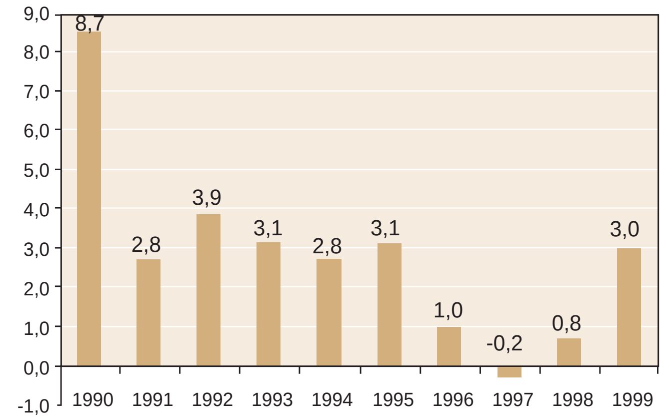
IV. PUBLIC FINANCE

The increase in the fiscal deficit from 0,8 percent of GDP in 1998 to 3,0 percent in 1999 was mainly a result of the adverse effect of the contraction in domestic demand on tax collections and the rise of public sector wages and pensions in April.

GRAPH 7
NON-FINANCIAL PUBLIC SECTOR DEFICIT
(Percentage of GDP)



The deficit was financed with domestic sources (2,3 percent of GDP) and privatization income (0,7 percent of GDP), while external financing was -0,1 percent of GDP. Domestic financing involved a withdrawal of foreign-currency funds from the Central Bank for US$ 1 034 million and a S/. 1 475 million increase in net credit from the Banco de la Nación. The latter operation demanded the allocation of Treasury Bonds at the Banco de la Nación for US$ 269 million in order to repurchase Brady Bonds previously acquired by this institution.

External financing included disbursements by US$ 812 million, of which US$ 634 million were intended to finance investment projects. Amortization amounted to US$ 873 million, including US$ 269 million for the repurchase of Brady Bonds.

TABLE 22
NON-FINANCIAL PUBLIC SECTOR OVERALL BALANCE
(Percentage of GDP)

	1997	1998	1999
SAVINGS IN CURRENT ACCOUNT	5,2	4,0	1,9
CAPITAL REVENUE 1/	0,0	0,1	0,1
CAPITAL EXPENDITURE	5,1	4,9	5,0
OVERALL BALANCE	0,2	- 0,8	- 3,0
FINANCING	- 0,2	0,8	3,0
1. External	- 0,4	0,4	- 0,1
a. Disbursements	0,9	1,8	1,6
b. Amortization	1,3	1,4	1,7
2. Privatization	0,9	0,5	0,7
3. Domestic	-0,7	- 0,1	2,3
Note:			
PRIMARY SURPLUS/DEFICIT	2,0	1,2	- 0,8

1/ Excluding privatization

TABLE 23
NON-FINANCIAL PUBLIC SECTOR PRIMARY BALANCE
(Percentage of GDP)

	1997	1998	1999
General Government	1,3	1,1	-1,1
1. Consolidated Central Government	1,3	1,0	-1,0
a. Central Government	0,8	0,6	-1,2
b. Rest of government	0,4	0,4	0,1
2. Local governments	0,0	0,1	-0,1
State-owned enterprises	0,8	0,2	0,3
TOTAL	2,0	1,2	-0,8

The overall deficit resulted from the deterioration of the primary balance (from a surplus of 1,2 percent of GDP in 1998 to a deficit of 0,8 percent in 1999), which in turn was associated with the reduction of the Central Government balance in 1,8 percentage points of GDP —from 0,6 to –1,2 percent of GDP— due to the fall of revenues from 15,7 to 14,5 percent of GDP between 1998 and 1999 and the increase in non-financial expenditures from 15,2 percent of GDP in 1998 to 15,7 percent of GDP in 1999. The rest of Central Government institutions primary balance, also declined from 0,4 to 0,1 percent of GDP, mainly due to the increase in the Health Security Institution (EsSalud) expenses and the bonuses paid by the National Pension Savings Fund (Fonahpu).

1. Central Government

Central Government Revenues

Central Government current revenues amounted to 14,5 percent of GDP, a reduction of 1,2 percentage points from the previous year, as a result of the contraction in domestic demand —which affected income, value-added, excise and import tax collections negatively— and the increase in tax refunds.

The National Tax Superintendency (Sunat) continued improving efficiency of tax administration with the aim of increasing tax compliance. Sunat launched the Telematic Declaration Program, which allows contributors to register and pay taxes through magnetic means.

Income Tax

Income tax collections reached 2,9 percent of GDP, down 16,4 percent in real terms from the previous year. This reduction was due to the corporate tax, which decreased from 2,1 to 1,6 percent of GDP, as a result of the application of tax credits from previous fiscal years, sluggish economic activity and the Extraordinary Net Worth Tax rate cut. On the other hand, tax collections from personal income were 1,1 percent of GDP, similar to the previous year.

TABLE 24
CENTRAL GOVERNMENT OPERATIONS
(Percentage of GDP)

	1997	1998	1999
SAVINGS IN CURRENT ACCOUNT	2,7	2,0	0,0
1. Revenue	15,9	15,7	14,5
2. Expenditures	13,2	13,7	14,5
a. Non-Financial	11,4	11,8	12,4
b. Interest	1,8	1,9	2,1
CAPITAL REVENUES 1/	0,1	0,3	0,3
CAPITAL EXPENDITURES	3,7	3,4	3,4
OVERALL BALANCE	-0,8	-1,0	-3,0
FINANCING	0,8	1,0	3,0
1. External	0,0	0,3	-0,2
a. Disbursements	1,2	1,7	1,5
b. Amortization	1,2	1,4	1,7
2. Privatization	0,9	0,5	0,7
3. Domestic	-0,1	0,2	2,4
Memo:			
PRIMARY BALANCE	0,8	0,6	-1,2

1/ Excluding privatization.

Customs Duties

Revenues from import taxes represented 1,6 percent of GDP, down 0,1 of percentage point from the previous year, as a result of lower imports (18 percent). However, the decrease was partially offset by the average devaluation of the domestic currency (15 percent).

Value-Added Tax (IGV)

Value-added tax collections, which amounted to 6,3 percent of GDP, dropped 0,3 of a percentage point from the previous year —a 3,4 percent reduction in real terms—mainly as a result of the downturn in domestic demand. The new tax benefits applied during the year included the Amazon Development Law, the exoneration of social housing from the value-added tax and the reduction in the rate of the value-added tax on rice.

Excise Taxes (ISC)

Excise tax collections dropped 2,8 percent in real terms, mainly due to the smaller collections of taxes on non-fuel goods such as soft drinks, liquors and vehicles resulting from weak demand.

Fuel tax collections totaled 1,2 percent of GDP, similar to the previous year. The excise tax on fuels had two modifications. The first one (introduced in April) was an average increase of 6 percent, from S/. 0,98 to S/. 1,04 per gallon. In September there was a new increase in the excise tax on fuels, with the exception of the taxes on kerosene and liquefied gas, which were reduced by 10 percent. The average tax on fuels by the end of 1999 was S/. 1,10 per gallon.

TABLE 25
CENTRAL GOVERNMENT REVENUE

	Percentage of GDP			Real % change		% Structure		
	1997	1998	1999	1998	1999	1997	1998	1999
I. TAX REVENUE	**14,1**	**13,8**	**12,6**	**-2,8**	**-7,4**	**88,5**	**87,9**	**86,5**
1. Income Taxes	3,6	3,5	2,9	-4,3	-16,4	22,8	22,3	19,8
-Payment on account	3,3	3,2	2,7	-3,6	-15,2	20,6	20,3	18,3
-Clearing	0,4	0,3	0,2	-11,1	-28,1	2,2	2,0	1,5
2. Import taxes	1,6	1,7	1,6	9,1	-4,8	9,9	11,0	11,1
3. Value-added tax	6,6	6,6	6,3	-0,5	-3,4	41,4	42,1	43,2
4. Excise tax	2,1	2,1	2,0	-5,1	-2,8	13,5	13,1	13,5
-Fuel	1,2	1,2	1,2	-3,4	1,1	7,7	7,6	8,2
-Others	0,9	0,9	0,8	-7,3	-8,2	5,7	5,4	5,3
5. Other tax revenue	1,1	0,9	0,9	-15,9	-2,8	7,0	6,0	6,2
6. Tax refunds	-1,0	-1,0	-1,1	6,7	5,4	-6,0	-6,6	-7,4
II. NON-TAX REVENUE	**1,8**	**1,9**	**2,0**	**2,9**	**5,2**	**11,5**	**12,1**	**13,5**
III. TOTAL CURRENT REVENUE	**15,9**	**15,7**	**14,5**	**-2,1**	**-5,9**	**100,0**	**100,0**	**100,0**

Tax Refunds

Tax refunds amounted to 1,1 percent of GDP, up 0,1 percent of GDP from the previous year. The increase was explained mainly by value-added tax refunds to mining companies.

Central Government Expenditures

In 1999, the Central Government expenditure focused to maintain the targets established in the Budget Law. Notwithstanding the deterioration of fiscal revenues, the low dynamism of domestic demand discarded the application of significant expenditure cuts.

Central Government expenditures reached 17,8 percent of GDP, up 0,7 of a percentage point of GDP from 1998. Non-financial expenditures rose 0,5 percent of GDP to 15,7 percentage points, due to the salary increases granted to public sector active employees and pensioners in April, as well as to increased capital expenditures.

Even though there was a slight expansion of government expenditures to offset the deterioration of domestic demand during the first three quarters of the year, since the last quarter government expenditures —mainly in goods and services— decreased, once domestic demand started to bounce back.

Financial expenditures amounted to 2,1 percent of GDP, up 0,2 of a percentage point from the previous year, reflecting the effect of the rise in the

exchange rate on interest due, even though the amount remained around US$ 1 000 million.

Expenditures on wages and salaries were equivalent to 4,4 percent of GDP, up 0,2 of a percentage point from the previous year. This increase reflected the 16 percent raise granted to civil servants, as well as to public and private sector pensioners.

Goods-and-services expenditures declined 0,1 of a percentage point in 1999, mainly due to a reduction in funds allotted to the Ministry of Defense. This reduction was reflected in lower military equipment imports, in line with the ongoing pacification process.

Capital expenditures were 3,4 percent of GDP, almost the same level as in 1998. Capital expenditures financed by external disbursements amounted to US$ 609 million, up US$ 86 million from the previous year. The main projects were the Road and Highway Rehabilitation and Improvement Program, the improvements in the harbor of Callao, the recovery of agricultural zones damaged by “El Niño” Phenomenon, irrigation programs, land entitlement and the National Program for Hydrographic Basin Management and Soil Preservation, among others.

Also, were financed social assistance programs developed by the Compensation and Social Development Fund (FONCODES), the improvement of primary education, health and basic nourishment, and the San Gabán and Yuncan Hydroelectric Plants.

TABLE 26
CENTRAL GOVERNMENT EXPENDITURE

	Percentage of GDP			Real % change		% Structure		
	1997	1998	1999	1998	1999	1997	1998	1999
I. CURRENT EXPENDITURE	**13,2**	**13,7**	**14,5**	**2,9**	**7,6**	**78,1**	**80,3**	**81,2**
1. Non-financial expenditure	11,4	11,8	12,4	2,7	6,6	67,6	69,3	69,5
Wages	4,1	4,2	4,4	1,7	7,7	24,1	24,5	24,8
Goods and services	3,4	3,6	3,5	5,5	-0,3	20,1	21,1	19,8
Transfers	4,0	4,0	4,4	1,3	11,8	23,4	23,7	24,9
2. Financial expenditure	1,8	1,9	2,1	4,3	13,8	10,5	10,9	11,7
II. CAPITAL EXPENDITURE	**3,7**	**3,4**	**3,4**	**-9,5**	**1,4**	**21,9**	**19,7**	**18,8**
III. TOTAL EXPENDITURE	**16,9**	**17,1**	**17,8**	**0,2**	**6,4**	**100,0**	**100,0**	**100,0**
Note:								
NON-FINANCIAL EXPENDITURE	**15,1**	**15,2**	**15,7**	**-0,3**	**5,5**	**89,5**	**89,1**	**88,3**

BOX 4

LAW OF PRUDENCE AND FISCAL TRANSPARENCY

The Fiscal Responsibility and Transparency Law —enacted on December 27, 1999— is aimed at contributing to economic stability and economic growth through a sound fiscal framework for the medium-term. The Law restricts the fiscal deficit of the consolidated public sector, limits the growth of non-financial expenditures of the General Government and establishes a stabilization fund intended to face current income fluctuations associated with the business cycle. In election years, the Law imposes additional restrictions on both the Consolidated Public Sector deficit and General Government non-financial expenditures.

In order to give transparency and reliability to fiscal management, the Law establishes the publication of a three-year macroeconomic framework containing the fundamental principles of fiscal policy, as well as macroeconomic forecasts for variables such as income and fiscal expenditures, investment and public indebtedness. It also describes the way in which the macroeconomic framework is to be approved and published, so that the government's fiscal policy intentions will be clearly understood by the economic agents.

Quantitative Rules

1. The consolidated public sector deficit will not be greater than 2 percent of GDP in 2000; 1,5 percent in 2001 and 1 percent thereafter.
2. General Government expenditure will grow by no more than 2 percent in real terms.
3. Total Public Sector debt —adjusted by exchange rate variations, issues of new previsional bonds, variations in public sector deposits and debt assumed by the public sector— will increase no more than its deficit.
4. In election years, General Government non-financial expenditure between January and July will not be greater than 60 percent of the total foreseen in the annual budget. The Public Sector deficit for the first semester will not be greater than 50 percent of the deficit anticipated for the year.

Exception rules

1. In cases of national emergency or international crises, the executive branch can request Congress to suspend any of the quantitative rules for one year.
2. If there was evidence that GDP is decreasing or could decrease in real terms in the following period, the fiscal deficit as a percentage of GDP could be allowed to exceed the 1-percent rule, but in no case will be greater than 2 percent.

Fiscal Stabilization Fund

1. The following are resources of the Fiscal Stabilization Fund:
   - Current revenues from ordinary sources exceeding the average of the last three years by 0,3 percent of GDP.
   - 75 percent of privatization revenues, excluding resources earmarked for Fonahpu and liabilities assumed by the state.
   - 50 percent of net revenue from concessions.
2. Accumulated savings will not be greater than 3 percent of GDP and the excess will be destined to the Consolidated Previsional Reserve Fund or to the reduction of public debt.
3. Use of Fund resources will be contingent on an expected decrease in ordinary revenues of more than 0,3 percent of GDP relative to the average of the last three years, adjusted by significant changes in tax policy.

Transparency procedures

1. The Multiannual Macroeconomic Framework includes the Statement of Fiscal Policy Principles, which contains the economic policy guidelines and long-run fiscal objectives. Additionally, the Framework presents the 3-year targets for fiscal policy, as well as macroeconomic forecasts, fiscal revenues and expenditures, investment and public indebtedness. The Central Bank will issue a technical report, which will include an analysis of the compatibility of the Framework with the forecasts for the balance of payments and international reserves and with the monetary policy.
2. The Law establishes the way in which the framework will be approved and published, as well as the Performance Reports, the Responsibility Fulfillment Statement and the Interpretation and Prohibition Procedures, designed to convey to the public the intentions of the government concerning fiscal matters.

2. State-Owned Enterprises

In 1999, the deficit of non-financial state-owned enterprises was S/. 20 million —compared with a deficit of S/. 259 million in 1998— as a result of a better performance by Electroperu (electricity generation), Centromin (mining), Banco de Materiales (housing bank) and Etecen (electricity transmission), but partially compensated by the deterioration of regional electricity companies, Sedapal (water supply), Corpac (ports and airports) and Petroperu (oil).

3. Privatization

In 1999 more than 20 privatizations were completed, generating direct income of US$ 300 million, and investment projects commitments by US$ 324 million. The main privatization operations include the sale of the government share in Telefonica del Peru, Egenor, Edegel and Luz del Sur, the sale of the mining company Paragsha, the sale of lands in special projects such as Chavimochic, Chinecas, Jequetepeque-Zaña, as well as the concessions of the port of

Matarani, Enafer (railway system) and the electrical transmission line in the south of the country. The sale of government shares reached US$ 213 million, approximately 70 percent of the value of total 1999 sales.

The remaining government share in Telefónica del Peru (2,7 percent) was sold at the New York Stock Exchange for US$ 88 million. Buyers were institutional investors, basically mutual funds.

In the electricity sector, the American company Duke Energy International paid US$ 60 million —thus obtaining 90 percent of the company's equity— for the acquisition of the government's share in Egenor (30 percent). Additionally, the government sold its remaining stock in Luz del Sur (3,2 percent) for US$ 10 million. Twelve percent of Edegel's equity was sold in two parts (April and November) for US$ 55 million.

TABLE 27
PRIVATIZATIONS: 1999
(Millions of US$)

Privatization	Date	Buyer	Value	Investment
1. Reinforcement of Sistemas Electricos del Sur	Jan 29	Red Eléctrica de España	-.-	74,5
2. Luz del Sur Assets (3,2%)	Feb 2	Several	10,1	-.-
3. Lands of Chira-Piura (16 Has.)	Mar 18	Sindicato Energetico S.A.	0,0	0,0
4. Lands of Chavimochic (260 Has.)	Mar 30	Several	0,2	0,3
5. EDEGEL Assets (7%)	Apr 29	Several	30,9	-.-
6. Paragsha mining company (Centromin)	May 28	Volcan Mining Company S.A.	61,8	70,0
7. Concession of Port of Matarani	May 31	Empresa Terminal del Sur S.A.	10,9	7,8
8. Dairy plant of Tacna	Jun 15	Oscar Valdes Dancuart	0,2	-.-
9. Erial lands (407 Has.)	Jul 8	Several	0,2	0,2
10. Concession of the railway system	Jul 19	Ferrocarriles del Peru Consortium	-.-	157,0
11. Telefonica Assets (2,7%)	Jul 21	Several	88,4	-.-
12. Lands of Chinecas (3 100 Has.)	Jul 22	Picasso Candamo-Inv. Solimana S.A. Group	2,2	3,1
13. Lands of Chavimochic (1 100 Has.)	Aug 12	Several	0,7	1,1
14. EGENOR Assets (30%)	Oct 7	Duke Energy International	60,0	-.-
15. Lands of Jequetepeque-Zaña (5 700 Has.)	Nov 10	Cerro Colorado S.A.C. Consortium	2,3	8,0
16. EDEGEL Assets (5,4%)	Nov 23	Several	24,0	-.-
17. Lands of Majes-Siguas (1 100 Has.)	Nov 23	Los Pacaisitos – Asoc. Agricola Guardia Civil	2,9	1,1
18. Lands of Chira-Piura (118 Has.)	Nov 26	Several	0,1	0,1
19. Fundo Tournavista	Dec 10	Emp. Distrib.-Comercializadora Celia S.A.	2,3	0,4
20. Various assets			3,1	-.-
TOTAL			**300,2**	**323,6**

Source : Commission to Promote Private Investment (COPRI).

The state mining company Paragsha (producer of zinc, lead and silver), was sold for US$ 62 million. Volcan Mining Company S.A. acquired 100 percent of Paragsha and assumed an investment commitment of US$ 70 million, to be completed during the next 5 years.

Twelve thousand hectares of agricultural land were sold for an approximate value of US$ 9 million. Most of these lands corresponded to special projects such as Jequetepeque-Zaña (5,7 thousand Has.) and Chinecas (3,1 thousand Has.), among others.

Concerning concessions, the most important one was the 30-year concession of the Port of Matarani formerly administered and operated by Enapu S.A. The winning company, International South Terminal S.A. made an initial payment of US$ 9 million and pledged to invest US$ 8 million over the first five years. It is important to indicate that the government will receive 5 percent of gross revenues annually.

In July the Railway System of Enafer S.A was granted in concession for 30 years. It comprises the Center (590 Km.), South (854 Km.) and East South (134 Km.) routes, which were awarded to Ferrocarriles del Peru Consortium, formed by eight national and foreign companies. Thirty-three percent of gross income from the concession will accrue annually to the government. The consortium has committed to rehabilitate, maintain and modernize the railroad and the equipment in order to meet international standards in approximately 5 years. The estimated investment will amount approximately to US$ 157 million.

In January, the design, construction and operation of 444 Kms. of electrical transmission lines in the south of the country was granted in concession for 32 years to Red Electrica de España S.A., which proposed the lowest construction cost (US$ 75 million). This project, along with the Transmision Line Mantaro-Socabaya, will lead to the country's electric interconnection.

TABLE 28
NET PRIVATIZATION RECEIPTS
(Millions of US$)

Company	Amount
Telefonica Assets (2,7%)	85,5
EGENOR Assets (30%)	57,1
EDEGEL Assets (12,4%)	53,0
Refinery of Cajamarquilla 1/	41,6
Paragsha Mining Company (Centromin)	37,0
Sider Peru 2/	11,7
Petromar 2/	10,0
Luz del Sur Assets (3,2%)	9,8
Concession of the Port of Matarani	9,4
Banco Continental assets 2/	3,3
Other (installments and others sales)	70,1
TOTAL	**388,4**

1/ Includes installment payment and debt cancellation.
2/ Installment payments from previous privatizations.
Source : COPRI.

During 1999, revenue accruing to the government —after procedure costs— amount to US$ 388 million, of which US$ 260 million correspond to sales made in 1999 and US$ 128 million to the payment of installments from previous privatizations.