C. Fiscal Situation

Underlying much of the economic difficulty of the past decade has been the persistently weak financial position of the public sector which has led to a large volume of external debt and debt service payments. These debt service payments, in turn, have worsened the balance of payments and led to a need for still further borrowing. Given its central position in Peru's economic difficulties, a detailed discussion of the nature of the fiscal problem is in order.

Table 5 summarizes developments in the GOP's fiscal position since the last years of the military government. Beginning from a position of acute fiscal crisis in 1977 in which the consolidated public sector deficit reached 10 percent of GDP, the government made substantial progress in reducing the deficit through curtailment of consumption subsidies and other measures. Unfortunately, the 1979-80 commodity price boom permitted such a relaxation of fiscal effort that the beneficial effects of the earlier measures were largely undone. In addition, the new government undertook a number of measures which, while beneficial and perhaps even necessary in the long run, had the effect of weakening the fiscal situation.

1. Revenue

On the revenue side, the structure of central government current receipts is summarized on Table 6. The importance of personal income taxes has declined markedly since the beginning of the new government after increasing substantially in the last years of the previous government. This was largely a result of a reduction in the highest rates of personal income tax under the new government but also may reflect a decline in the level of compliance. Also as a result of a deliberate policy decision, the level of taxes on exports has been reduced drastically in order to remove disincentives to exports and, in mining, to increase incentives to reinvest. The most significant source of central government revenue has been and continues to be taxes on production and consumption which at the beginning of the period accounted for 46 percent of central government revenue, which declined in relative importance to 37 percent of the total in the last years of the military government, but which have again risen in relative importance in the last three years.

The last major source of revenue, and the most controversial, is taxes on imports. A major initiative of the new government was an attempt to reduce the levels of tariffs and reduce their dispersion as a part of an overall attempt to reverse the previous pattern of import substituting industrialization. The initial fiscal effects of import liberalization, which actually began late in the previous government, were favorable. The virtual elimination of quantitative restrictions on imports increased the volume of taxable imports. From 12 percent of central government revenues, equal to 2.2 percent of GDP, in 1979, taxes on imports rose to more than 21 percent of the total and almost 4 percent of GDP.

Unfortunately, the government's objective of reducing the average level of tariffs to a 25 percent average rate by 1984 (with a standard deviation of 8 percentage points) was frustrated by the need for increased revenue. The introduction by the government of a 15 percent tariff surcharge (later changed to a 10 percent ad valorem surcharge) reduced the loss of revenue due to declining import volumes but only at the cost of increasing the level of unweighted average tariffs to 41 percent, higher than it had been at the end of 1980.

2. Current Expeditures

The inability to control current expenditures, both of the central government and of the state enterprises, lies at the root of much of the GOP's fiscal problem. Significant gains were made by the military government under the 1978 EFF agreement with the IMF, in the reduction of consumption subsidies, public sector wages and salaries, and in defense spending. The revenue windfall which accompanied the 1979 commodity price boom created a strong political temptation to reverse those reductions and the government of the day, in its last months, succumbed to that temptation.

The pattern of central government current expenditures is shown in Table 5. The three significant items of current expenditure are payment of wages and salaries, interest on public sector debt, and defense spending. Beginning in 1978, when wages and salaries were equal to just under 5 percent of GDP, the military government reduced the real level of payments by almost a full percentage point. Subsequently the new government used its commodity windfall to restore and then somewhat increase the level of these payments which were equal to 5.3 percent of GDP in 1981 and 1982. During the current year, the level of these payments has fallen somewhat as wage increases have fallen behind the rate of inflation.

It should be emphasized that the primary cause of the changes in the level of public sector wage payments has been changes in the levels of public sector wages, not changes in the levels of public sector employment. As is true in the private sector, the Labor Stability Law, enacted by the military government, makes it virtually impossible to discharge government employees, even when their services are not longer needed. More seriously, it appears that attempts to control public sector spending primarily by the level of public sector compensation is having serious adverse consequences for the quality of the public sector workforce.

The most critical area where cuts in public sector spending have not been achieved is in the area of military spending. As indicated above, the military government achieved significant reductions in this area under the prodding of the IMF. However, under the current government, military spending has grown from less than 5 percent to almost six percent of GDP. It appears that significant cuts in defense spending are to be made in 1984 but the exact levels are not known at this time.

The one really uncontrollable item in the central government budget is the level of interest payments on the public sector debt, which are a function of the size of the debt, its distribution between local currency and foreign exchange instruments, and the levels of domestic and international interest rates. For practical purposes, none of these can be changed by the GOP without other unacceptable economic policy consequences.

3. Central Government Capital Expenditures

In addition to altering the level of public sector wages, the chief instrument used by the GOP for controlling the level of the public sector deficit has been through alterations in the level of the public sector investment budget. The sectoral distribution of the central government capital expenditure is shown in Table 7. The most striking aspect of these figures is the absence of any apparent trend. Although spending on transportation and communications, and on education have increased noticeably, the overall impression one receives from these data is that the GOP adjusts by stretching out everything rather than making clear intersectoral policy choices.

4. Financial Operations of the State Enterprises

A major component of the public sector deficit is the combined deficits of the state enterprises. In 1982, these totaled almost 5 percent of GDP. The origin of these deficits is a complex combination of a number of factors. Lax management is clearly an important one. Nonetheless, a key factor in the financial losses of public enterprises is central government pricing policy. An example is ENCI and ECASA whose very large operating deficits, equal to one percent of GDP in 1982, result from a deliberate policy decision to have thses entities sell their products below their cost of acquisition and distribution. Repeated GOP commitments to eliminate these subsidies have been frustrated by the protests of the urban consumers who benefit from them.

In a somewhat similar category is Electroperu. Its very large overall financial deficit, two percent of GDP, results primarily from an ambitious expansion program. However, on its current account, Electroperu shows a operating deficit despite a legal requirement that it price electricity so as to earn a target rate of return of eight percent.

In general then, although management improvements, or even outright divestiture, are badly needed to improve the overall public sector fiscal position, a firm GOP commitment to adequate pricing policies could bring some significant improvements.

5. Fiscal Effects of the Natural Disasters

In addition to their other effects, the natural disasters have had the effect of worsening the GOP's fiscal position. Overall, these effects are estimated to have increased the consolidated public sector deficit by an amount equal to 3.6 percent of GDP. Of this, losses in tax revenue account for 2.4 percent of GDP, of which the largest single factor was the decline in the sales, and thus the tax payments, of Petroperu. On the spending side, government expenditures increased by 0.5 percent of GDP in 1983 as a result of the disasters. Of this, 77 percent was a result of expenditures to repair infrastructure. Among the state enterprises, Petroperu lost 0.8 percent of GDP, while other state enterprises lost 0.1 percent of GDP.

D. Balance of Payments

The Peruvian balance of payments has suffered serious reverses in the past two years which Peru has been able to meet only by a drastic reduction in imports and a rescheduling of public sector debt.

1. The Trade Account

a. Exports

Table 8 summarizes recent developments in the merchandise export accounts. Beginning in 1979, Peru's exports increased dramatically primarily on the strength of major price increases in copper (51.9%), silver (88.0%), lead (250.6%), and above all, petroleum (110.8%). In addition, exports of non-traditional products were especially buoyant and the completion of the transandean pipeline enabled the country to achieve a 70.3 percent increase in the volume of petroleum exports.

The year 1980 saw a continuation of this generally favorable situation. Overall, exports increased 11.7 percent on the strength of a continued strong performance of non-traditional exports (23.3%), higher petroleum prices, and a continued generally strong performance of the minerals sector.

Beginning in 1981, this favorable situation was reversed dramatically. Sharply lower prices for most minerals, somewhat lower export volumes for petroleum, and generally soft world markets for non-traditional exports, particularly in Latin America, reduced exports by 16.5 percent.

The years 1982 and 1983 have seen no improvement in export performance. In 1982, a slight improvement in non-traditional exports and a sharp increase in fishmeal production was counterbalanced by still lower silver and copper prices. In 1983, whatever trends there might otherwise have been toward recovery were overwhelmed by the effects of "El Nijo". Fishmeal production has fallen by 48 percent. The value of petroleum exports has fallen by 26.3% due to production disruptions resulting from the floods, further declines in world market prices, and declining quality of the oil being produced. Non-traditional exports in 1983 have declined 17.1 percent in part due to restrictive measures taken by Peru's trading partners in response to the world financial crisis.

The outlook for Peru's exports for 1984 and beyond is for some improvement in export prices as the world economic recovery proceeds. However, the likelihood of major improvement in Peru's terms of trade is small. Capacity expansions in other producing nations are likely to limit price increases in copper and petroleum. Only the non-traditional exports category seems to hold great promise for the future and that only to the extent the markets are not blocked by protectionist measures in destination countries.

b. Imports

Trends in recent imports are summarized in Table 9. This table is divided into two parts. The upper part of the table gives the fob value of imports by major end-use category. The lower half of the table gives the same data expressed in terms of the percentage contribution of each end-use category to total imports.

The trend of each category of imports follows a fairly predictable pattern during the last years of the military government and the first years of the present government. Overall, merchandise imports increased 56.9 percent in 1980 owing to the availability of foreign exchange, the liberalization of the import regime, and, to a certain extent, to the progressive overvaluation of the sol. The rate of increase declined sharply in 1983 as the sol has depreciated in real terms and the pace of economic activity has declined sharply. The most striking increases in the earlier years were in consumer goods which increased 164.5 percent in one year, while consumer durables tripled in 1980 alone.

Nonetheless, it is possible to overemphasize the importance of the consumer goods import boom in the overall growth of imports during this period. Of the total increase in imports of $1.9 billion in 1980 and 1981, only one quarter consisted of direct imports of consumer goods. In 1979, the last full year of the military government, direct imports of consumer goods, durable and non-durable, accounted for 7.9 percent of total imports. By the end of 1981, even taking into account that there was considerable pent-up demand, particularly for durables, consumer goods accounted for only 15.9 percent of the total.

Far more significant was the enormous increase in imports of capital goods of all kinds during this period. Even taking into account that there was a considerable amount of restocking after the constricted import availability of the 1970s, the increase in capital goods imports during this period was formidable. From a level of $625 million in 1979, such imports reached $1.5 billion in 1981.

The category of imports which lost ground in relative terms during this period was that of inputs into domestic production. From 46.4 percent of total imports in 1979, these accounted for only 36.2 percent in 1981, and declined still further, to 34.1 percent, in 1982. This is not surprising since the liberalization of the trade regime under the democratically elected government tended to reduce the relative importance of the protected domestic manufacturing sector, which is the sector most dependent on imported inputs.

2. The Service Account

Table 10 gives a detailed breakdown of the balance of payments since 1978 with projections for 1984. By far the largest single item in the service account is public sector interest payments. These have been a function of the size and composition of external public debt and of the level of international interest rates since much of the commercial debt carries variable interest rates which are based on the London Inter-Bank Offer Rate (LIBOR). Public sector interest payments rose steadily from $434 million in 1978 to $716 million in 1981 for both reasons. Payments declined slightly in 1982 due to slightly lower interest rates but have increased substantially in 1983 because commercial reschedulings have been accompanied by significantly higher interest rates. Rescheduled interest payments are recorded on Table 10 as if they had been paid with an offsetting entry in the capital account.

Overall, the trend in the services and transfers account has been one of gradually increasing deficits as deficits in factor services, transport and insurance, and other services have far outweighed small surpluses in the travel account.

3. Capital Account

The balance on capital account is a product of a wide variety of factors including investor confidence and the general state of economic activity. Since these have varied widely in Peru in recent years, it is hardly surprising that there has been equally wide variation in the balance on capital account.

a. Direct Investment and Other Long-Term Private Investment

The most striking characteristic of private sector capital inflows has been their relatively small size even in periods of "good business climate." Beginning in 1978 when the net inflow of private long-term capital was only $39 million (of which direct investment was only $25 million), net inflows totaled only $92 million in 1980, rose briefly to almost $400 million in 1981 with substantial investments in petroleum exploration, and quickly fell back to almost zero in 1983. With the single exception of 1981, the flows representing foreign direct investment are insignificant.

One reason for this lack of external investment is the Andean Pact's "Decision 24" which sharply restricts foreign investors' ability to establish majority-owned foreign affiliates and establishes limits on profit remittances. Perhaps more important has been the history of nationalizations under the military government and a fear that these could be repeated under a future elected leftist government. In an economic environment which has been precarious at best, potential investors have simply chosen to go elsewhere.

b. Public Sector Capital Imports

The recent history of public sector capital imports is well-known and will be summarized only briefly here. Under the military government, extraordinarily high levels of public sector indebtedness were incurred, little of it for productive purposes. In 1978, the government entered into reschedulings of its official and commercial debts. The subsequent commodity price boom of 1979 enabled it to retire a portion of the rescheduled debt. Beginning in 1981, the government, its financial prospects somewhat improved, secured significant external financing for an ambitious program of public sector infrastructure investment. However the persistence of the world recession and the balance of payments impact of the natural disasters of 1983 have again forced the Peruvian authorities to seek reschedulings of the official debt. While providing short-term relief, these reschedulings significantly increase the longer-term burden of the outstanding debt, making it highly unlikely that public sector capital imports can be a significant source of development financing in the foreseeable future.

4. Long-Term Balance of Payments Outlook

The recovery of the world economy in 1984 should bring some improvement in the Peruvian balance of payments picture. However, for a number of reasons, the degree of balance of payments improvement is likely to be limited. In the trade account, the prices of a number of critical primary materials, which provide the bulk of merchandise export receipts, are likely to show only limited improvement. Copper and petroleum in particular are likely to show only limited price recovery because of capacity expansions in other third-world producing countries. The prospects for non-traditional manufacturers, which would appear to hold some promise, are limited by the weak balance of payments positions of most other Latin American countries, the principal markets for such exports. On the service side, there is no escaping the interest payments due on the large, and still growing, external debt. In 1984, interest on the public sector debt alone will reach $1.068 billion. When the $511 million due on private sector debt is added, interest payments alone will absorb 40 percent of total receipts from exports of goods and non-factor services. In addition, there is little hope for significantly lower real interest rates in international financial markets as expanding world economic activity increases the overall international demand for credit.

E. Balance of Payments Effects of the Natural Disasters

In addition to negative effects on income and consumption, the natural disasters of 1983 had a negative impact on the balance of payments. It should be noted that Peru's balance of payments registered a surplus of $136 million in 1982 and a deficit of $31 million in 1983--that is a comparative deterioration of $167 million. Thus, axiomatically the over-all impact of world recession, restrictive demand management by the Government of Peru, and natural disaster amounted to a net loss of $167 in foreign exchange assets. Inasmuch as domestic recession would serve to reduce imports, and Peru's 1983 commodity imports were $1.1 billion (30 percent) lower than 1982 commodity imports, one can suspect that the impact of the disaster was substantially higher than the combined, final impact (a $167 million decline). However, the disaster also reduced imports through the secondary income loss resulting from the reduction of exports caused by disaster.

In clarifying this problem, we define two analytical approaches for assessing the impact of the disaster on external accounts. A general equilibrium analysis examines the state of a country's external accounts "with" and "without" disaster. This approach recognizes fully secondary impacts of disaster, notably that the loss of export earnings caused directly by the disaster will reduce incomes and hence the magnitude of imports related to the reduction of income. Thus, the second round effects of the reduction of income will mitigate the effects of the direct loss of foreign exchange earnings. However an accurate assessment using this analysis requires more refined data than are available at present. Moreover, it also requires careful definition of the moral appropriateness of the "with disaster" governmental policies. Specifically, the more the government attempts to aid the victims of disaster the larger the negative impact on the balance of payments, and this question boils down to how much is needful and necessary. Even though analytically less satisfying, partial equilibrium analysis can also be used to explore the impact of disaster on external accounts. In this approach improvement of external accounts caused by the secondary effects of the disaster are ignored. In defending this analytical choice, we also note that even though the magnitude of erosion attributable to disaster using partial equilibrium analysis may exceed the magnitude derived with general equilibrium analysis, the strength of improt decline in the Peru case far exceeds what can be attributed to the secondary income declines of disaster alone. And it is also for this reason that partial equilibrium approach is perferred.

Turning to quantification of the impact of natural disaster on Peru's balance of payments, a recent IMF study (EBS/84/59) estimated Peru's 1983 calendar year export earnings shortfall from trend at SDR 142 million (about $156 million) and notes this as resulting from the combined impact of adverse weather, labor strikes, and external prices. However, the IMF study does not attempt to disaggregate these causal forces. In a genral equilibrium analysis, for example, it might be supposed reasonably that half of the decline in export earnings (or $80 million) was related to the disaster. However, on a commodity specific basis (partial equilibrium analysis) the disaster-caused decline of export earnings appears more impressive. As examples, the decline in exports of petroleum and derivatives was about 1.5 million barrels, with a market value of $45 million. The volume of 1983 fishmeal exports were also substantially below that of previsou years, 178 thousand metric tons versus an average of 497 thousand metric tons for the previous 5-year period. At an average price of $379.8 per MT for 1983 (which was also lower than the previous 5-year average of $406.6 per MT), the loss from 1983 fishmeal exports amounted to $121.2 million.

As noted above, Peru's 1983 commodity imports amounted to only $2,647 million as compared with $3,787 million in 1982. This decline was due in the first instance to demand management policies of the government which were related to its EFF arrangement with the IMF. The mechanism of these policies on imports works through the decline in demand for domestically produced goods which, in turn, reduced the demand for the imported component of those goods. However, it should be noted that the decline in imports greately exceeded what could be attributed to the decline in domestic production, i.e. a 10-11 percent decline in domestic output would, other things being equal, produce a decline of imports not in excess of 20 percent. (The impact of newly negative expectations on imports, particularly capital goods may account for the excessive decline of imports; however, the data are too new and aggregative to permit more analysis on this question at present.) In stark contrast to the global decline of imports, and most obviously and directly related to disaster, in 1983 Peru increased purchases of rice, sugar, soya oil, milk power, and potatoes. The total value of these increased food imports amounted to $145 million. Apart from these food imports, capital goods imports for reconstruction amounted to $55 million. Of course, some of these imports were financed by long-term loans or grants and these will be considered below.

The obvious direct impacts of disaster can be summarized as follows (in millions of U.S. dollars):

Loss of foreign exchange from reduced exports	
fishmeal	$121
petroleum	$ 45
Loss of foreign exchange from increased imports	
food imports	$145
rehabilitation imports	$ 55
Less: external credits linked to rehabilitation efforts	$ 95
Less: external grants linked to rehabilitation efforts	$ 43
Total impact of Disaster on B/P	$228

F. The Growth of Domestic Credit and the Level of Economic Activity

The disaster's disruption of normal production had a negative effect on the cash flows of firms in all areas of the country. This increased the demand for credit at a time when the public sector's own borrowing requirements were also being increased by the disaster-caused worsening (equal to 3.8 percent of GDP) of its fiscal position. At the same time, the disaster-related loss in foreign exchange reserves forced the Central Bank to take restrictive measures to prevent further outflows.

The relationships among the growth of domestic credit, the size of the domestically financed public sector deficit, the balance of payments deficit, and the level of economic activity are among the oldest and most thoroughly studied in economics. Nonetheless, a brief recapitulation of the main relationships and conclusions may be useful to provide a context for the PAAD.

To begin with, changes in the balance of payments directly affect the level of banking system reserves in the absence of offsetting actions by the central bank. An increase in exports or a capital inflow, through the process by which their proceeds are converted into domestic currency, produce an increase in "high powered money" which fractional reserve banking converts into a multiple increase in the level of bank deposits (the precise ratio of increased bank deposits to the original increase in "high powered money" depends on a number of factors, the most important of which is the level of required reserves).

On the other hand, increases in the volume of real credit increase the level of demand for current output and assets in general. Included in this increase in some proportion will be increases in the demand for importables, domestically produced exportables, and foreign assets. Thus, changes in the levels of domestic credit lead directly to changes in the balance of payments. 1/ Changes in the overall level of domestic credit which the monetary authorities can accommodate are directly connected to the monetary authority's target levels of foreign exchange reserves and the availability of additional external credit. This is true regardless of the ostensible purposes for which credit is provided.

Finally, the availability of credit to the private sector is determined by the total availability of credit from domestic and foreign sources, less the public sector borrowing requirement. This last point may appear trivial when expressed in this fashion but it is not uncommon to focus on the use of domestic credit by the public sector and ignore the fundamental fungibility of domestic and external credit. Thus, during the course of 1983, the consolidated public sector deficit reached an amount equal to 10.3 percent of GDP. Of this, the amount financed domestically was equal to only 1.8 percent of GDP. The remainder, equal to 8.5 percent of GDP, was financed externally (for the most part, this was the effect of the commercial and bilateral reschedulings which were used, essentially, to finance the enormous 1983 public sector deficit). However, in a situation in which a contraction of domestic credit was essential to counteract the balance of payments deficit resulting from the natural disasters, the additional (involuntary) external saving which the refinancings represented could have been used to lessen the necessary reduction in credit to the private sector, if it had not been for the GOP's heavy fiscal losses resulting from the disasters.

1/ It should be emphasized that these changes in the balance of payments resulting from changes in the rate of domestic credit creation do not necessarily, or even usually, come about as a result of changes in the domestic price level raising domestic production costs and making domestic goods "less competitive." Rather, it operates directly on the domestic excess demand for tradable goods whose prices, in a small open economy, are externally determined.

A number of these relationships are illustrated on Table 12. It is clear from the table that, over the period 1980-82, the rate of growth of real private sector credit was quite rapid. Beginning in 1980 with a 23 percent real expansion, credit to the private sector expanded at a 15 percent rate in 1981 and 12 percent in 1982. This rapid rate of expansion was made possible by a number of unusual factors. At the beginning of the period, Peru was experiencing a substantial balance of payments surplus as a consequence of the 1979-80 commodity price boom. The expansionary effects of this were prolonged through 1981 and into 1982 as a result of a deliberate decision of the authorities to more than compensate for the contractionary effects of the deteriorating balance of payments in order to maintain the level of economic activity. The authorities were able to do this because of the relatively high absolute level of foreign exchange reserves accumulated during the 1979-80 period. Beginning in late 1982, this situation changed abruptly. Foreign exchange reserves had reached minimum acceptable levels and the central bank initiated a sharp contraction in the level of commercial bank reserves. Two additional factors complicated monetary management during this period. One was the natural disasters themselves, which produced a sudden increase in the demand for credit both for reconstruction and to compensate for reduced cash flows. The other was the failure in March of Banco Comercial (and subsequently two other financial institutions). Prior to March 1983, there had been a steady increase in the deposit-to-reserve ratio as a result of the government's institution of a zero marginal reserve requirement in order to reduce the spread between loan and deposit interest rates. Beginning in March, the deposit-reserve ratio began to fall sharply.

This presence of excess reserve in the banking system has led some to question whether the decline in private sector credit outstanding is a consequence rather than a cause of the present depressed state of the economy. A number of factors have convinced the Mission that the decline in credit is a consequence of a declining supply rather than a declining demand for credit. First, the presence of excess reserves is concentrated in certain banks. For the month of July 1983, for example, Banco de Credito, Banco Popular, and Banco de Lima were essentially fully loaned up in soles, while Interbank, Citibank, Banco Wiese, and Banco Continental had substantial excess soles reserves. This is far more consistent with a--perhaps well-founded--concern on the part of certain banks for the quality of their portfolios than a general lack of credit demand by borrowers. Second, conversations with commercial bankers, businessmen, and central bank officials have all confirmed that, in their view, there is a substantial excess demand for credit at the present time, primarily as an consequence of the natural disasters.

G. Balance of Payments Gap for 1984 and its Consequences

The deficit in the 1984 balance of payments shown in Table 10 is a normative one based on an estimate of the level of imports which would be necessary to make up about half of the decline in real GDP experience in 1983. Even though the forecast 1984 level of commodity imports is only marginal higher than the 1983 level, the 1984 level will be higher because some $200 million of non-productive (military) have been eliminated from the forecast as related to the GOP-IMF negotiations. In addition some decrease in required food imports is now expected in 1984 due to an expected improvement in agricultural output.

The contrast to past requirements, the 1984 IMF Stand-by agreement will not be available to close the $145 million forecast gap. The IMF agreement requires the Central Bank to maintain through year-end 1984, the level of its net international reserve position as of year-end 1983. Thus, the Central Bank must add the full amount of IMF drawings to its holdings of gross foreign assets. Therefore, in 1984, IMF resources are no available to lower the $145 million gap.

Unless external funds can be found to fill this gap, Peru will be forced to reduce imports. We suspect that the level of productive imports is barely adequate to handle a projected mild (about 5 percent) increase of aggregate demand. One other possible source of coverage for import expansion would be to draw down the gross foreign exchange holdings of the Central Bank (which are equivalent to about six months import coverage). Apart from the question of compliance with its IMF agreement, these foreign exchange holdings consist largely of dollar deposits and certifications that are not available to pay for imports and which must be redeemed upon demand in a foreign exchange crunch--if the Belaunde government is to avoid a most terrible dishonor.

III. PROGRAM RATIONALE

A. Rationale

The natural disasters of 1983 came at a critical time in the history of Peru. The democratic government which came to power in July 1980 reversed the developmental strategy of the previous government which relied on extensive state participation in the economy and a full panoply of controls and regulations. The Belaunde government introduced a strategy which emphasized the elimination of excessive state intervention and the restoration of an economy directed by market forces.

The natural disasters were unusual in that they also contained important macroeconomic implications. In most disasters, the effects are sufficiently localized that relief efforts only have to concentrate on relief to those in acute distress and repairs to housing and essential infrastructure. Such disasters do not usually have a macroeconomic impact, nor adversely impact large numbers of people outside the areas immediately affected.

In the case of Peru in the disasters of 1983, the situation contains an important additional element. The loss in current output was enormous, $1.1 billion. In addition, the decline in current output has had a particularly heavy impact on the balance of payments. This balance of payments impact came at a time when the Peruvian economy was already in the middle of a crisis due to the depressed state of world demand for its exports, its large external debt obligations, and the serious distortions in its economic structure inherited from previous governments. With foreign exchange reserves at minimum acceptable levels and in a situation in which output would have declined 5.1 percent without natural disasters, the burden of economic management has been made much more difficult. Although the GOP has increased the sol/dollar exchange rate by 130 percent during the course of 1983, the bulk of the burden of balance of payments management has fallen on aggregate demand management and, given the GOPs difficulty in controlling the size of the fiscal deficit, a disproportionate share of demand management has fallen on monetary policy and the private sector.

The GOP has attempted to deal with the severe decline in the supply of real domestic credit, which has resulted from the need to limit the loss of foreign exchange reserves, by making BCR credit lines available through the Banco Industrial (BIP). However, the GOP's ability to do this has been limited by their need to limit the overall availability of credit. In the absence of additional foreign exchange resources to permit a net increase in the level of credit, expansion of special discount lines through public sector financial institutions is essentially a zero-sum game. Only by providing additional foreign exchange can the tight balance of payments situation which resulted from last year's natural disasters be prevented from further contracting economic activity.

Thus, at a critical time in the nation's history, when the fundamental future orientation of the nation's economic structure is being debated, Peru is faced with another year of relative stagnation in per capita income as a result of the balance of payments and fiscal effects of last year's natural disasters. If Peru's free market orientation is to continue, it is imperative that ways be found to restore confidence in the basic strategy of the present government. To do this, it is essential that foreign exchange resources be provided so as to permit a more expansionary policy which will make possible a perceptible improvement in living standards in 1984.

B. Relationship to Mission CDSS

The assistance proposed in this PAAD is a fundamental part of the strategy proposed in the Mission's recent CDSS presentation. The dimensions of the current economic crisis are such that they threaten to undo the significant progress that has been made over the last three years in establishing a workable policy and institutional framework for free-market-oriented, long-term development. Indeed, there is a significant danger that the present economic crisis will discredit the free market model and lead the next government to return to the statist development model of the last decade. In the face of this danger, the mission proposed in its CDSS that the FY 84-85 program focus on Peru's most immediate needs, placing emphasis on the implementation of ongoing development and reconstruction programs, and on the provision of immediate support through this loan, an ESF-funded program loan in early 1985 and in FY-86, and continued significant PL-480 Title I and II assistance. During the same FY 84-85 period, the

Mission proposes to continue policy dialogue with the GOP and other groups and continue efforts to build a sound analytical and institutional base for further development policy discussion and program formulation.

Both the CDSS strategy and the assistance proposed in this document will also address the concern recently expressed by Deputy Secretary Dam that adjustments be made in the Peru program which would help the country move from its current deficit position in the short term. High level U.S. Treasury officials who have recently visited Peru have also indicated their support for program assistance to Peru.

C. Peru's Relations with the IMF

In June 1982, Peru entered into a three year Extended Fund Facility arrangement with the IMF. At the same time, Peru arranged a drawing under the Compensatory Financing Facility. Drawings under the two programs would have totaled $960 million over the three year period of the program.

Throughout 1983, Peru had serious difficulty meeting the fiscal targets of the program, which envisioned a reduction of the consolidated fiscal deficit from 8.7 percent of GDP in 1982, to 3.8 percent in 1983. Figures for the first two quarters indicated that Peru was slightly out of compliance. By September, however, it was clear to the Fund staff that the original program, especially on its fiscal targets, had been irretrievably breached. This fiscal collapse was partly a result of the effects of the natural disasters as discussed above, which accounted for 3.8 percent of GDP of the deterioration, out of an estimated 1983 deficit of 10.3 percent of GDP. In addition, measures announced by the GOP in early August preannouncing the exchange rate three months in advance and limiting price increases for petroleum products threatened, in the Fund's view, both still further erosion on the fiscal side and a serious loss of international price competitiveness.

Since September, discussions for a resumption of Fund support have continued. In December, the outlines of a new program were agreed. The new program would include an 18 month Standby Agreement. The total amount of drawings would be $250 million (somewhat less than would have been available from the EFF). The new program will place heavy emphasis on fiscal control and will involve the elimination of food subsidies, a range of new taxes and measures to enhance collections of existing taxes, increases in gasoline and electricity prices, some reduction in military spending, and a further reduction in the already substantially reduced level of investment spending. The new program will also apparently involve the elimination of preannounced exchange rate changes and a commitment to maintain the existing real exchange rate but no large exchange rate adjustments at the outset. The IMF will also soon name a Resident Representative in Peru to improve coordination with the GOP in the implementation of the program.

The Mission has reservations about the feasibility of the new IMF targets, from what we know of them. The program appears to rely very heavily on cuts in current spending and new revenue sources which may not be politically or even technically feasible. For example, the revenue projected from new taxes and improved tax administration appear optimistic. Moreover, the program appears to place more emphasis on monetary stringency and less on exchange rate adjustment than would seem warranted by the present depressed state of the Peruvian economy. Nevertheless, the basic thrust of the program, to reduce the present extremely high level of public sector borrowing in order to permit expansion of the private sector, to maintain price competitiveness in international trade, and to maintain an orderly expansion in domestic credit, are essential to recovery and renewed growth. Therefore, the Mission plans to coordinate very closely with the GOP and the new IMF Resident Representative to monitor progress in implementation of the program.

D. Level of Assistance

To assist the GOP in coping with the balance of payments consequences of the natural disasters, the Mission proposes to provide program resources to the GOP in return for a mutual understanding of needed improvements in the implementation of disaster assistance. The amount proposed in this document, $60 million, is significantly less than the Mission believes warranted by the degree of the disaster and the size of the unfinanced gap. The mission would prefer to provide an amount closer to one-fourth of the estimated foreign exchange loss resulting in 1983 from the disasters. That amount would be sufficiently large that, when combined with amounts which will be received from the Fund and amounts which could become available from the IBRD, the commercial banks, and other donors, would bring output and employment significantly closer to their 1982 levels. However, $60 million, when combined with resources available from other sources, will permit a relaxation of monetary stringency and an expansion of domestic output and employment as well.

IV. PROGRAM IMPLEMENTATION

A. Disbursement Mechanism

It is the Mission's plan to disburse the $60 million of foreign exchange in two tranches. The first disbursement would be in an amount of $30 million and would serve to provide substantial immediate relief from disaster-caused losses in foreign exchange. The second disbursement would also be $30 million and would be made six months after the first if the understandings reached in negotiating the program were adhered to.

A necessary precondition to the implementation of the program is an understanding with the Central Bank about the level of real credit expansion to the private sector. As explained in the previous section, the chief short-term determinant of the availability of credit to the private sector, given the size of the balance of payments deficit and the availability of other external resources, is the public sector's use of credit. Such an understanding will be an integral part of an agreement with the IMF. Therefore, evidence of the IMF Board approval of the Standby Agreement will be sufficient to meet this condition.

The Mission will seek an understanding with the GOP on the monetary program for 1984 and the measures the GOP plans to take to overcome the disaster-related decline in private sector credit. The agreement would include: 1) an understanding on the total value of real credit to the private sector, 2) the distribution of that credit between special discount lines and increases in commercial bank reserves, and 3) agreement with the GOP regarding its policy on interest rates and any other measures which would improve savings mobilization and efficiency of savings use.

In addition to the conditions on global public sector resource use, the Mission regards additional understandings on specific questions related to the implementation of disaster programs as essential to the achievement of the objectives of the program. The Mission is well aware that increases in disaster spending, in the context of fixed overall budget totals, imply reductions in other budget categories which may be politically difficult. However, the GOP's approach to budgetary control has been to impose spending, hiring, and contracting controls across the board. The effect of this has been to severely hinder the implementation of critical rehabilitation and development projects. The Mission intends to negotiate an understanding regarding more flexibility with regard to hiring and contracting procedurtes. Such an agreement will be a condition precedent to first disbursement. Adherence to the agreement will be a condition precedent to disbursement of the second tranche.

The Mission has not yet approached the GOP about the proposed administrative reforms. However, the Mission will negotiate the following agenda with the GOP:

(1) Increased flexibility for INADE to reprogram funds in accordance with project needs and implementation performance.

(2) Greater flexibility to increase staff either directly or through contracting for both INADE and the Departmental Development Corporations (CORDES). The ability to increase staff during the fiscal year whenever increased disaster project needs are identified and funding sources are available. The ability to compensate project personnel adequately so as to obtain qualified individuals, either by being able to pay salaries above GOP civil service levels or by being able to contract at market prices. The ability to contract directly with foreign experts. A mechanism established so that INADE and the CORDES can directly enter into agreements with ministries and other GOP entities to carry out disaster activities.

(3) Greater procurement and contracting flexibility for both INADE's Disaster Relief and Reconstruction Division and for CORDES in disaster-declared areas.

(4) An improved and effective management information system established in INADE and the CORDES, so that data are readily available on use of DRR funds, progress of DRR activities, and the state of harvests and other socio-economic indicators.

(5) An improved and effective financial management capability to assist CORDEs in establishing sound financial management systems.

The Mission has chosen not to implement a commodity import program because it is our judgment that a commodity import program (CIP) could not function in the present Peruvian institutional environment. Peru has essentially no administrative restrictions on trade or foreign exchange transactions. The establishment and maintenance of such a regime, which allows scarce foreign exchange to be allocated by the market to its highest value uses, through one of the most difficult periods of Peru's history represents perhaps the most significant policy accomplishment of the present government. It has been the AID's experience that a CIP cannot disburse in such an environment due to the various additional costs which importers must incur in drawing against it.

B. Attribution of Dollar Resources

Between 35 and 40 percent of Peruvian imports originate in the United States. In any given year, such imports amount to approximately $1 billion. Since Peru has no system of exchange controls or import licensing, it is impossible for the GOP to absolutely assure us that imports from the U.S. will exceed disbursements under the loan. Nevertheless, it is clear that in any given period, Peruvian imports from the U.S. will far exceed the assistance provided. Peruvian trade statistics make it possible for the GOP to demonstrate to the Mission exactly how much was imported from the U.S. during a calendar quarter by major tariff category. Therefore, as part of the agreement the GOP will agree that it will report to the Mission within 60 days of the end of each calendar quarter in which there are disbursements under the loan, the amount of imports from the U.S. during that quarter.

C. Use of Counterpart

The essence of this program is to provide foreign exchange to ameliorate the balance of payments effects of the natural disasters. The local currency generated under the program will be used to provide funds on a priority basis to promote productive employment activities in areas directly and indirectly affected by the disaster. To achieve these objectives, the GOP will establish a special account in the Banco Industrial (BIP) or other appropriate financial institution with the local currency equivalent of the first $30 million of loan proceeds. The account will be used to address the immediate need to create and maintain productive employment in areas most directly affected by the disaster and elsewhere in the country. One use of the account will be to provide direct support for worthwhile, employment creating activities in disaster-affected areas. The fund will be used to provide increased credit to private sector firms. In most cases this will involve preserving currently existing employment in firms which, although commercially viable in the longer run, are currently in financial distress because of the disaster-caused recession. Given the apparent reluctance of many commercial banks to increase lending in the current environment, it is likely that the major part of such funds will be disbursed through the Banco Industrial (BIP). The BIP has already disbursed significant amounts of Central Bank rediscount funds through such a program in 1983. The Mission has examined the implementation capability of the BIP and is confident of its capacity to implement the program. Nonetheless, the Mission intends to provide technical assistance funded under PD&S to the BIP (and if appropriate to other financial institutions) to assure that funds from the special account are directed to economically efficient firms whose financial distress is only a direct or indirect result of the disaster-related recession. Prior to the disbursement of the second $30 million, the Mission will evaluate the BIP local currency loan program and will explore the feasibility of establishing a mechanism to rediscount local currency funds through commercial intermediaries. If it is determined that a rediscount mechanism is feasible, the second tranche of local currency will be provided through commercial banks.

The implementing agency for these loans (BIP, or COFIDE in the case of discounts to commercial banks) would examine the financial condition of potential borrowers. Given the badly decapitalized nature of many business firms in Peru, it is likely that in many cases an additional equity contribution either from present stockholders or from outsiders would be a precondition of the implementing agency for the use of special fund resources. This, however, would be decided by the implementing agency on a case-by-case basis.

The implementing agencies would have broad discretion in selection the loan terms and grace periods for special fund subloans. The Mission will include in its agreement with the GOP assurances that interest rates are at commercial levels and that there is a reasonable probability that interest rates will be positive in real terms.

Another adverse effect of the disasters has been a serious decline in public sector revenues. This has forced a severe curtailment in the implementation of public sector investments including the implementation of high priority donor assisted projects.. We would plan to leave open the option of utilizing some portion (about 25%) of counterpart generations to accelerate the implementation of high-impact, employment-generating disaster and development projects, including projects funded by other donors.

Issues:

The guidance cable (State 13848) raised a number of points which the Mission has attempted to address in this document. These include:

1) IMF Agreement.

The Mission regards the financing package of an IMF Standby, commercial bank rescheduling, and Paris Club rescheduling as an essential precondition to the restoration of self-sustaining growth. In addition, the Mission regards the basic elements of an IMF program, fiscal discipline, an orderly expansion of domestic credit, and the maintainance of exchange rate competitiveness, as essential to long term recovery. However, because of the Mission's doubts of the feasibility of certain elements of the anticipated IMF program as we understand them, we will be far more concerned over the next year with the qualitative performance of the GOP than with the success or failure to meet specific quantitative performance targets. In addition to the policy thrust of the program, there is still a need for detailed coordination with the Fund on the interrelationship of this program with the Fund's fiscal and monetary targets. As there is not yet a Fund resident representative in Peru, these consultations will take place in Washington.

2) Use of Local Currency

The four issues raised in State 13848 regarding local currency uses reflect important concerns which the Mission has attempted to address throughout this document. Specifically, these are:

(a) Is the present depressed state of the Peruvian economy due to the world recession and the disasters rather than to lack of credit?

The response to this question has been presented in considerable detail elsewhere in this paper. Briefly, the constraint to increasing private sector production and employment in the short term is the depressed level of aggregate demand. Aggregate demand is a variable determined both by autonomous and policy variables. In the first instance, the depressed level of aggregate demand was a result of the world recession. This is estimated to have caused about one-half of the decline in output experienced in 1983. However, the GOP could have offset these aggregate demand effects, as it did in 1981 and early 1982, except for its weak foreign exchange reserve position. In fact, because of the serious reserve loss resulting from the disasters, it was found necessary to contract aggregate demand still further. Without the capability to expand private sector credit, a healthy reactivation of the Peruvian economy will not be possible.

(b) Feasibility of establishing a Debt-Restructuring Fund

The Mission is not at this time proposing a debt restructuring fund as a use of local currency proceeds. The Mission is proposing a use of credit which would be coordinated in many cases with commercial bank reschedulings. The difference between a debt restructuring fund and what has been proposed here is that debt restructuring would substitute for existing commercial bank exposure rather than provide additional resources. The Mission believes that, to the extent feasible, commercial banks should be encouraged to reschedule their existing exposure as part of an overall refinancing package. The Mission's conversations with commercial banks suggest that this is feasible.

(c) Size of resources provided under the program relative to the size of the problem.

The Mission regards the level of resources provided in the PAAD as the minimum necessary to produce a significant stimulation of the Peruvian economy during 1984. The additional resources will make possible increased imports of $60 million which will permit an expansion of real GDP of 0.8 percent. In the absence of additional resources, per capita GDP will increase by only 0.4 to 1.4 percent from their extremely depressed levels of 1983. The additional assistance will be sufficient to engender increased confidence in long-run economic recovery.

(d) Use of Targeted Private Sector Credit

Recent studies carried out for the Mission including the Coopers & Lybrand Private Sector Assessment and the Development Alternatives Inc. FRAI Evaluation have concluded that before AID can implement a long-range private sector strategy in Peru, it must first address the acute shortage of working capital credit faced by private sector firms. The Mission's investigation of this problem revealed that there were two constraints. The first was the overall decline in the level of real credit outstanding as a result of the need to address the balance of payments crisis. The second problem was the reluctance on the part of banks to increase their exposure with firms which could not offer substantial additional collateral. This reluctance became particularly acute after the failure of Banco Commercial in March 1983. In addition, many commercial banks in Peru are members of industrial groups and there is some evidence that, in a period of declining credit availability, banks are giving first priority to firms controlled by their group. Finally, the opening up of the Peruvian economy encouraged some firms to undertake new investments in non-traditional exports many of which were heavily debt financed. With depressed export markets, a shrinking equity base, and a reluctance on the part of banks to extend additional funds, these firms face bankruptcy. Ironically, other firms which undertook investments in the protected environment of the mid-1970s have long since had their debts wiped out by unanticipated inflation.

For the above reasons, the Mission believes it essential that an attempt be made to target additional credit to economically efficient firms. Although fungibility is inherently an issue in any credit program, the Mission intends to provide technical assistance to the implementing agency and negotiate criteria and procedures to assure that only economically efficient firms, whose distress is a result of the disaster-worsened recession, will be recipients of credit under the program.

Table 1
Sectoral Origin of Gross Domestic Product
(millions of 1970 soles)

	1978	1979	1980	1981	1982	1983p
Agriculture and Livestock	39,896	41,125	38,918	43,900	45,525	41,880
Fishing	3,567	4,235	4,017	3,523	3,452	2,196
Mining & Petroleum	29,456	32,948	32,025	30,616	32,483	30,372
Manufacturing	75,682	78,634	82,802	82,719	80,496	70,040
Construction	14,003	14,521	17,257	19,156	19,597	14,698
Government	25,159	25,833	25,420	26,015	26,535	26,535
Other	125,920	129,342	135,174	140,041	140,317	125,584
TOTAL	313,983	325,838	335,613	345,970	348,395	311,305

(Percentage of Total)

	1978	1979	1980	1981	1982	1983p
Agriculture and Livestock	12.71	12.62	11.60	12.69	13.07	13.45
Fishing	1.23	1.30	1.20	1.02	0.99	0.71
Mining & Petroleum	9.38	10.11	9.54	8.85	9.32	9.76
Manufacturing	24.10	24.13	24.67	23.91	23.10	22.50
Construction	4.46	4.46	5.14	5.54	5.62	4.72
Government	8.01	7.68	7.57	7.52	7.62	8.52
Other	40.10	39.70	40.28	40.48	40.28	40.34
						0
TOTAL	100.00	100.00	100.00	100.00	100.00	100.00

(Percentage Change on Previous Year)

	1978	1979	1980	1981	1982	1983p
Agriculture and Livestock		3.05	-5.37	12.50	3.70	-6.01
Fishing		9.52	-5.15	-12.30	-2.02	-36.36
Mining & Petroleum		11.85	-2.80	-4.40	6.10	-6.50
Manufacturing		3.90	5.30	-0.10	-2.70	-12.98
Construction		3.70	18.84	11.00	2.30	-25.00
Government		-0.50	1.55	2.34	2.00	0
Other		2.72	4.51	3.68	0.20	-10.50
TOTAL		3.75	3.00	3.09	0.70	-10.65

Source: Banco Central de Reserva, unpublished data

Table 2

Manufacturing Production
(percent change on previous year)

	1979	1980	1981	1982	Proportion of of 1979 Production *
TOTAL	3.9	5.2	0	-2.3	100.0 *
Fishmeal	4.6	-32.9	4.8	29.3	*
Food beverages & Tobacco	4.5	5.6	0.8	0.2	26.1
Textiles	4.0	-2.0	-3.7	-7.8	12.4
Lumber and Furniture	-5.2	-2.4	-6.9	N.A.	2.1
Paper, Printing and Publishing	-13.0	20.7	5.3	-10.9	4.5
Petroleum Derivatives and other Chemicals	2.6	10.6	2.2	2.4	18.5
Nonmetallic Min. Prod.	2.0	8.3	2.6	-6.2	4.9
Basic Metal Ind.	14.7	-2.2	-6.3	-0.4	16.6
Metallic Prod. & Mach.	-1.1	23.9	5.1	-15.7	12.9
Other	-4.1	10.0	-6.6	N.A.	0.7

Source: IMF, World Bank
* Total Excludes Fishmeal

TABLE 3
FUNCTIONAL DISTRIBUTION OF GDP
(percentage of total)

	1978	1979	1980	1981	1982	1983p
CONSUMPTION						
Public Sector	12.6	10.9	12.8	12.0	12.6	13.0
Private Sector	70.6	68.5	68.7	68.5	66.7	68.5
TOTAL	83.2	79.3	81.5	80.4	79.3	81.5
GROSS DOM. INVESTMENT						
Fixed Cap. Form. (Public)	5.2	4.9	7.4	8.8	9.0	6.7
Fixed Cap. Form. (Private)	6.8	8.3	8.9	10.1	9.3	6.9
Change in Stocks	0.5	0.2	0.7	1.8	0.9	1.0
TOTAL DOMESTIC INVESTMENT	12.5	13.5	17.0	20.7	19.2	14.6
TOTAL DOMESTIC EXPENDITURE	95.7	92.8	98.5	101.2	98.5	96.2
EXTERNAL SECTOR						
Exports of Goods & NFS	15.5	18.7	17.2	16.0	17.0	16.8
Imports of Goods & NFS	11.3	11.5	15.6	17.2	15.6	13.0
EXTERNAL SECTOR NET	4.3	7.2	1.5	-1.2	1.5	3.6
GDP AT MARKET PRICES	100.0	100.0	100.0	100.0	100.0	100.0

Source: Banco Central de Reserva; 1978-82: Memoria 1982
1983: unpublished data

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Table 4
Production Losses Resulting from Disasters by Sector
(millions of 1970 soles)

	GDP 1982	GDP 1983	Losses Due to Disasters Direct	Indirect	Total	GDP 1983 w/o disasters	Percentage Changes in GDP Actual	w/o Disaster	Change
Agriculture & Livestock	45,525	41,880	5,056		5,056	46,936	-8.0	3.1	-11.1
Fishing	3,452	2,196	900		900	3,096	-36.4	-10.3	-26.1
Petroleum & Mining	32,483	30,372	1,494		1,494	31,866	-6.5	-1.9	-4.6
Manufacturing	80,486	70,040	1,995	2,014	4,009	74,049	-13.0	-8.0	-5.0
Construction	19,597	14,698			0	14,698	-25.0	-25.0	0
Government	26,535	26,535			0	26,535	0	0	0
Other	140,317	125,584	6,035	1,603	7,638	133,222	-10.5	-5.1	-5.4
GROSS DOMESTIC PROD.	348,395	311,305	15,480	3,617	19,097	330,402	-10.6	-5.2	-5.5

Source: BCR, Resena Economica, forthcoming.

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Table 5
Central Government Financial Operations
(percent of GDP)

	1978	1979	1980	1981	1982
CURRENT INCOME					
Income Taxes	2.57	3.83	6.01	3.59	3.48
Property Taxes	0.66	0.58	0.67	0.72	0.70
Import Taxes	2.33	2.20	3.20	3.81	3.45
Export Taxes	1.91	2.85	2.49	1.38	0.86
Prod & Cons. Taxes	7.30	7.36	7.67	7.46	8.49
Other Taxes	0.72	0.42	0.63	0.59	0.60
Non-tax Income	0.30	0.65	-0.04	0.51	0.45
TOTAL CURRENT INCOME	15.79	17.90	20.63	18.06	18.03
CURRENT EXPENDITURES					
Wages & Salaries	4.72	3.96	4.82	5.30	5.29
Goods & Services	0.60	0.62	0.73	0.77	0.73
Transfers:					
Non-financial Public Enterprises	0.30	0.03	0.02	0.01	0.01
Other Gov.	0.72	0.78	1.11	1.06	0.77
Pensions & others	1.20	1.10	2.23	1.74	1.28
Interest	4.31	4.47	4.33	4.53	4.04
Defense	5.56	3.37	4.94	4.42	5.88
TOTAL CURR. EXPENDITURES	17.40	14.33	18.18	17.84	17.99
SAVINGS ON CURRENT ACC'T	-1.61	3.57	2.45	0.23	0.04
CAPITAL INCOME					0.06
CAPITAL EXPENDITURE	3.47	4.15	5.30	5.15	4.05
DEFICIT OF CENTRAL GOV'T	-5.08	-0.58	-2.85	-4.92	-3.95
FINANCING					
External	0.48	-0.55	0.20	1.68	2.95
Internal	4.60	1.13	2.65	3.24	1.00
TOTAL FINANCING	5.08	0.58	2.85	4.92	3.95
SURPLUS OF NON-FINANCIAL STATE ENTERPRISES	-1.38	-0.58	-2.23	-3.45	-4.72
SURPLUS--OTHER GOVERNMENT	0.30	0.10	0.34	-0.04	-0.05
CONSOLIDATED PUBLIC SECTOR	-6.16	-1.07	-4.74	-8.41	-8.73

Source: Banco Central de Reserva, Memoria 1982.

Table 6

Structure of Central Government Current Receipts

(percent of total)

	1978	1979	1980	1981	1982
Income Taxes	16.29	21.38	29.15	19.69	19.32
Property Taxes	4.17	3.26	3.24	4.01	3.86
Import Taxes	14.77	12.32	15.51	21.08	19.11
Export Taxes	12.12	15.94	12.67	7.62	4.79
Prod & Cons. Taxes	46.21	41.12	37.19	41.30	47.08
Other Taxes	4.55	2.36	3.04	3.28	3.34
Non-tax Income	1.89	3.62	-0.20	2.82	2.49
TOTAL CURRENT INCOME	100.00	100.00	100.00	100.00	100.00

Source: Banco Central de Reserva, Memoria 1982.

Table 7

Gross Capital Formation by Central Government

(as percent of GDP)

SECTORS	1978	1979	1980	1981	1982
Food and Agriculture	0.96	1.01	0.67	0.76	1.18
Fishing	0.06	0.10	0.06	0.09	0.05
Mining and Energy	0	0	0.16	0.14	0.08
Transport & Comm.	0.66	0.64	0.65	1.26	1.20
Industry, Tourism, etc.	0.12	0.13	0.14	0.17	0.09
Education	0.18	0.13	0.08	0.21	0.23
Health	0.12	0.16	0.14	0.18	0.11
Housing & Const.	0.24	0.23	0.30	0.11	0.15
Other (mainly multisectoral prog.)	0.18	0.39	1.40	1.25	0.62
Capital Transfers	0.90	1.17	1.70	0.96	0.33
TOTAL	3.41	4.15	5.31	5.15	4.05

Source: Banco Central de Reserva, Memoria 1982.

Table 8
Volume, Unit Prices, and Value of Exports
(metric tons and million U.S. dollars)

	1978	1979	1980	1981	1982	1983	1984 proj.
TRADITIONAL:							
Fishmeal:							
Volume	483.0	657.0	416.0	315.0	616.0	178.0	200.0
Price (U.S.$/met.ton)	397.1	389.7	469.4	448.0	328.8	379.8	418.0
Value	191.8	256.0	195.3	141.1	202.5	67.6	83.6
Cotton:							
Volume	18.1	19.8	32.4	31.7	59.0	28.4	5.4
Price (cents/lb.)	95.4	112.1	100.7	91.5	65.0	65.4	80.0
Value	38.1	48.9	71.9	64.0	84.6	41.0	9.5
Sugar:							
Volume	291.0	181.0	53.0		59.0	77.0	100.0
Price (cents/lb.)	8.0	8.6	11.2		15.0	18.5	18.0
Value	51.3	34.3	13.1	0	19.5	31.4	39.7
Coffee:							
Volume	53.6	69.5	44.1	45.4	43.6	54.0	49.0
Price (cents/lb.)	142.2	159.8	145.0	105.9	117.9	98.8	117.3
Value	168.1	244.9	141.0	106.0	113.3	117.6	126.7
Copper: (incl. unref. silver)							
Volume	343.3	377.0	350.1	324.0	335.0	309.0	348.0
Price (cents/lb.)	53.9	83.4	97.4	74.1	62.3	67.8	65.0
Value	408.0	693.3	751.9	529.4	460.2	462.0	498.8
Iron & Iron Ore:							
Volume	4771.0	5749.0	5730.0	5269.0	5660.0	3800.0	4000.0
Price (U.S.$/net ton)	15.4	14.8	16.5	17.7	19.1	17.6	16.0
Value	73.5	85.1	94.5	93.3	108.1	66.9	64.0
Silver (refined)							
Volume	41.6	23.8	16.0	28.1	26.0	33.2	26.5
Price (U.S.$/troy oz.)	5.0	9.3	19.6	11.1	7.9	11.7	8.5
Value	208.0	221.7	313.6	311.9	205.4	388.4	225.3
Lead (incl. unref. silver)							
Volume	176.0	156.0	154.0	146.0	177.1	192.0	184.0
Price (cents/lb.)	23.1	96.2	112.8	68.0	55.2	67.8	67.8
Value	89.6	330.9	383.0	218.9	215.6	287.0	275.1
Zinc							
Volume	437.0	422.4	437.7	477.0	491.0	484.0	495.0
Price (cents/lb.)	13.8	18.6	21.8	25.4	24.8	26.6	29.4
Value	133.0	173.7	210.4	267.2	268.5	283.9	320.9
Petroleum & Deriv.							
Volume	13.8	24.1	22.4	19.9	22.7	20.9	23.0
Price (U.S.$/barrel)	13.0	27.1	35.3	34.7	31.6	26.6	26.1
Value	180.0	652.0	792.0	690.1	719.0	555.9	600.3
Other Traditional Prod.	56.0	125.6	103.0	120.0	135.0	121.0	151.0
TOTAL TRADITIONAL	1597.4	2866.5	3069.8	2548.9	2531.0	2422.7	2394.0
NON-TRADITIONAL PRODUCTS	344.0	809.6	845.0	701.0	762.0	535.0	755.0
TOTAL F.O.B. VALUE	1941.4	3676.1	3914.8	3249.9	3293.0	2957.7	3149.0

Source: 1978-83: Banco Central de Reserva, unpublished data
1984: Mission estimates

Table 9
Imports by End Use 1979-1983
(million U.S. dollars)

	1979	1980	1981	1982	1983
CONSUMER GOODS					
Non-durables	120	303	336	282	
Durables	35	107	267	213	
TOTAL	155	410	603	495	421
PRIMARY MATERIALS & INTERMEDIATE PRODUCTS					
Fuels & Lubricants	55	39	78	48	
Agricultural Inputs	57	69	114	119	
Industrial Inputs	793	1041	1184	1123	
TOTAL	905	1149	1376	1298	973
CAPITAL GOODS					
Construction Materials	31	42	141	164	
Agricultural Machinery	26	51	42	36	
Industrial Machinery	408	696	832	882	
Transportation Equipment	160	308	439	348	
TOTAL	625	1097	1454	1430	901
GRANTS AND ADJUSTMENTS	266	416	370	572	352
TOTAL IMPORTS	1951	3062	3803	3787	2647

Source: Banco Central de Reserva, 1979-82: Memoria 1982,
1983: unpublished data

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TABLE 10
PERU: BALANCE OF PAYMENTS, 1982-1984
(millions of U.S. dollars)

	1982	1983	1984
CURRENT ACCOUNT			
Merchandise Exports,FOB	3293	2955	3150
Merchandise Imports,FOB	-3787	-2647	-2683
Balance of Trade	-494	308	467
Freight & Insurance,net	-119	-61	-56
Tourism (Travel), net	46	15	40
Transportation, net	-110	-115	-132
Interest & Profit, net	-1012	-1143	-1415
Other Services, net	-126	-88	-92
Balance on Services	-1321	-1392	-1655
Transfers, net	167	219	191
Balance on Current Account	-1648	-865	-997
CAPITAL ACCOUNT			
Private Direct Investment	48	15	-39
Loans to Private Sector	157	-61	-61
Balance on Private Capital	205	-46	-100
Gross Disbursements to Public Sector	2042	2550	2506
Official Loans	(1933)	(1535)	(1171)
Refinancing	(109)	(1015)	(1335)
Gross Amortization of Public Sector	-1048	-1153	-1554
Official Loans	(-966)	(-1153)	(-1554)
Refinancing	(-82)	--	--
Balance on Official Capital	994	1397	952
SDR Allocation	--	--	--
Errors & Omissions and Short-Term Capital	585	-517	--
Over-all Balance	136	-31	-145
FINANCING			
Change in Net International Reserve Position (increase is minus sign)	-136	31	145
Central Bank, net (note a)	-78		
Change in Gross FX Assets	-387		
Change in Gross FX Liabilities	304		
Other Banks, net	-58		

Note (a): A negative sign for FX assets indicates an increase; a positive sign for FX liabilities indicates an increase.

Table 12

Foreign and Domestic Reserves and Credit Expansion

(thousand million soles)

	1979	1980	1981	1982	Sept 1983
Net Int'l Reserves of the Financial System	151	525	391	887	1573
Domestic Credit					
Net Public Sector	302	537	974	1364	2235
Private Sect. Credit	498	971	1928	3717	5929
Total	792	1507	2902	5081	8164
Lima CPI (end Dec.)	122.09	196.34	339.63	586.26	1103.89

(thousand million 1979 soles)

	1979	1980	1981	1982	Sept 1983
Net Int'l Reserves of the Financial System	124	267	115	151	143
Domestic Credit					
Net Public Sector	247	273	287	233	203
Private Sect. Credit	401	494	569	634	537
Total	649	768	856	867	740

(percent change on previous year)

	1980	1981	1982	Sept 1983
Net Int'l Reserves of the Financial System	116.15	-56.83	31.19	-5.75
Domestic Credit				
Net Public Sector	10.45	5.13	-19.02	-12.92
Private Sect. Credit	23.23	15.03	11.49	-15.23
Total	18.36	11.51	1.25	-14.68
Corr. Bank Soles Deposits		725	1251	1517
Bank Soles Reserves		215	215	318
Deposit Reserve Ratio		3.37	5.82	4.77
Dollar Certificates		359	914	1646
Share of Dollar Cert. in Total Deposits		33.12	42.22	54.89

Source: Banco Central de Reserva, Nota Semanal No. 39, 1983.

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Annex I

BALANCE OF PAYMENTS
(U.S. Dollar Millions)

	1978 Credit	1978 Debit	1978 Net	1979 Credit	1979 Debit	1979 Net	1980 Credit	1980 Debit	1980 Net
Goods and Services									
Merchandise f.o.b.	1941	1601	340	3676	1954	1722	3716	3490	226
Freight and Insurance	81	88	-7	69	102	-33	84	191	-107
Investment Income:									
Public Sector	14	434	-420	54	544	-490	188	667	-479
Private Sector	2	160	-158	4	445	-441	14	444	-430
Total Investment Income	16	594	-578	58	989	-931	202	1111	-909
Other Transport	99	175	-76	92	178	-86	137	296	-159
Travel	141	33	108	186	45	141	292	107	185
Government n.i.e.	19	41	-22	43	43	0	52	54	-2
Other Services	119	132	-13	130	144	-14	149	231	-82
Total Goods and Services	2416	2664	-248	4256	3455	801	4632	5880	-248
Transfers	60	4	56	152	0	152	147	0	147
BALANCE ON CURRENT ACC'T			-192			953			-101
CAPITAL ACCOUNT									
Long Term Capital:									
Private Sector:									
Direct Investment	119	94	25	352	281	71	395	368	27
Other	97	83	14	88	120	-32	180	116	64
Total L-T Private Sector	216	177	39	440	401	39	575	484	91
Public Sector:									
Official Loans	788	659	129	1084	659	425	1208	921	287
Refinancing	266	0	266	539	121	418	572	282	[illegible]
Other	[illegible]	11	-11	0	26	-26	0	6	-6
Total Public Sector	[illegible]	[illegible]	384	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TOTAL LONG-TERM CAPITAL	[illegible]	[illegible]	423	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Short Term Capital and Errors and Omissions Net			-155			-67			328
Allocations of SDRs			[illegible]			[illegible]			[illegible]
SURPLUS OR DEFICIT			76			1564			[illegible]
Reserve Movements (increase -)									
Central Reserve Bank			[illegible]			[illegible]			[illegible]
Assets			[illegible]			[illegible]			[illegible]
Liabilities			[illegible]			[illegible]			[illegible]
Banco de la Nacion			-19			[illegible]			[illegible]
Assets			18			-405			[illegible]
Liabilities			-37			-77			74
Specialized Banks			3			75			11
Commercial Banks			-166			-62			53
RESERVE MOVEMENTS			-76			-1564			-767

Source: 1978-80: Banco Central de Reserva, unpublished data

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Annex I

BALANCE OF PAYMENTS

(U.S. Dollar Millions)

	1981 Credit	1981 Debit	1981 Net	1982 Credit	1982 Debit	1982 Net	1983 Credit	1983 Debit	1983 Net
Goods and Services									
Merchandise f.o.b.	3249	3802	-553	3293	3787	-494	2955	2647	308
Freight and Insurance	144	263	-119	138	258	-119	124	185	-61
Investment Income:									
Public Sector	188	721	-533	95	713	-618	83	789	-706
Private Sector	16	502	-486	14	408	-394	12	449	-437
Total Investment Income	204	1223	-1019	109	1121	-1012	95	1238	-1143
Other Transport	143	296	-153	155	265	-110	165	280	-115
Travel	262	176	86	251	205	46	202	187	15
Government n.i.e.	59	66	-7	61	70	-9	62	73	-11
Other Services	162	286	-124	178	295	-117	185	262	-77
Total Goods and Services	4223	6112	-1889			-1815	3788	4872	-1084
Transfers	161	0	161	167		167	219	0	219
BALANCE ON CURRENT ACC'T			-1728			-1648			-865
CAPITAL ACCOUNT									
Long Term Capital:									
Private Sector:									
Direct Investment	483	358	125	466	418	48	15	0	15
Other	295	160	135	378	221	157	164	225	-61
Total L-T Private Sector	778	518	260	844	639	205	179	225	-46
Public Sector:									
Official Loans	1628	944	676	1933	966	967	1535	1153	382
Refinancing	80	367	-287	109	82	27	1015		1015
Other	0	1	-1			0			0
Total Public Sector	1708	1312	388	2042	1048	994	2550	1153	1397
TOTAL LONG-TERM CAPITAL	2478	1830	648	2886	1687	1199	2729	1378	1351
Short Term Capital and Errors and Omissions (net)			469			585			-517
Allocations of SDRs			21						0
SURPLUS OR DEFICIT			-590			136			-31
Reserve Movements (increase = -)									
Central Reserve Bank			693			-72			
Assets			1087			-387			
Liabilities			-394			315			
Banco de la Nacion			-82			-112			
Assets			-159			244			
Liabilities			77			-356			
Specialized Banks			-9			83			
Commercial Banks			-12			-34			
RESERVE MOVEMENTS			590			-135			31

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STATUTORY CHECKLIST FOR FY 84

COUNTRY CHECKLIST

A. GENERAL CRITERIA FOR COUNTRY ELEGIBILITY

1. FAA Sec. 481, FY 84 Continuing Resolution. Has it been determined or certified to the Congress by the President that the government of the recipient country has failed to take adequate measures or steps to prevent narcotic and psychotropic drugs or other controlled substance (as listed in the schedule in Section 202 of the Comprehensive Drug Abuse Prevention and Control Act of 1971) which cultivated, produced or processed illicitly, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully? — No

2. FAA Sec.620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) the debt is not denied or contested by such government? — No

3. FAA Sec. 620(e)(1). If assistance is to a government, has it (including government agencies or subdivisons) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or — No

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control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?

4.	FAA Sec. 532(c), 620(a), 620(f), 620D; FY 1982 Appropriation Act Secs. 512 and 513. Is recipient country a Communist country? Will assistance be provided to Angola, Cambodia, Cuba, Laos, Vietnam, Syria, Libya, Iraq, or South Yemen? Will assistance be provided to Afghanistan or Mozambique without a waiver?	No
5.	ISDCA of 1981 Secs. 724, 727 and 730. For specific restrictions on assistance to Nicaragua, see Sec. 724 of the ISDCA of 1981. For specific restrictions on assistance to El Salvador, see Secs. 727, and 730 of the ISDCA of 1981.	Not applicable
6.	FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action of U.S. property?	No
7.	FAA Sec. 620(l). Has the country failed to enter into an agreement with OPIC?	Due to legal restrictions in Andean Pact agreement, Peru is unable to sign agreement with OPIC. Negotiations, however, are taking place.
8.	FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters?	(a) Yes
	(b) If so, has any deduction required by the Fishermen's Protective Act been made?	(b) Yes, but a waiver of this provision has been obtained.

9. FAA Sec. 620(q); FY 1982 Appropriation Act Sec. 517. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any AID loan to the country? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the appropriation bill appropriates funds?

(a) No

(b) No

10. FAA Sec. 620(s). If contemplated assistance is development loan or from Economic Support Fund, has the Administrator taken into account the amount of foreign exchange or other resources which the country has spent on military equipment? (Reference may be made to the annual "Taking into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)

Yes, the Administrator has taken such into account in the FY 84 Taking Into Consideration Memorandum.

11. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?

No

12. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget?

Peru is not in arrears in payment of its UN obligations.

13. FAA Sec. 620A; FY 1982 Appropriation Act Sec. 520. Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism? Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed a war crime? — No

14. FAA Sec. 666. Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA? — No

15. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or denoted a nuclear explosive device, after August 3, 1977? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.) — No

16. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Session of the General Assembly of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the — No

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communique issued? If so, has the President taken it into account? (Reference may be made to the Taking into Consideration memo.)

17. ISDCA OF 1981 Sec. 721. See special requirements for assistance to Haiti. — Not applicable

18. FY 1984 Continuing Resolution. Has the recipient country been determined by the President to have engaged in a consistent pattern of opposition to the foreign policy of the United States? — No

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria.

a. FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy? — No

2. Economic Support Fund Country Criteria.

a. FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest? — No

b. ISDCA of 1981, Sec. 725(b). If ESF is to be furnished to Argentina, has the President — Not applicable

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certified that (1) the Govt. of Argentina has made significant progress in human rights; and (2) that the provision of such assistance is in the national interests of the U.S.?

c. <u>ISDCA of 1981, Sec. 726(b).</u> If ESF assistance is to be furnished to Chile, has the President certified that (1) the Govt. of Chile has made significant progress in human rights; (2) it is in the national interest of the U.S.; and (3) the Govt. of Chile is not aiding international terrorism and has taken steps to bring to justice those indicted in connection with the murder of Orlando Letelier?

Not applicable

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NONPROJECT CHECKLIST

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. FY 1982 Appropriation Act Sec. 523; FAA Sec. 634A; Sec. 653(b).

(a) Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the assistance; (b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than $1 million over that amount)?

(a) A Congressional Notification for the assistance will be sent in accordance with standard AID procedures.

(b) No

2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

No further legislative action by Peru is required.

3. FAA Sec. 209. Is the assistance susceptible to execution as part of regional or multilateral program? If so, why is assistance not so executed? Information and conclusion whether assistance will encourage regional development programs.

The assistance is not susceptible to execution as part of a regional or multilateral program. The assistance will neither encourage nor discourage regional development programs.

4. FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan

The assistance will encourage efforts of Peru to increase the flow of international trade by providing foreign exchange to permit importation of off-shore goods and services and to foster private initiative and competition by helping maintain the liquidity of Peruvian private business firms. This assistance will not associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

directly encourage development of cooperatives etc., discourage monopolistic practices, or strengthen free labor unions.

5. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

The assistance will encourage U.S. private trade and investment abroad by strengthening Peru's balance of payments position and helping the Peruvian private sector to remain financially sound though the current economic crisis.

6. FAA Sec. 612(b), 636(h); FY 1982 Appropriation Act Sec. 507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

The GOP is making local currency available for disaster reconstruction through emergency reconstruction bonds. The sale of these bonds has provided the GOP with substantial local currency for disaster recovery.

7. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No

8. FAA Sec. 601(e). Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Not applicable

9. FY 1982 Appropriation Act Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive

Not applicable

capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

B. <u>FUNDING CRITERIA FOR NONPROJECT ASSISTANCE</u>

1. <u>Nonproject Criteria for Development Assistance</u>

a. <u>FAA Sec. 102(b), 111, 113, 281(a).</u> Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the selfhelp efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

(a) The assistance will enhance the role of the poor in development by helping provide productive employment opportunities for those directly affected by the El Niño disasters and those indirectly affected due to the economic losses caused by such disasters.

(b) The assistance will assist urban and rural poor through the generation fo productive employment opportunities.

(c) Peru has been helping itself to recover from the effects of the El Niño disasters principally through a large reconstruction program financed in part from reconstruction bonds that most formally employed Peruvians were required by law to purchase.

(d) Women will participate on an equal basis in the assistance.

(e) This assistance will not directly impact on regional cooperation between Peru and its neighbor countries.

b. <u>FAA Sec. 103, 103A, 104, 105, 106.</u> Does the assistance fit the criteria for the type of funds (functional account) being used?

Yes

c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

Not applicable

d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

Yes

e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"? (M.O. 1232.1 defined a capital project as "the construction, expansion, equipping or alteration of a physical facility or facilities financed by AID dollar assistance of not less than $100,000, including related advisory, managerial and training services, and not undertaken as part of a project of a predominantly technical assistance character.

Not applicable

f. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.

This assistance will assist Peru in dealing with the macro economic effects of the El Niño disasters. The floods in the north and severe droughts in the south have adversely affected Peru's balance of payments and reduced its ovceral1 economic output in 1983. These economic reverses have come at a time when Peru was attempting to restore democracy and to move away from the statist economic policies of prior military governments toward a free market economy. The assistance will thus help to stabilize Peru's economy and in turn help encourage democratic self government and free market economic policies.

2. Nonproject Criteria for Development Assistance (Loans Only)

a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan, at a reasonable rate of interest.

Last year Peru renegotiated its foreign debt to ensure long-range capability to meet its loan repayment obligations and is now negotiating further assistance with the IMF.

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan?

Not applicable

c. ISDCA of 1981, Sec. 724(c) and (d). If for Nicaragua, does the loan agreement require that the funds be used to the maximum extent possible for the private sector? Does the project provide for monitoring under FAA Sec. 624(g)?

Not applicable

3. <u>Nonproject Criteria for Economic Support Fund</u>

a. <u>FAA Sec. 531(a).</u> Will this assistance promote economic or political stability? To the extent possible, does it reflect the policy directions of FAA Section 102?	Not applicable
b. <u>FAA Sec. 531(c).</u> Will assistance under this chapter be used for military, or paramilitary activities?	Not applicable
c. <u>FAA Sec. 534.</u> Will ESF funds be used to financed the construction of the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such use of funds is indispensable to nonproliferation objectives?	Not applicable
d. <u>FAA Sec. 609.</u> If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?	Not applicable

associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

directly encourage development of cooperatives etc., discourage monopolistic practices, or strengthen free labor unions.

5. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

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The GOP is making local currency available for disaster reconstruction through emergency reconstruction bonds. The sale of these bonds has provided the GOP with substantial local currency for disaster recovery.

7. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No

8. FAA Sec. 601(e). Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Not applicable

9. FY 1982 Appropriation Act Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive

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(a) A Congressional Notification for the assistance will be sent in accordance with standard AID procedures.

(b) No

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B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Development Assistance

   a. FAA Sec. 102(b), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the selfhelp efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

   b. FAA Sec. 103, 103A, 104, 105, 106. Does the assistance fit the criteria for the type of funds (functional account) being used?

This assistance is provided to Peru for disaster relief, rehabilitation and reconstruction pursuant to the deobligation reobligation authority in the Supplemental Appropriations Act, 1983, as extended by Continuing Resolution for FY 1984. Hence the nonproject criteria for development assistance are not applicable.

c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"? (M.O. 1232.1 defined a capital project as "the construction, expansion, equipping or alteration of a physical facility or facilities financed by AID dollar assistance of not less than $100,000, including related advisory, managerial and training services, and not undertaken as part of a project of a predominantly technical assistance character.

f. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

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

LAC/DR-IEE-84-24

ENVIRONMENTAL THRESHOLD DECISION

Project Location	:	Peru
Project Title and Number	:	PAAD - Balance of Payments 527-0278
Funding	:	$60,000,000
Life of Project	:	One year
IEE Prepared by	:	USAID/Lima
Recommended Threshold Decision	:	Catagorical Exclusion
Bureau Threshold Decision	:	Concur with Recommendation
Copy to	:	John Sanbrailo, Director, USAID/Lima
Copy to	:	Doug Chiriboga, LAC/DR
Copy to	:	USAID/Lima
Copy to	:	IEE File

James S. Hester Date 3/23/84

James S. Hester
Chief Environmental Officer
Bureau for Latin America
and the Caribbean

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ENVIRONMENTAL DETERMINATION

Project Location: PERU

Project Title and Number: Project Assistance Approval Document-Balance of Payments Assistance 527-0278

Funding: FY-84 $60,000,000

Project Description: As a result of the floods, landslides, and drought of 1983, the already acute balance of payments and budgetary crises facing Peru were made even worse. These natural disasters caused over half a billion dollars in foreign exchange losses. As a consequence, the country has experienced an even greater decline in economic activitiy and employment nationwide than otherwise would have been the case without the disasters. The purpose of the proposed program is to make available $60.0 million in foreign exchange to help relieve balance of payments pressure resulting from the disasters.

Statement For Categorical Exclusion

It is the opinion of the USAID/PERU Project Committee that the Project does not require an Intitial Environmental Examination, because its activities are within the classes of actions described in Section 216.2, paragraph(c)(2) "Categorical Exclusions" of 22 CFR Part 216:

Section 216.2(c)(1)(i)
The action does not have an effect on the natural environment.

Concurrance of the Acting Mission Director

I have reviewed the above statement and concur in the determination that the Project "Balance of Payments Assistance" does not require an Initial Environmental Examination.

3/5/84
Date

George A. Hill
George A. Hill
Acting Director

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