IV.

Public Finance

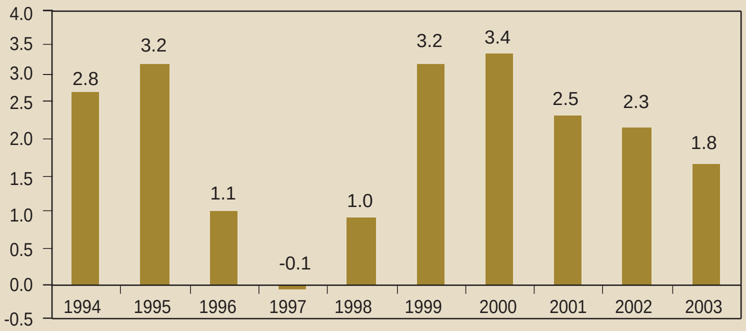
During 2003, fiscal policy's main target was to consolidate public finance sustainability through a gradual reduction of fiscal deficit, as established by the Fiscal Responsibility and Transparency Law. Fiscal deficit reduction was achieved thanks to increased economic activity and the implementation of tax measures, which raised government revenues, and in turn enabled to meet the need for public spending.

Non financial public sector deficit fell from 2.3 percent of GDP in 2002 to 1.8 percent of GDP in 2003, mainly due to an increase in the primary balance (a surplus of 0.4 percent of GDP, the first positive balance in four years) of 0.5 percent of GDP. This result reflected the favorable development of central government accounts, from a primary deficit of 0.2 percent of GDP to a surplus of 0.2 percent of GDP.

Central Government current revenues grew by 8.0 percent in real terms, from 14.4 to 14.9 percent of GDP. This was due to new mechanisms of retentions, collections and withdrawals concerning the Value Added Tax (IGV) since mid 2002, a one-percentage-point increase in the IGV tax rate (from 18 to 19 percent) in place since August 2003, additional advance payments of the Corporate

GRAPH 14

NON-FINANCIAL PUBLIC SECTOR DEFICIT
(Percentage of GDP)



Source: MEF, Banco de la Nación, BCRP, SUNAT, EsSalud, local governments, state-owned companies and public institutions.

Income Tax, and the sustained growth in economic activity.

Central Government non-financial expenditure went up 5.2 percent in real terms, growing from 14.7 percent of GDP in 2002 to 14.8 percent of GDP in 2003, mainly due to the real growth of 5.9 percent in current expenditures and 1.0 percent in capital expenditures.

The fiscal deficit (1.8 percent of GDP, equivalent to US$ 1,072 million) was basically financed by net foreign borrowing of US$ 844 million. Disbursements totaled US$ 2,101 million and external debt amortizations US$ 1,187 million. Disbursements were obtained from US$ 1,246 million worth of overseas bond issues and from loans of multilateral organizations amounting to US$ 855 million, of which US$ 336 million were channeled to investment projects.

During the year three sovereign bond issues were placed overseas. Two of

TABLE 27

NON-FINANCIAL PUBLIC SECTOR OVERALL BALANCE

	Millions of nuevos soles			Percentage of GDP		
	2001	2002	2003	2001	2002	2003
I. Primary balance	**- 362**	**- 245**	**905**	**-0.2**	**-0.1**	**0.4**
1. Central government primary balance	**-1,230**	**- 310**	**453**	**-0.7**	**-0.2**	**0.2**
a. Current revenues	27,059	28,559	31,551	14.4	14.4	14.9
i. Tax revenue	23,541	24,062	27,405	12.5	12.1	12.9
ii. Non-tax revenue	3,518	4,498	4,146	1.9	2.3	2.0
b. Non-financial expenditure	28,580	29,241	31,460	15.2	14.7	14.8
i. Current	24,349	25,285	27,375	12.9	12.7	12.9
ii. Capital	4,231	3,956	4,084	2.2	2.0	1.9
c. Capital revenues	291	371	361	0.2	0.2	0.2
2. Primary balance of other entities	**868**	**65**	**452**	**0.5**	**0.0**	**0.2**
a. Rest of central government	300	127	218	0.2	0.1	0.1
b. Local government	166	176	334	0.1	0.1	0.2
c. State-owned enterprises	402	- 237	- 100	0.2	-0.1	0.0
II. Interest payments	**4,266**	**4,281**	**4,633**	**2.3**	**2.2**	**2.2**
1. Foreign debt	3,665	3,515	3,763	1.9	1.8	1.8
2. Domestic debt	601	766	869	0.3	0.4	0.4
III. Overall balance (I-II)	**-4,628**	**-4,526**	**-3,728**	**-2.5**	**-2.3**	**-1.8**
1. Net foreign financing	1,755	4,144	2,935	0.9	2.1	1.4
(Millions of US$)	$ 498	$1,183	$ 844	0.9	2.1	1.4
a. Disbursements	$1,318	$2,863	$2,101	2.5	5.0	3.4
b. Amortization	$ 735	$1,793	$1,187	1.4	3.2	1.9
c. Other	-$ 85	$ 113	-$ 71	-0.2	0.2	-0.1
2. Net domestic financing	1,739	-1,122	612	0.9	-0.6	0.3
3. Privatization revenues	1,134	1,503	181	0.6	0.8	0.1

Source: MEF, Banco de la Nación, BCRP, SUNAT, EsSalud, local governments, state owned companies and public institutions.

them took place in the first quarter for a total of US$ 750 million and the last one in November for US$ 500 million. The proceeds of this placement will be used to finance the 2004 fiscal budget.

Domestic financing (S/. 612 million) was basically explained by the net placement in local markets of Treasury Bonds for S/. 727 million (placement totaled S/. 1,712 million and redemption S/. 985 million), and Treasury Bills for S/. 200 million. These operations allowed the government to increase the Treasury's deposits in Banco de la Nación by S/. 227 million.

It is worth mentioning that in 2003 the government decided to promote the domestic market for public debt through the Market Makers Program, a tool designed to enhance financial markets deepening and to reduce external debt dependency risk. In the same token, a new short-term public debt instrument, Treasury Bills, was implemented in 2003 in order to meet the government's seasonal liquidity requirements in a transparent and less costly way.

The proceeds from the private investment promotion process totaled US$ 52 million, of which US$ 27 million corresponded to partial installments from previous privatizations, US$ 10 million to loan transfers and US$ 15 million to the payment by Jorbelec S.A.

1. Central Government revenues

During year 2003, central government current revenues totaled S/. 31,551 million (14.9 percent of GDP), implying a growth rate of 8.0 percent in real terms. This outcome was higher by 0.5 percent of GDP respect to the previous year, due to the increase in tax revenues (0.8 percent of GDP), which was partially offset by the reduction in non tax revenues (less than 0.3 percent of GDP).

Tax revenues behavior mainly reflected the higher collections from Income Tax (0.8 percent of GDP) and Value Added Tax (0.3 percent of GDP). This increase was partially offset by lower revenues from the State's Assets Tax –IAE, (-0.2 percent of GDP) and Custom Duties (-0.1 percent of GDP).

Income tax collections reflected the impact of the additional advance of the Corporate Income Tax and higher coefficients used to compute monthly advance income tax payments, owing to higher profits during fiscal year 2002. Likewise, Value Added Tax (IGV) collections growth was explained by tax administration measures (the inclusion of several goods in the withdrawal scheme and the implementation of the collection scheme on imports since late 2003); the one- percentage-point increase in the tax rate since August, and the increase in domestic demand (3.8 percent in real terms).

TABLE 28

FISCAL REVENUE COEFFICIENTS
(Percentage of GDP)

	2001	2002	2003
Fiscal burden of the general government 1/	17.3	17.3	17.6
Fiscal burden of the consolidated central government 2/	16.4	16.3	16.6
Fiscal burden of the central government	14.4	14.4	14.9
Tax burden of the central government 3/	12.5	12.1	12.9

1/ Fiscal burden of the consolidated central government and own resources of local government.
2/ Including central government current revenues, contributions to the social security system and pension system, and own resources from the Consolidated Previsional Reserve Fund (FCR), the National Pension Savings Fund (Fonahpu), regulatory institutions and registry offices.
3/ Central government tax revenues. The 2001 and 2002 include the Extraordinary Tax on State Assets.

Source: MEF, Banco de la Nación, BCRP, SUNAT and Petroperú.

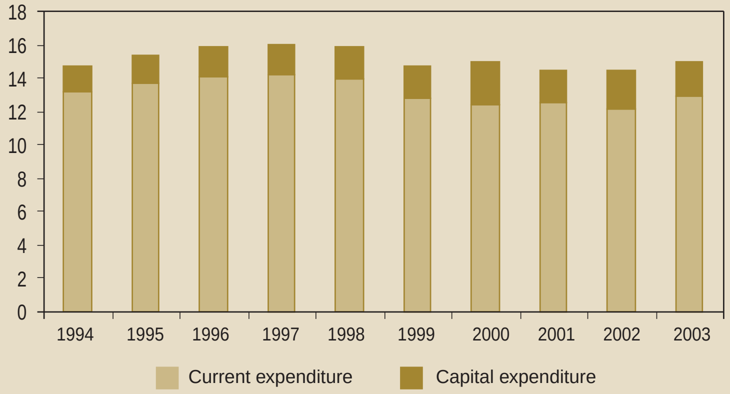
Non-tax revenues fell by 0.3 percent of GDP, mainly because year 2002 figures included extraordinary revenue generated by the payment from Antamina (US$ 111 million). In addition, FEDADOI revenues fell from US$ 82 million to US$ 21 million while resources directly collected by government units (basically fees) fell by 5 percent in real terms.

2. Central Government expenditures

Central government non-financial expenditures grew 5.2 percent in real terms, up to 14.8 percent of GDP, 0.1 percent of GDP higher than the year before. Current expenditures showed the biggest increase (5.9 percent in real terms), due to higher payroll spending

GRAPH 15

CENTRAL GOVERNMENT NON-FINANCIAL EXPENDITURES
(Percentage of GDP)



Source: MEF and Banco de la Nación.

TABLE 29

CENTRAL GOVERNMENT EXPENDITURES

	Percentage of GDP			Real % change		Percent structure		
	2001	2002	2003	2002	2003	2001	2002	2003
I. NON-FINANCIAL EXPENDITURE	**15.2**	**14.7**	**14.8**	**2.0**	**5.2**	**87.6**	**88.1**	**88.2**
1. CURRENT EXPENDITURE	**12.9**	**12.7**	**12.9**	**3.6**	**5.9**	**74.6**	**76.2**	**76.8**
a. Wages and salaries	4.4	4.5	4.6	8.2	6.0	25.2	26.9	27.1
b. Goods and services	3.9	3.5	3.5	-7.7	4.5	22.7	20.7	20.6
c. Transfers	4.6	4.8	4.9	8.8	6.8	26.6	28.6	29.1
– Pensions	1.8	1.8	1.7	4.6	0.6	10.4	10.7	10.3
– ONP-Fonahpu	0.8	1.0	1.0	32.6	6.7	4.6	6.0	6.1
– To Foncomun	0.7	0.7	0.8	4.3	8.8	4.2	4.4	4.5
– Royalties	0.1	0.2	0.2	36.4	69.4	0.7	0.9	1.4
– Others	1.2	1.1	1.1	-0.7	7.1	6.7	6.6	6.7
2. CAPITAL EXPENDITURE	**2.2**	**2.0**	**1.9**	**-6.9**	**1.0**	**13.0**	**11.9**	**11.5**
a. Gross capital formation	1.9	1.7	1.7	-6.8	0.1	11.2	10.3	9.9
b. Others	0.3	0.3	0.3	-7.7	6.6	1.7	1.6	1.6
II. INTEREST PAYMENTS	**2.2**	**2.0**	**2.0**	**-3.1**	**3.7**	**12.4**	**11.9**	**11.8**
1. Domestic debt	0.2	0.2	0.2	3.4	-5.4	1.4	1.5	1.3
2. Foreign debt	1.9	1.7	1.8	-3.9	4.9	11.0	10.4	10.4
III. TOTAL (I+ II)	**17.3**	**16.7**	**16.8**	**1.4**	**5.0**	**100.0**	**100.0**	**100.0**

Source: MEF, Banco de la Nación and BCRP.

and transfers to local governments. Central government capital expenditure grew by 1.0 percent in real terms, with respect to 2002, ending its continuous fall observed since 1999.

During 2003, the government raised the wages of employees in the Education (school teachers and university professors) and Judiciary (administrative personnel) sectors. In addition, the

TABLE 30

INVESTMENT PROJECTS TRANSFERRED TO REGIONAL GOVERNMENTS: 2003

	Project	Regions	Date of Transfer
1	Olmos-Tinajones	Lambayeque, Cajamarca y Piura	July
2	Chavimochic	La Libertad	August
3	Majes-Sihuas	Arequipa	August
4	Tambo-Ccaracocha	Ica	August
5	Alto Mayo	San Martín	September
6	Chira-Piura	Piura	October
7	Rio Cachi	Ayacucho	November
8	Pasto Grande	Moquegua	December

Source: MEF.

compensations received by military and police personnel were increased.

Likewise, current transfers to local governments increased because of higher Mining Royalty transfers, which reflected higher profits in the mining sector and the higher transfer of the Municipal Promotion Tax related to Value Added Tax (IGV) collection.

In 2003, the government transferred to the newly elected regional governments eight investment projects previously managed by INADE (National Institute for Development, a national government entity) and valued at over US$ 5,260 million.

Central government interest payments amounted to 2.0 percent of GDP, similar to the debt service observed in 2002, growing 3.7 percent in real terms, mainly because of higher Sovereign Bonds liabilities (US$ 132 million).

3. Private Investment Promotion Process

During 2003, privatization and concessions proceed totaled US$ 2.3 million, which generated investment commitments of US$ 118 million. Main transactions were the contract to supply natural gas from Camisea granted to Empresa de Generación Termoeléctrica de Ventanilla (ETEVENSA), the sale of state-owned shares of Natividad mining company, and the transfer option of the contract for the Toromocho cooper project.

The "take or pay" contract to supply natural gas, signed by ELECTROPERÚ and the firm involved in the extraction of natural gas from Camisea, was transferred to ETEVENSA. This contract requires a minimum investment of US$ 100 million to adapt existing plants for the use of natural gas. Likewise, the contract assures the provision of thermo electric power from ETEVENSA to ELECTROPERÚ for a seven-year period.

State-owned shares in Natividad mining company (a subsidiary of CENTROMÍN PERÚ) were sold, generating proceeds of US$ 1 million and investment commitments for US$ 3 million. Likewise, the selling of real estate property of ELECTROPERÚ and the national government generated proceeds of US$ 1 million.

Peru Cooper Syndicate was granted the transfer option, for a five-year period, of the Toromocho copper project. The firm offered to pay 0.51 percent of net sales as royalties and to engage in investment projects for US$ 12 millions.

Central government cash revenues from privatizations and concessions amounted to US$ 52 million, of which US$ 2 million were deposited in the Fiscal Stabilization Fund – FEF –, while US$ 50 million were transferred to the Treasury.

Main revenues were the installments from the privatization of PETROMAR (US$ 10 million) and PETROPERÚ's storage terminals (US$ 9.9 million); and the penalty payment of Jorge Rodríguez Banda S.A. –JORBELEC- (US$ 15 million), due to the restitution of four regional power-generating firms to the government. Additionally, the debt transfer in connection with the privatization of the power distribution firm Electro Sur Medio generated revenues of US$ 9.8 million, while installments from previous privatizations of real estate, land and other government assets totaled US$ 7.3 million.

TABLE 31

TREASURY'S CASH REVENUES

(Millions of US$)

Firm	Amount
Petromar (Installment)	10.0
Petroperú's storage terminals (Installment)	9.9
Transfer of portfolio of loans	9.8
JORBSA Eléctrica SAC	15.0
Others assets and installment	7.3
TOTAL	**52.0**

Source: PROINVERSIÓN and MEF.

BOX 6

METHODOLOGICAL CHANGES IN GOVERNMENT FINANCE STATISTICS

Pension Reform Bonds

Beginning with this Annual Report, a new recording criterion for Pension Reform Bonds ("Bonos de Reconocimiento") has been adopted. Pension Reform Bonds were delivered to those workers who joined the private pension system, in compensation for their contributions to the Public Pension System. These bonds are redeemed at retirement date. Although they carry a nominal interest rate of zero, the principal grows with inflation, as measured by the percentage change of the Consumer Price Index –CPI-.

The new recording criterion takes into account:

- *Re-classifying the redemption of these bonds as domestic public debt amortization*: This operation was previously recorded as a current transfer included in general government non-financial expenditures. The new methodology implies a lower level of spending and hence a higher overall balance.

- *Imputing Pension Reform Bonds indexation as interest*: Any increase in the stock of Pension Reform Bonds resulting from the indexation of their value to the CPI is now recorded as public debt interest. This criterion implies a lower overall balance.

This change in methodology is aimed to reduce discrepancies between overall balance and the change in the stock of public debt. The net effect on the overall balance depends on the relative magnitude of the redemption of Pension Reform Bonds and the adjustment in the stock due to inflation. Thus, high inflation rates and a low pace of bond redemptions imply a reduction in the overall balance (higher deficit or lower surplus), as observed in 1997-2001; while lower inflation rates generate a reduction in fiscal deficit, which occurred in 2001-2003. However, it should be stressed that all changes in the overall balance due to the new recording criterion for Pension Reform Bonds are small, so that there has been no significant change in the main trend of the fiscal balance reported by the Central Bank.

NON-FINANCIAL PUBLIC SECTOR (NFPS) OVERALL BALANCE

	1997	1998	1999	2000	2001	2002	2003
FCR (millions of soles)							
I. Overall balance (old methodology)	**51**	**353**	**3**	**107**	**46**	**-115**	**-533**
a) Amortization (+)	104	132	169	168	164	185	591
b) Interest (-)	-232	-348	-279	-328	11	-144	-235
II. Overall balance (=I + a + b)	**-78**	**138**	**-107**	**-53**	**222**	**-74**	**-177**
NFPS (percentage of GDP)							
I. Overall balance (old methodology)	**0.2**	**-0.8**	**-3.2**	**-3.3**	**-2.6**	**-2.3**	**-1.9**
a) Amortization (+)	0.1	0.1	0.1	0.1	0.1	0.1	0.3
b) Interest (-)	-0.1	-0.2	-0.2	-0.2	0.0	-0.1	-0.1
II. Overall balance (=I + a + b)	**0.1**	**-1.0**	**-3.2**	**-3.4**	**-2.5**	**-2.3**	**-1.8**

Other changes

Non-tax revenues generated by *Derecho de Vigencia de Minas* (an annual fee for operating mining activities) and *Canon Minero* (a royalty on mining activities) are now registered as Central Government current revenues and then imputed in non-financial expenditure as current transfers to Local Government. Previously, these resources were directly recorded as Local Government non-tax revenue. The new recording criterion takes into account the fact that these sources of fiscal revenues are regulated at the national level of government and is consistent with the recommendations included in the Government Finance Statistics Manual published by the IMF.

Likewise, the institutional coverage of Central Government statistics has improved, by including the operations of Conafran, Zofratacna and Huampani Recreational Center.