Multiannual Macroeconomic Framework 2002-2004

1. Introduction

The Peruvian population —which counts over 26 million people— requires minimum arrangements to ensure both social coherence and integral development. An adequate attitude from society as a whole —reflected in consistent policies— would generate over the medium term a balanced environment that would favor human development. On the contrary, a negative or passive attitude regarding the elements needed for development would lead to social fragmentation and increasing violence, poverty and social alienation. This in turn would render unfeasible the democratic system.

The challenge facing the Peruvian society is enormous. The transition period ahead will require painful choices, given the scarcity of public resources and the presence of institutional and organizational limitations. On the one hand, family consumption depends on the sustainability of investment and savings over several decades; on the other hand, requirements for the fulfillment of the state's basic functions double the available resources. Therefore, Peru should try to establish a strategy for integral development despite its ethnic and cultural heterogeneity. The use of various means to communicate and share ideas would lead to mutual cooperation —whatever the composition of forces in society and government may be— and would:

A) Create adequate employment opportunities for all citizens. The generation of adequate saving and investment depends mainly on the private sector. This requires cooperation from society as a whole, particularly from the public sector. The public sector —which plays a subsidiary role in economic life— must maintain macroeconomic equilibrium and adequate social conditions, and make the infrastructure investments needed to ensure competitiveness. Additionally, the public sector must allocate resources for additional social investment in depressed areas in order to generate the conditions for sustainable development in every province. Transference of capital intended to foster economic participation must be consistent with local conditions.

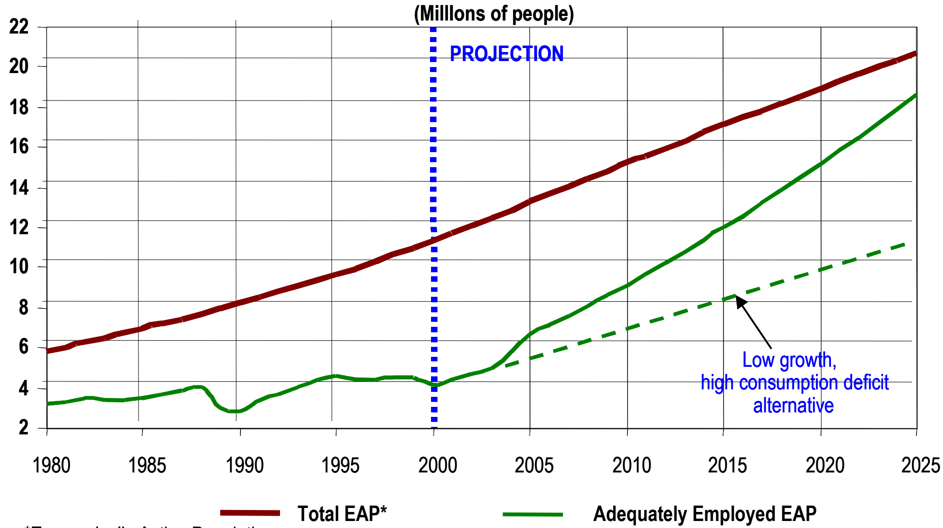
There are no immediate solutions, as can be inferred from the long-run trends in adequately employed population (Chart 1). Only a sustainable process of integral development and a substantial increase in private investment —resulting from promotion policies, greater confidence and domestic stability— can permanently reduce the current employment deficit.

B) Develop efficiency and austerity in public sector performance by means of a reformed organizational structure based on clearly established competencies and responsibilities at the national and sub-national levels; a new approach to public sector careers; and the implementation of contractual management strategies focused on the state's core functions (foreign defense, human rights protection, and general welfare promotion based on justice and integral development). Probity, proper programming and transparent evaluation practices should guide the actions of a reformed public sector.

Chart 1

ADEQUATELY EMPLOYED POPULATION: TRENDS THROUGH 2025

(Milllons of people)



*Economically Active Population
Source: INEI and MEF

C) Promote equality of opportunities for all, mainly through permanent access to adequate education, health, justice and prevention services for high-risk groups. Foremost importance is given to the preservation of human resource potential —especially in the population below three years of age— and to prevention in all areas.

D) Allocate adequately all other available resources —according to simple, clear and explicit priority criteria— in order to promote local development, strengthen the social fabric, and create institutional capabilities in every province.

A change of mentality towards healthier and more productive lifestyles; the adequacy of the state; and the availability of minimum material resources for the realization of human potential, are necessary conditions to maintain and consolidate social integration, which is essential for medium-term development. In order to advance towards integral development, a full comprehension of social realities is essential.

The Multiannual Macroeconomic Framework (MMF) for 2002-2004 is hereby presented in compliance with the Fiscal Responsibility and Transparency Law (Law No. 27245) and its statute (Supreme Decree 039-2000-EF). The MMF —to be detailed in the following pages— is consistent with the Economic Program and the Declaration of Fiscal Policy Principles, which in turn follow the basic features of government policy for the medium and long term.

This framework contains a set of economic policies related mainly to macroeconomic stability, institutional consolidation, transparency of public actions, promotion of private investment and rationalization of government expenditure, all of which are essential to achieve an average annual growth rate around 5-6 percent and to guarantee that the most needed population will be provided with basic social services. Since private investment and adequate employment are necessary for social equilibrium, a medium-term approach is adopted in the following section to analyze the use of public resources.

In order to prevent damages in the population's basic capabilities, the government must effectively ensure nutritional damage control in high-risk groups. This would require approximately US$ 200 million per year, as well as basic health services and primary education amounting to US$ 520 million and US$ 1 700 million per year, respectively. Without this minimum social protection, it will not be possible to attain a sustained increase in human capabilities and productivity, which are essential for economic growth. Additionally, maintenance and operation of the basic economic infrastructure needed for production support requires a minimum US$ 200 million per year.

Public resources considered in the MMF ensure adequate provision of these services, except for primary school, which is a central element in the long-term development process. Given that the current level of public expenditure in primary education is US$ 500 million per year, an enormous social effort will be required to achieve this objective.

Even though it has been estimated that the resources needed for central and local government activities and projects until 2006 exceed US$ 12 billion per year, only half the amount is available. The current deterioration in the provision of services is not only the result of decreasing resources, but also of inadequate expenditure priorization and institutional management weaknesses.

The MMF respects the limits imposed by current regulations. In the following weeks it will be necessary to design detailed policies to introduce substantial changes in various aspects of national life. Such proposals would enable the newly elected government to maintain macroeconomic equilibria and improve living conditions.

It is necessary to display a greater social effort. A profound change of attitude would allow the economy to grow at rates above 6-7 percent on average, and thus to generate the resources the government needs to fulfill the social duties described above. Such growth pace would translate immediately into better living conditions and a lower consumption deficit. However, in order to achieve this, it is necessary to ensure sustainability of growth and to implement a structural reform program geared to modify current development trends.

Indeed, growing steadily is as important as growing at higher rates, since sharp and temporary contraction periods (Chart 3) have negative permanent effects on potential capabilities —especially in the less-favored segments of the population. Sustainability relies on the availability of resources needed to fund healthy and accelerated growth, which in turn depends on higher domestic and foreign saving. Therefore, it is necessary to link the government's investment policy with a responsible and aggressive strategy regarding privatizations and concession contracts, as well as public actions in general with development plans and concertation initiatives at the provincial level. The scarcity of fiscal resources in the coming years implies that the private sector will be responsible for the provision of public goods and services —in particular major economic infrastructure—, with the state playing an efficient and transparent subsidiary role.

Sustained development necessarily implies national, regional and local public actions geared to support development plans at the provincial level and open to development initiatives executed under local coordination. Such approach must become the backbone of a new long-run development strategy. The identification of needs, resources, markets and economic flows at the provincial level are therefore an urgent task.

Thus, it is necessary that transitory regional administration councils coordinate development programs with local governments and the rest of the province-level social fabric, in order to stimulate local conditions for development. Additionally, a joint effort at the provincial and national levels is suggested as a means to integrate output and services generated in frontier and less-developed zones into the domestic and international markets. It is also necessary to strengthen the institutional framework for frontier and international relations, as a means to encourage the development of business and investment opportunities in these zones and reduce the adverse effects of international shocks.

Additionally, the less favorable international scenario expected in the coming years makes it necessary to implement a reform strategy aimed at modifying the economic and social structure in a way consistent with globalization and generating an internationally competitive productive sector. The resulting capital accumulation process would expand the production frontier and increase consumption possibilities.

This implies the attainment of investment levels around 30 percent of GDP at the end of the decade, as well as a continuous improvement of the population's capabilities. The latter depends on the provision of adequate social services such as nutrition, health, education, justice, housing and the efficient allocation of the public resources needed for this end, which is estimated at around 10 percent of GDP.

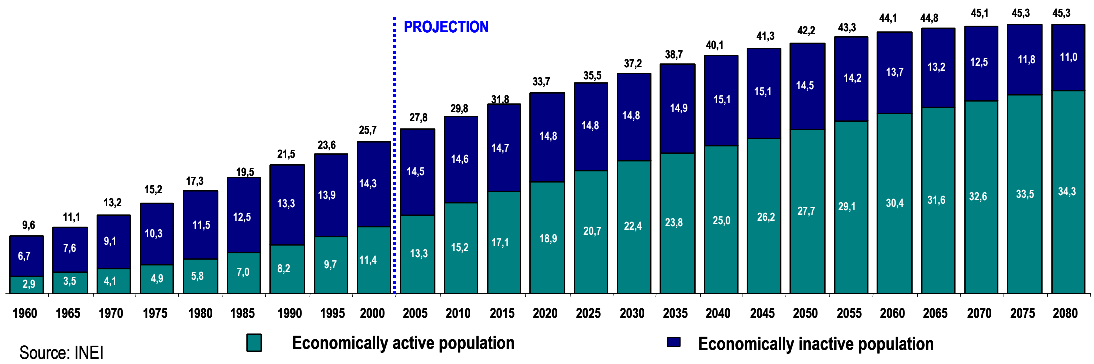
In operative terms, this scenario will not be possible unless basic political agreements are celebrated to develop a deep and comprehensive fiscal reform that would generate the resources the government needs to fulfill the subsidiary role it must play in a social market economy. It would also be necessary to advance effectively towards the decentralization of the provision of basic social services at the provincial level; transform public administration by means of performance evaluation and active participation of the civil society in public expenditure control; and rationalize and modernize the armed forces and the police force.

Considering that the government elected in June will be sworn in on July 28, it was deemed appropriate to sketch future actions according to the current legislation in order to start policy discussion during the current transition regime. The new strategies should be aimed at a thorough structural reform process that would allow high and sustained growth and eliminate the consumption deficit of extreme poverty population by the end of the decade.

2. General medium- and long-term trends

The economically active population (EAP) grows at significant rates, and will reach 18,9 million (56 percent of total population) in 2020. Unless a significant increase in the rate of job creation occurs, it will be extremely difficult to revert the current employment deficit —over 5 million adequate jobs. This is reflected in the 13,9 million people below the poverty line, of which 3,8 million live in extreme poverty.

Chart 2
TOTAL AND ECONOMICALLY ACTIVE POPULATION: TRENDS THROUGH 2080
(Millions of people)

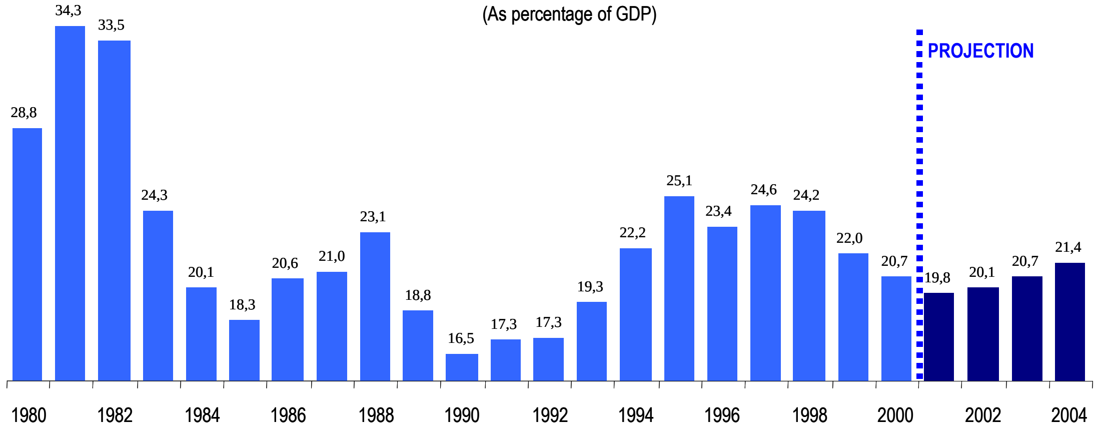


Source: INEI

Poverty, alienation and inequality are incompatible with justice and democracy. The search of equality and effective protection for all —especially the less favored segments of population and all groups exposed to risk— must be a permanent principle of action for both society and government.

It is necessary to realize that public and private investment, both domestic and foreign —-which currently represent 20 percent of GDP—, is not enough to absorb the population that enters the labor force every year.

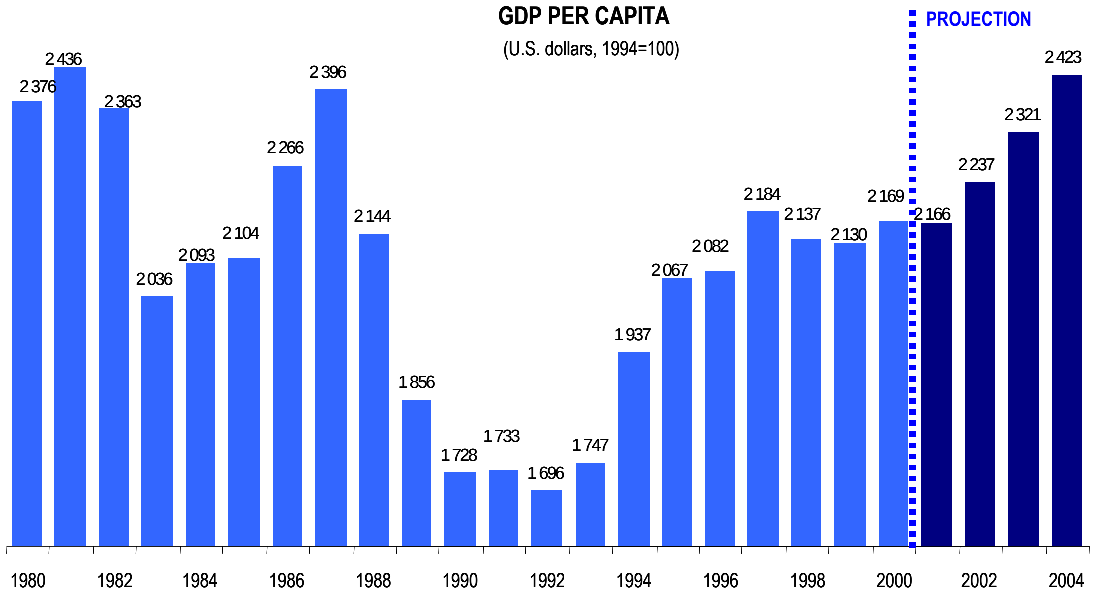
Chart 3
INVESTMENT
(As percentage of GDP)



Source: INEI, BCRP and MEF

Investment must grow to levels around 30 percent of GDP in order to allow the economy to expand its production possibility frontier and grow steadily at rates over 6 percent per year. This would increase GDP per capita —currently below early-eighties levels—, eliminate the current deficit of adequate employment and generate 300 thousand new jobs every year to absorb EAP growth.

Chart 4
GDP PER CAPITA
(U.S. dollars, 1994=100)



Source: INEI, BCRP and MEF

The improvement in the main social indicators —such as life expectancy, literacy and child mortality— has been insufficient compared to Latin American averages. The purchasing power of persons and families has deteriorated, life quality is poor and new forms of delinquency have appeared. Persisting problems related with health, education, housing, underemployment and unemployment, security and violence need to be addressed.

Fifteen percent of the population is unable to consume a US$ 1-a day per capita basket; that is, the consumption deficit amounts to US$ 238 million per year. Furthermore, a basic US$ 2-a-day per capita basket is beyond reach of half of the population, which implies a consumption deficit around US$ 2 645 million per year. The attainment of a basic consumption level should be regarded as a short-term or emergency policy. However, medium-term standards —US$ 3,2 dollars a day per capita— imply that the deficit to be covered amounts to US$ 13 billion per year.

In order to become a regional leader in the medium and long term, Peru must develop sound democratic practices, achieve steady growth with equity, promote human development and preserve the environment and the cultural heritage. An internationally competitive private sector —supported by a modern and efficient public sector— must become the engine of development. All citizens should have access to adequate nutrition, health, education, justice and housing services that would enable them to develop their capabilities and lead healthy, creative, free and productive lives. Public policy must be primarily oriented towards human development, and therefore economic policy must be consistent with social policies geared to build an effective social protection network. An integral approach to development implies that the achievement of medium- and long-term equilibria must consider the availability of resources and productive capabilities, family welfare, environmental care, consumption needs, human and physical capital accumulation requirements, social security and consumer protection, among other aspects.

On the one hand, short-term policies must stimulate aggregate demand and drive GDP growth rates to potential levels. On the other hand, medium- and long-term policies should seek to attract domestic and foreign capital, improve labor force qualification and enhance natural-resource profitability through the implementation of wide-ranging second-generation structural reforms. These polices would be aimed at surmounting the current recessive phase, which started in 1998. By significantly increasing factor productivity, such policies would enhance competitiveness and therefore favor integration into the world economy.

The productive sector should acquire an adequate scale, become technologically robust, and use regionally available resources. It is necessary to promote development strategies that focus on the province as sociopolitical reference unit and allow adequate articulation with larger units such as departments and macro-regions. The transition government has adopted measures to strengthen the autonomy and powers of local governments, formed multi-sector groups and promoted concertation committees involving private sector organizations, the civil society, cooperation agencies and the public sector. These policies are intended to build consensus and solve conflicts based on mutual tolerance and respect for cultural diversity and minorities.

Indeed, the efforts to be displayed will be progressive and complex, and therefore it must be acknowledged that the current unsatisfied needs will persist, but with a decreasing trend. Moreover, the international environment will not be as favorable as in the last decade. In 1993-1998, foreign investments amounting to US$ 16,1 billion, coupled with first-generation structural reforms, led to significant output growth.

Growth requires modern, consistent and responsible policies regarding privatizations and concession contracts. Private sector participation allows greater management efficiency, provides a stable flow of investments, ensures reinvestment in infrastructure and leads to better results concerning service quality, transference of technology and employment in industry and related-service companies. Therefore, public investment must be complemented by a comprehensive and efficient concession program, which would allow the state to retain its assets while simultaneously promoting investment and increasing the provision of essential services. Additionally, the legal and institutional framework must be strengthened through the enactment of efficient regulations and the development of public sector organizations able to withstand the effect of economic cycles and successfully combat corruption. Such institutional safeguards would effectively resist political pressure and provide stability, continuity and governance.

In compliance with these guidelines, the transition government has respected the autonomy of the Central Reserve Bank (BCRP), strengthened the autonomy of regulatory and supervisory organizations, enhanced the technical capabilities of public organizations such as the Ministry of Economy and Finance (MEF), and facilitated the coordination among ministries through the CIAEF-CIAS information system.

In order to face the challenges described above, the state must promote comprehensive development at the provincial level, efficiently provide public goods and services —especially in the social area—, make transparent and neutral use of public resources, and effectively play a subsidiary role in resource allocation.

This scenario requires regulations concerning fiscal prudence and transparency and access to information about public finances, as well as respect for the regulations concerning corruption, transparency, political neutrality and proper use of resources that the transition government has promoted. Priority should be given to policies geared to reduce the consumption deficit —particularly in families in danger of losing their human potential— through nutrition, health, education, justice, housing, public security and additional social investment in less-developed zones.

In order to ensure an adequate distribution of public resources according to the guidelines and priorities stated above, any additional funding will be used to improve management, quality and scope in the provision of goods and services in the following twelve Fiscal Budget functional programs: collective and individual health, initial, primary and secondary education, justice, sanitation, internal order, social promotion and assistance, agriculture promotion, land transportation and energy.

3. Economic Program and Fiscal Policy Principles

The economic program is aimed at achieving high and sustained economic growth in the medium and long term —with low inflation rates and a level of foreign reserves that would ensure external sustainability—, promoting investment and creating private sector jobs. These objectives would contribute to progressively reducing the consumption deficit and improving living standards in a sustained way.

Reaching this goal requires a prudential fiscal policy that would allow the private sector to become the engine of growth through investment. Fiscal policy must not crowd out the private sector nor contribute to current account deterioration. In this way, private sector investment and savings decisions would have a wider scope, the debt burden on future generations would decrease, and domestic and foreign investor confidence would improve.

Tax policy must be guided by fiscal prudence, as well as by the principles of neutrality, simplicity and equality. The tax structure should be based on three kinds of taxes: a value added tax —applied generally on all production stages—; the income tax —which should be equally levied on persons and companies with no exemptions; excise taxes —complementary to the value added tax, and levied on health and environmental criteria.

Public expenditure policies —subject to performance assessment— must be aimed at increasing social expenditure, reducing public debt and alleviating the tax burden on the private sector. Moreover, the government would promote transparent programming and evaluation, in which public expenditure would be subject to public scrutiny.

The government will seek to improve the efficiency of social programs and increase the productivity of public resources. Public policy must focus on protection of high-risk families, especially children under the age of five —with emphasis on children under the age of three—, pregnant mothers, breast-fed children, and persons affected by tuberculosis and other contagious diseases; and provision of basic health attention —essentially preventive—, pre-school and primary education —with emphasis on the articulation of the initial and primary levels—, basic justice —intended to enforce fundamental rights and ensure access to conflict prevention and solution mechanisms—,housing, safe water and public security. Additionally, development would be enhanced through social investment in roads, highway maintenance, small irrigation systems, sanitation, agriculture promotion and electricity, particularly in depressed zones.

It follows that ministries in charge of social matters must unify criteria and programs to combat poverty, and that social policy must consider people's capabilities and cultural wealth, not only their lack of material means. Its execution must contribute to emphasize the independence, responsibility and autonomy of social organizations and individuals.

Economic policy will aim at supporting stability, which is essential to achieve economic growth with equity. This in turn would allow expansion of the population's capabilities, greater social welfare and governance. Economic stability leads to lower perceived country risk and therefore to decreasing domestic interest rates —which reflect money market conditions and financial risk—, thus creating favorable conditions for investment and employment.

The floating exchange rate system will continue to allow adjustment of the real exchange rate to changes in economic fundamentals, thus smoothing the effects of temporary external shocks and contributing to balance of payments viability. Public investment will be oriented towards increasing production-support infrastructure and maintaining current infrastructure, in order to diminish costs and promote efficiency, productivity, competitiveness and job-creation. Such policies would allow the economy to further benefit from integration into international markets.

Trade policy will continue to be aimed at gaining access to international markets, which would promote competitiveness and efficiency in the economy. Adequate and transparent regulations would encourage better market functioning, prevent discriminatory actions, and promote the privatization and concession process. The MMF considers a tariff reduction —consistent with integration agreements— oriented towards improving competitiveness.

4. General Situation and Perspectives

4.1 Economic situation in 2000

The year 2000 was rife with difficulties and exceptional and complex changes. However, GDP grew 3,6 percent, which was explained by 5,7 and 3,1 percent growth rates in the primary and non-primary sectors, respectively. The rate of growth of aggregate GDP decreased consistently over the period due to the expansion of public expenditure in the first half of the year and a subsequent contraction in the second half of the year, and to the behavior of private investment.

Employment in the year 2000 did not show the same behavior as GDP. According to information provided by the Ministry of Labor and Social Promotion, employment in firms with ten or more workers decreased 2,6 percent on the national level and 2,5 percent in Metropolitan Lima. Employment in firms with more than 100 workers in Metropolitan Lima also declined 0,6 percent over the year.

The 3,7-percent increase in consumer prices was similar to the one registered in 1999. This variation was due mainly to a rise in fuel prices, which was partially offset by a decrease in the rate of depreciation and in the prices of agricultural products.

Banks showed a cautious lending policy, and access to international credit remained difficult. Interest rates declined, with the exception of the interbank rate in foreign currency. However, despite de reduction of real interest rates —which led to a reduction of the private sector's debt burden—, the rate of non-performing loans to total credit grew further to 10,2 as of end-2000.

The Consolidated Public Sector deficit reached 3,1 percent of GDP in 2000. Central Government non-financial public expenditures grew 0,8 percent in real terms. After growing 14,9 percent in real terms in the first half relative to the same period of the previous year, non-financial expenditures were substantially reduced in the second half, in order to avoid further deterioration of fiscal accounts. Central Government tax revenues diminished 0,2 percent in real terms over the year, reflecting weakening economic conditions in the non-primary sector.

As of end-2000, the BCRP's net international reserves (NIR) reached $8 180 million, $ 224 million lower than the balance at the end of 1999. The loss is smaller than in 1999, due mainly to a lower current account deficit and higher capital inflows.

The current account deficit decreased from 3,7 percent of GDP in 1999 to 3,0 percent of GDP in 2000. The reduction was explained mainly by a lower trade balance deficit, which decreased from 1,2 percent of GDP in 1999 to 0,6 percent in 2000, and was associated with a higher pace of growth of exports over imports.

Concerning social aspects, the share of the population living in poverty —54-percent, roughly the same as in the early 1990s— and is focused basically in the rural area.

4.2 Perspectives for 2001

The international environment in 2001 seems less favorable than in 2000. According to the IMF, the world economy will grow 3,4 percent in 2001 —a lower rate that the one forecasted in December 2000— as a consequence of the slowdown of the U.S. economy, which would reach a modest 1,5 percent. Latin America would grow around 3,8 percent in 2001, and inflation would be 5-6 percent in the region.

Developments in the domestic economy reflect uncertainty about private spending —stemming from last year's political events— and a private investment reversal associated with the electoral period.

In supply-determined sectors such as agriculture and fisheries, lower-than-expected growth would be due to a decrease in cultivated land. Floods affecting 9,3 percent of the country's cultivated area caused a 1,8 percent land loss in August 2000-March 2001. The slight increase in fisheries is due to a high extraction volume of anchovy since December 1999. In contrast, mining growth would be substantial in 2001 due to the beginning of operations of the Antamina project in the second half of the year.

In March, aggregate GDP fell for the fourth consecutive month, which led to a 2,6 fall in the first quarter. The Peruvian economy is expected to grow 1,5 percent in 2001, which implies a rate of growth of 4-5 percent in the second half of the year.

Additionally, inflation is expected to remain around an annual rate of 3,0 percent, the current account deficit would be approximately 2,6 as a percentage of GDP, and the BCRP's NIR accumulation would reach $215 million, as a result of a recovery in foreign investment since the second half of the year and higher public foreign indebtedness.

In 2001, exports would rise 8,0 percent —which is below the rate of growth initially expected— due to the slowdown of the U.S. economy, the overproduction of coffee in the region and the strengthening of the dollar relative to other currencies, the latter leading to a weaker demand for gold and silver. Expected import growth in 2001 —3,3 percent— would be driven by capital imports associated with the Antamina project, among other factors. The trade balance is expected to reach equilibrium in 2001.

During fiscal year 2001, the Consolidated Public Sector's net financing would be equivalent to 1,5 percent of GDP. The lower deficit relative to the one registered in 2000 is associated with the decrease in the General Government and the Rest of Public Sector deficits (1,9 and 0,3 percent of GDP, respectively). General Government expenditure would decrease 1,5 percentage points of GDP, to 16,8 percent of GDP in 2001, while revenues would fall 0,8 percentage points of GDP, to 15,0 percent of GDP, despite the expected increase in tax revenues (0,3 percentage points of GDP) to 12,3 percent of GDP. The decrease in General Government revenues would be associated with a fall in non-tax revenues, associated with lower transfers from state-run firms' profits to the Treasury, and to a lesser extent with lower capital revenues.

The 2001 fiscal deficit would be financed with foreign resources equivalent to 1,1 percent of GDP and domestic resources —including revenues from privatization— equivalent to 0,5 percent of GDP. Disbursements from multilateral organizations and other cooperation sources would amount to $1 349 million in 2001. This amount includes $499 million earmarked for investment projects and freely disposable disbursements equivalent to $850 million.

Finally, it should be noted that during the rest of 2001, special attention would be given to the quality of public investment and the transference of capital to frontier and less-developed zones through development programs. By means of adequate allocation, monitoring and evaluation mechanisms, the initial fall in public expenditure —due to the complex process of administrative transition that took place during the first quarter— will be reverted.

4.3 Macroeconomic Scenario 2002-2004

The policies laid out in this framework, together with the prudent monetary policy to be applied by the Central Reserve Bank in 2002-2004, will allow expected growth over this period to be driven by the expansion of the private sector and exports. These results assume a normal environment with no negative external or domestic events. The implementation of prudent economic policies and reforms would contribute to strengthening the financial system and gradually reducing the country risk. It should be stressed that growth levels would be higher if society as a whole commits to the efforts described in the introduction of this framework.

In 2002-2004, annual average inflation would be within a 2,0-2,7 percent range, and a NIR accumulation of approximately $1 290 is expected. Thus, NIR would reach $9 685 million —equivalent to approximately 12 months of imports— as of end-2004. This would contribute to strengthening the country's external position and reducing vulnerability to adverse foreign shocks. The greater part of the current account deficit would be covered with long-term private capitals.

The expected average annual GDP growth rate of approximately 5,5 percent —associated with the economic recovery that would take place since the third quarter of 2001— would be driven by average annual growth rates of 10,5 and 8,1 percent for investment and exports, respectively. Private investment growth would be reflected in its ratio to GDP, which would grow from 16,3 percent in 2001 to 18,2 percent in 2004. Additionally, the rise in private consumption —around 5,3 percent per year— would lead to a 3,6-percent average increase in per capita consumption.

Table 1
MAIN MACROECONOMICS INDICATORS

	1999	2000	2001	2002	2003	2004
Population (thousands of people)	25 232	26 552	26 090	26 521	26 951	27 379
Consumption deficit						
Food	277	238	237	190	160	134
Basic	2 811	2 645	2 662	2 281	2 011	1 753
Gross Domestic Product						
Billions of nuevos soles	176	188	197	211	228	246
Annual percent variation	1,4	3,6	1,5	5,0	5,5	6,0
Investment (percentages of GDP)	22,0	20,7	19,8	20,1	20,7	21,4
Public	4,8	3,9	3,5	3,3	3,3	3,2
Private	17,2	16,8	16,3	16,8	17,4	18,2
Exchange Rate						
Annual average	3,38	3,49	3,58	3,66	3,68	3,70
End of period	3,51	3,53	3,63	3,67	3,69	3,71
Consumer Price Index						
Average (annual percent changes)	3,5	3,8	3,0	2,7	2,0	2,0
End of period (annual percent change)	3,7	3,7	3,0	2,0	2,0	2,0
Public Sector Deficit/Surplus						
Overall Public Sector	-3,0	-3,2	-1,5	-1,0	-0,8	-0,7
General Government	-3,1	-2,5	-1,9	-1,2	-0,9	-0,7
Global Demand and Supply (real percent changes)	-1,6	3,6	2,3	5,3	5,9	6,2
Domestic Demand	-2,6	2,9	1,1	4,6	5,7	5,8
Private consumption	-0,2	4,1	3,0	5,0	5,4	5,4
Public consumption	3,6	6,0	-5,9	-1,0	1,0	1,0
Fixed gross domestic investment	-11,9	-4,7	-2,0	8,1	9,1	10,6
Private	-16,3	-1,6	-0,1	9,7	10,0	11,8
Public	7,2	-15,4	-9,4	0,8	4,9	4,6
Exports of goods/services	5,4	8,0	9,5	9,4	6,7	8,1
Imports of goods/services	-17,1	3,6	7,1	7,4	8,2	7,2
External Sector (Millions of U.S. dollars)						
Exports of goods/services	6 119	7 028	7 594	8 444	9 271	10 289
Imports of goods/services	6 749	7 349	7 594	8 201	8 995	9 779
Current Account Balance (percentages of GDP)	-3,7	-3,0	-2,6	-2,8	-2,8	-2,9
BCRP net international reserve flow	-775,0	-190,0	215,0	820,0	350,0	120,0

Sources: INEI, BCRP and MEF

All economic sectors are expected to grow. Primary sector output would increase 6,6 percent, while the non-primary sector would expand by 5,2 percent on average in this period.

The expected growth of the agriculture and livestock sector —4,7 percent per year— would be driven by agriculture —5,4 percent per year—, which would reflect a modernization process involving an increase in private investment and crop diversification. Livestock output would expand 3,8 percent on average due to higher cattle, poultry and milk output. An adequate regulatory framework would allow productive units to operate efficiently and benefit from technical assistance provided by the public sector, as well as from access to private-sector financing and to new markets for agricultural export products.

Table 2
GROSS DOMESTIC PRODUCT
(Percent variations in real terms)

	1999	2000	2001	2002	2003	2004
Agriculture and Livestock	12,0	6,4	1,5	4,2	5,0	5,0
Fishing	28,9	8,1	2,2	2,3	3,5	3,0
Mining and fuels	11,8	2,4	10,1	12,5	7,6	12,1
Manufacturing	0,3	6,5	0,3	5,8	6,0	6,0
Construction	-10,8	-4,5	-4,7	6,5	7,5	9,0
Commerce	-1,6	5,3	1,3	4,4	5,9	5,6
Other Services	1,2	2,8	1,6	4,0	4,8	5,2
GDP	1,4	3,6	1,5	5,0	5,5	6,0

Source: MEF

Policies must enable agriculture to become modern and competitive. The state would provide adequate public infrastructure, encourage private sector leadership and stimulate competitive insertion into the international trade. Therefore, it is necessary:

- To introduce regulations to induce efficient and sustainable exploitation of natural resources —such as land, water and woods—, accelerate the land titling process, promote forest concession contracts and encourage development of a water market.

- To favor financing and insurance mechanisms through medium- and long-term credit provided by commercial banks, as well as through organizations specialized in small and medium farmers and municipal savings banks.

- To develop a technology-generation system integrated with international research networks, which would allow technology dissemination and competitive insertion into foreign markets. Additionally, an adequate productive and commercial information system would allow better crop scheduling, identification of agricultural products with export potential, and use of information concerning prices, market seasonality, consumption trends and presentation requirements.

Fisheries would grow 2,9 percent per year, due to greater catches of fish for direct human consumption (4,6 percent on average) and a slight increase in industrial fisheries (0,9 percent on average). The latter would reflect the fact that anchovy catches would remain at levels similar to those registered in 2000. Efficient and sustainable exploitation requires policies geared to prevent over-investment and promote accelerated development of marine cultivation.

In order to stimulate private-sector output growth, promote diversification of hydro-biological resources, encourage generation of greater value added and induce preservation of the marine biomass and the ecosystem, it is necessary:

- To promote adequation of the fleet size to legal catch levels and reorientation to higher value added fishing activities.

- To stimulate marine cultivation and other new fishing activities by means of research.

- To reactivate financial support to artisanal fishers and marine cultivation through the National Fishing Development Fund (FONDEPES), in order to enhance the value added of fishing activities.

Average annual growth in the mining and hydrocarbons sectors, which is expected to reach 10,7 percent in 2002-2004, would be based on metallic mining —mainly copper, gold, iron and zinc. The most important projects would be Antamina (copper, zinc and silver), Cerro Lindo (silver, zinc and copper), Tambo Grande (gold and silver), Minas Conga (copper and gold), Quellaveco (copper), Cerro Corona (copper), Huarón (zinc) and the expansion of some of the current copper and zinc operating units (such as Southern and Volcán). In the hydrocarbons sector, the beginning of operations of the Camisea project would allow distribution of gas since 2004.

The consolidation of this sector requires the establishment of:

- A stable legal framework that would provide the most adequate solution of conflicts with farmers concerning land property, and that would favor the award of concession contracts.

- Additionally, it is necessary to encourage exploration of mineral resources and transformation of low-value or raw materials into greater value-added mineral concentrates.

In the energy sector, it is necessary to expand the electric infrastructure towards populated centers with potential for economic and social development. Only direct subsidies —complementary to private investment— should be provided. In order to promote the development of natural gas projects as a potential energetic resource for industry, electricity generation and transportation, the government will:

- Maintain an adequate role in regulation and supervision; stimulate private investment in energy generation, transmission and distribution; and refrain from keeping assets other than those necessary to execute its subsidiary role in medium- and long-run development. The legal framework should be stable, promote efficient tariff formation and encourage competition.

- Accelerate privatizations and concession contracts as a means to stimulate the development of the electricity sector. Increased electricity interconnection would contribute to equalizing demand and supply, aligning tariffs with international levels, improving the quality of hydroelectric and gas thermal generation, and enhancing the reliability of the electric power system.

The manufacturing sector would grow 5,9 percent per year on average in 2002-2004, reflecting non-primary sector growth (6,4 percent). The latter would be due to an increase in aggregate demand —mainly in private consumption—, other productive activities and exports. These developments would be associated with lower labor costs —especially due to a gradual reduction of the Extraordinary Solidarity Tax-IES— and actions oriented towards increasing access to export markets and eliminating under-valuation and dumping. Domestic market growth would be stimulated through public access to information systems and basic infrastructure geared to facilitate market integration consistent with a decentralization process. Manufacturing primary sector growth (4,4 percent) would be explained by an increase in non-iron metal refining activities, fisheries and sugar industries —due to normal climatic conditions— and oil derivatives.

The government must promote the domestic and international competitiveness of industry and tourism, emphasize environmental sustainability and regional development, and facilitate access to international markets. Furthermore, it is necessary:

- To support industrial competitiveness through the development of the Network of Technological Innovation Centers (CITE network).

- To improve information and stimulate technological innovation, especially in small- and medium-size businesses (PYMEs).

- To assure maximum benefit from Peru's participation in integration processes and international trade negotiations.

Construction sector growth —7,7 percent per year on average in 2002-2004— would reflect the expansion of private investment in mining, industry, tourism and commerce; an increase in concession contracts for roads, airports and ports and public services; and self-construction of housing units. The latter would be associated with the growing operations of the *Mivivienda* housing credit program and the *Banco de Materiales* —a government-supported housing bank—, and with the progressive recovery of bank lending through the development of the mortgage secondary market and securitization.

Government actions must promote access to free spaces, and increase investment in equipment and urban infrastructure for social purposes, with the aim of diminishing the housing deficit and reducing building costs. Therefore, it is fundamental:

- To establish a National Urban Development Plan to encourage private investment in housing.

- To create a program oriented towards low-income segments, which would be jointly financed by Mivivienda, local governments, commercial banks and building companies.

Moreover, this sector will benefit from the transportation and communications policy, which will be oriented towards the promotion of a feasible, efficient, safe and competitive transportation system. National, regional and third-level agencies would contract private companies to give maintenance to road networks, and the government would accelerate concession contracts for ports and airports. These policies would assure efficient road maintenance, lower costs and enhanced competitiveness.

The commerce and "other services" sectors would grow 5,3 and 4,7 percent per year on average, respectively, due to an increase in telecommunications, lodging, education and health services, among others. The government must establish high quality standards for tourism services, educate the population in the value and importance of tourism, and promote the diversification of tourism products. The number of visitors is expected to reach 1,4 million in 2004.

Concerning the external sector, the expected trade balance surplus in 2002-2004 would be due to a 10,7-percent annual average increase in FOB exports. The latter would be associated with the beginning of operations of the Antamina copper-zinc project (third quarter of 2001) and of the Conga y Quellaveco mines. FOB imports would grow 8,8 percent per year on average in 2002-2004, due to an increase in intermediate and capital good imports. Additionally, an annual trade balance surplus of about US$ 343 million on average is expected in that period.

5. Revenues, Expenditures and Public Financing in 2002-2004

The public sector must follow a cautious behavior in order to preserve fiscal discipline as established by the Fiscal Responsibility and Transparency Law. The public sector deficit, which is expected to reach 1,0 percent of GDP in 2002, would diminish to 0,8 and 0,7 percent in 2003 and 2004, respectively. However, it is necessary to identify a set of conditions that would allow higher growth.

Table 3
MAIN PUBLIC SECTOR INDICATORS
(Percentages of GDP)

	1999	2000	2001	2002	2003	2004
OVERALL PUBLIC SECTOR REVENUES						
GENERAL GOVERNMENT	15,6	15,8	14,0	14,7	14,5	14,2
CENTRAL GOVERNMENT	14,4	14,6	14,0	13,8	13,7	13,3
TAX REVENUES	12,4	12,0	12,3	12,1	12,0	11,5
OVERALL PUBLIC SECTOR EXPENDITURES						
GENERAL GOVERNMENT	18,6	18,3	16,8	16,0	15,4	14,9
NON-FINANCIAL	16,5	16,2	14,7	13,9	13,4	12,9
INTERESTS	2,1	2,2	2,1	2,1	2,0	2,0
PUBLIC SECTOR DEFICIT/SURPLUS						
OVERALL PUBLIC SECTOR	-3,0	-3,2	-1,5	-1,0	-0,8	-0,7
GENERAL GOVERNMENT	-3,1	-2,5	-1,9	-1,2	-0,9	-0,7
FINANCING						
EXTERNAL	-0,1	1,2	1,1	0,3	0,1	0,0
DOMESTIC [1/]	3,1	1,9	0,5	0,7	0,8	0,7

[1/] Includes use of revenues from privatization.
Source: INEI, BCRP, MEF, SUNAT and Customs

The deficit in 2002-2004 would be financed mainly through foreign and public sector resources. The latter would include revenues from privatization and concession contracts for electric companies, ports and roads, which would improve efficiency throughout the economy, provide the resources needed to meet the increasing social demands and ensure sustained growth over the coming years. Financing requirements in 2002 would be covered by foreign disbursements amounting to US$ 1 080 million, of which US$ 580 million would be earmarked for investment projects and US$ 500 would be freely disposable.

Box 1

Scheduled Privatizations and Concession Contracts

(Millions of U.S. dollars)

Sustained economic growth at rates of 5-6 percent per year requires a modern, responsible policy regarding privatizations and concession contracts, which would be oriented towards enhancing efficiency and competitiveness. Such policy would contribute to generating the public resources needed to fulfill the state's primary objectives, especially in the social field. The MMF foresees the following privatization and concession contracts:

	2001	2002-2004
PRIVATIZATIONS	Edelnor	Conchán refinery
	Relapasa	EGASA
Value of transactions	JORBSA Distribution Company	EGESUR
2 209	Etevensa	Mantaro hydroelectric dam
	Piura Electric Company	Electro Sur East
Projected investments	Electro Andes	Electro Sur
1 1516	Iscaycruz (government's share)	Electro Sur West
	Toromocho prospect	
	Michiquillay prospect	
	Mining prospects	
	IMEX Callao	
	Bayóvar project	
	Real estate	
	Irrigation projects and uncultivated lands	
	Marine cultivation projects	

	2001	2002-2004
CONCESSION CONTRACTS	Telecom and multimedia services	Sanitation: Piura, Lambayeque
Value of transactions	ETECEN-ETESUR	Sanitation: Trujillo, Tumbes, Pisco
245	Ancón-Huacho-Pativilca road	Chincheros International Airport (Cusco)
	Road network No. 6	Talara refinery
Projected investments	Tourism-Civic Center building	Regional ports (Paita, Salaverry, Chimbote, Pisco and Ilo)
2 415	Tourism-Tierra Chaco	Port of Callao
	Oroya-Carhuaquero-Paragsha-Antamina and Aguaytía-Pucallpa transmission lines	
	Antamina-Huallanca-Cajamarca-Carhuaquero and Zorritos-Zarumilla transmission lines	
	Regional airports	
	Olmos hydro-energetic project	
	Biabo forest	
	Jorge Chávez Airport	
	Local telephony and local carrier services	

Source: COPRI and MEF

The 0,2 percent point decrease in tax revenues in 2002 would result from the adjustment in the income tax rate —partially offset by improved efficiency in tax collection. In 2003 the Extraordinary Solidarity Tax would be reduced to 3 percent and then eliminated in 2004. In order to consolidate the efficiency of the tax administration, several sectoral and regional tax exemptions would be progressively eliminated. Additionally, tariff reductions consistent with integration agreements would further improve competitiveness.

Table 4
GENERAL GOVERNMENT REVENUES
(Percentages of GDP)

	1999	2000	2001	2002	2003	2004
CURRENT REVENUES	**15,3**	**15,5**	**14,8**	**14,6**	**14,5**	**14,1**
CENTRAL GOVERNMENT	**14,4**	**14,6**	**14,0**	**13,8**	**13,7**	**13,3**
TAX REVENUES	12,4	12,0	12,3	12,1	12,0	11,5
Income Tax	2,9	2,7	2,9	2,4	2,5	2,6
Import Duties	1,6	1,5	1,4	1,3	1,2	1,1
Value Added Tax (IGV and IPM)	6,3	6,4	6,3	6,8	7,0	7,1
Excise Taxes (ISC)	2,0	1,8	1,9	2,1	2,1	2,1
Other	0,9	1,0	1,3	1,1	0,8	0,3
Certificates	-1,2	-1,4	-1,5	-1,6	-1,6	-1,7
NON-TAX REVENUES	2,0	2,6	1,7	1,7	1,7	1,8
OTHER ENTITIES	**0,8**	**0,9**	**0,8**	**0,8**	**0,8**	**0,7**
CAPITAL REVENUES	**0,3**	**0,3**	**0,1**	**0,1**	**0,1**	**0,1**
TOTAL REVENUES	**15,6**	**15,8**	**15,0**	**14,7**	**14,6**	**14,2**

Source: INEI, BCRP, MEF, SUNAT and Customs

Under this scenario, General Government revenues in 2002-2004 would remain stable at 14,4 percent of GDP. Central Government tax and non-tax revenues would stabilize around 11,9 and 1,7 percent of GDP, respectively. Current revenues of other General Government entities in 2002 and 2003 would remain at the same level as in 2001 —0,8 percent of GDP on average—, and drop to 0,7 percent of GDP in 2004. General government capital revenues would stay around 0,1 percent of GDP on average in 2002-2004.

Table 5
GENERAL GOVERNMENT EXPENDITURES
(Percentages of GDP)

	1999	2000	2001	2002	2003	2004
NON-FINANCIAL EXPENDITURES	**16,5**	**16,1**	**14,7**	**13,9**	**13,4**	**12,9**
Of which:						
Projects under execution	2,7	1,9	1,2	1,2	1,3	1,4
New investments	0,3	0,5	0,3	0,3	0,3	0,4
INTERESTS	**2,1**	**2,2**	**2,1**	**2,1**	**2,0**	**2,0**
TOTAL EXPENDITURES	**18,6**	**18,3**	**16,8**	**16,0**	**15,4**	**14,9**

Source: INEI, BCRP and MEF

General Government financial expenditures would decrease from 2,1 percent of GDP in 2002 to 2,0 percent of GDP in 2004, reflecting the use of financial instruments to improve Peru's public debt profile and alleviate the debt burden in the short term. General Government non-financial expenditures in 2002 would rise to 13,9 percent of GDP, and gradually decrease to 12,9 percent of GDP in 2004. It should be noted that the Fiscal Responsibility and Transparency Law limits the expansion of General Government non-financial expenditures to 2 percent per year in real terms.

A rationalization and prioritization program would accompany the projected expenditure execution, especially in nutrition, health, education, justice, housing, public security and additional social investment to support economically depressed zones. Such policy would prevent the restriction of fiscal resources from resulting in damage to human potential in high-risk families, and would guarantee the basic social services needed to increase opportunities and improve living standards.

These priorities would be reflected progressively in the Fiscal Budget, which would rise from S/. 34,5 billion —equivalent to US$ 9 646 million— in 2001 to S/. 38,6 billion —equivalent to US$ 10 430 million— in 2004.

Table 6
PUBLIC BUDGET: ECONOMIC DISTRIBUTION
(Millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004
NON-FINANCIAL EXPENDITURES [1/]	**16,5**	**16,1**	**14,7**	**13,9**	**13,4**	**12,9**
FINANCIAL EXPENDITURES						
Debt service	2,7	1,9	1,2	1,2	1,3	1,4
Retirement pension payments	0,3	0,5	0,3	0,3	0,3	0,4
TOTAL	**2,1**	**2,2**	**2,1**	**2,1**	**2,0**	**2,0**

[1/] Excludes retirement pension payments
Source: MEF

The fiscal budget should be redistributed according to the lines described above in order to meet social demands and consolidate the structural conditions needed for sustained growth. The proposed functional distribution —excluding financial expenditures and retirement pension payments— proposed for the coming years considers increases in the relative share of education and culture (from 24,1 percent in 2001 to 27,0 percent in 2004), health and sanitation (from 14,4 percent in 2001 to 15, 9 percent in 2004), justice (from 3,2 percent in 2001 to 4,4 percent in 2004) and transportation (from 5,7 percent in 2001 to 7,0 percent in 2004), and reductions in defense and national security (from 21,8 percent in 2001 to 18,5 percent in 2004) and administration and planning (from 9,9 percent in 2001 to 8,0 percent in 2004).

Box 2
Public Expenditure Priorities

Even though social expenditure increased over the last years, and in spite of the efforts displayed by grass-roots, non-governmental and international organizations, a growing number of Peruvians live in poverty. Assistance programs should be minimized in favor of social polices oriented towards generating and strengthening economic, social, political and cultural capabilities, mainly in the less-favored segments of the population.

In compliance with national laws concerning fiscal responsibility and transparency, citizen access to public finance information, corruption, political neutrality and adequate use of fiscal resources —which the transition government has dutifully enforced— priority must be given to reducing the consumption deficit —particularly in families that are in imminent danger of potential human damage. Therefore, the following policies would be implemented:

Nutrition: Nutrition and prevention policies for high-risk families, especially children below five years of age (with emphasis on children below three years of age), pregnant mothers and breast-fed-children. Low-income families will be encouraged to use nutrition programs for children only when strictly necessary. Implementation of education actions regarding nutrition and nutrition safety, and improvement of nutrition surveillance systems with community participation.

Health: Access to basic health for all citizens, with emphasis on equity, environmental care and contagious disease prevention and control. Promotion of joint provision of services by the Ministry of Health, the public health care agency (ESSALUD), the armed forces, the police force and private suppliers. Basic health —essentially preventive—, low-complexity assistance —including treatment of persons with tuberculosis and other contagious diseases—, enforcement of family planning and promotion of responsible paternity. Protection of pregnant women by means of four pre-birth controls and food supplements to prevent anemia. All births must be institutional. Promotion of pregnancy surveillance and education concerning pregnancy and child care.

Education: Enhancement of the social role of the teaching career; improvement of learning-process quality, with emphasis on coverage and equity; promotion of initial, primary and secondary education, ensuring a minimum of eleven school years. Creation of the conditions needed for maximization of school attendance and incorporation into the educational system. The education of rural children should take into account the realities of multilinguism and the preservation of cultural diversity. It is necessary to strengthen social surveillance mechanisms in order to implement these policies.

Justice: Strengthening of the rule of law, enforcement of fundamental rights and obligations, prevention of all forms of discrimination based on gender, ethnicity, sex, color, language, age, political orientation, social origin, economic position, birth, religion or any another condition. Increased access to justice —especially in isolated zones—, with emphasis on conflict-solution at peace courts. Use of basic modules to facilitate conflict-solution and ensure the enforcement of fundamental rights. Promotion of defense committees and other conflict-solution mechanisms at the communal level, with emphasis on the defense of children and women against family violence and sexual abuse.

Housing: The government will expand access to safe water, sanitation and electricity in poor populations, and will support the construction of basic housing units.

Public security: The fight against delinquency will be consistent with law and order, and will assure peaceful coexistence under scarcity conditions.

Additional social investment: Transference of capital at the local level would reduce the consumption deficit of families and improve the socio-economic infrastructure. A local and regional development plan —involving maintenance, construction and improvement of highways, rural roads and small-scale irrigation systems, as well as sanitation, agriculture promotion and rural electrification— would create business opportunities for private-sector enterprises, stimulate local demand and contribute to job creation. The civil society and local authorities would jointly coordinate these policies.

In order to ensure adequate allocation of public resources according to these guidelines and priorities, the excess funds from any financing source will be used to improve management, quality and coverage in the following twelve functional programs included in the General Budget: collective and individual health, initial, primary and secondary education, justice, sanitation, internal order, social and communal promotion and assistance, agriculture promotion, land transportation and energy.

Table 7
NON-FINANCIAL EXPENDITURES: FUNCTIONAL DISTRIBUTION [1/]
(Millions of U.S. dollars)

	1999	2000	2001	2002	2003	2004
ADMINISTRATION AND PLANNING	767	660	587	474	482	477
AGRICULTURE	379	359	290	314	323	318
SOCIAL ASSISTANCE	566	485	596	424	420	421
COMMUNICATIONS	14	19	19	21	23	24
DEFENSE AND NATIONAL SECURITY	1 428	1 545	1 291	1 175	1 123	1 103
EDUCATION AND CULTURE	1 553	1 548	1 428	1 483	1 547	1 608
ENERGY AND MINERAL RESOURCES	99	76	69	81	84	90
INDUSTRY, TRADE AND SERVICES	38	36	30	39	36	33
JUSTICE	200	201	188	181	211	260
LEGISLATIVE BRANCH	59	71	66	58	58	59
FISHERIES	26	29	30	27	28	28
FOREIGN AFFAIRS	102	107	92	102	104	107
HEALTH AND SANITATION	790	835	854	852	911	949
LABOR	11	13	9	12	12	13
TRANSPORT	517	396	340	363	397	419
HOUSING AND URBAN DEVELOPMENT	47	42	39	36	48	51
TOTAL	**6 596**	**6 424**	**5 929**	**5 641**	**5 807**	**5 962**

[1/] Excludes retirement pension payments
Source: MEF

It is necessary to continue simplifying public administration in order to improve quality and effectiveness in the provision of services. Additionally, the government will implement a public expenditure evaluation system based on performance indicators. Such system will contribute to increasing efficiency in the use of public resources by means of decentralized citizen participation, surveillance and control.

Furthermore, government organizations must progressively focus their policies towards coinciding administrative jurisdictions, in order to facilitate joint design, execution and evaluation of social policies. Such coordination and integration of public sector programs would be based on local management, and would recognize the importance of local-government capabilities in social development.

In fiscal year 2002 the government will introduce a fund that will contribute to the competitive development of provinces and frontier zones through pre-investment studies and provision of infrastructure and public goods. These policies —which would follow the *economic corridors* approach— would be complementary to private efforts and would contribute to job creation and the adequate provision of services such as basic education and primary health assistance. Concertation committees formed to coordinate the fight against poverty at the local level will have access to information that will be instrumental in the improvement of productive systems and environmental and social conditions.

Additionally, the government will set out to decentralize and rationalize public expenditure. Therefore, the fiscal budget draft for 2002 —which would be organized at the provincial level, in addition to current criteria— would incorporate the Transitory Committees for Regional Administration (CTARs) into the Prime Minister's Office, the Regional Directions into the existing ministries according to their competencies, the National Education and Health Infrastructure Institute (INFES) into the Ministry of Education, and the major agricultural projects into the Ministry of Agriculture. These innovations would contribute to enhancing productivity and creating the conditions for the decentralization of expenditure execution.

The government will need to cover an annual average deficit amounting to US$ 522, as well as foreign and domestic amortizations amounting to US$ 1 051 million and US$ 288 million, respectively. Additionally, annual foreign disbursements would amount to US$ 1 127 million per year. The active management policy required to improve the foreign and domestic debt service profile would contribute to country risk reduction. Enhancement of Peru's credit rating to investment grade would in turn result in lower interest rates and increased financing options.

Table 8
OVERALL PUBLIC SECTOR DEFICIT/SURPLUS
(Percentages of GDP)

	1999	2000	2001	2002	2003	2004
GENERAL GOVERNMENT	**-3,1**	**-2,5**	**-1,9**	**-1,2**	**-0,9**	**-0,7**
REST	**0,1**	**-0,6**	**0,3**	**0,2**	**0,0**	**0,0**
TOTAL	**-3,0**	**-3,2**	**-1,5**	**-1,0**	**-0,8**	**-0,7**
FINANCING	**3,0**	**3,2**	**1,5**	**1,0**	**0,8**	**0,7**
EXTERNAL	-0,1	1,2	1,1	0,3	0,1	0,0
DOMESTIC [1/]	3,1	1,9	0,5	0,7	0,8	0,7

[1/] Includes use of revenues from privatization
Source: INEI, BCRP and MEF

Disbursements earmarked for investment projects would reach US$ 610 million per year. Additionally, the government would need to obtain freely disposable disbursements amounting to US$ 517 million per year. These could be provided by multilateral organizations, or raised by selling bonds in the international market. The latter requires consistent macroeconomic policies aimed at reducing the country risk.

Concerning structural reforms, the government must continue privatizing assets and awarding concession contracts. This would contribute to greater economic efficiency and provide resources while the country gains access to international capital markets. Pending asset sales and concession contracts —notably the privatization of electric companies and the Talara and Conchán refineries— would generate resources amounting approximately to US$ 2 100 million in 2002-2004. These resources would accrue to the Treasury (US$ 1 150 million), the Public Saving Fund (US$ 660 million) and the Fiscal Stabilization Fund (US$ 300 million). The latter's resources would amount to US$ 440 million by end-2004.

Finally, in order to strengthen fiscal transparency mechanisms and allow effective citizen control of the use of public resources, The MEF will publish every year before March 30 the Annual Performance Report, which would be based on an evaluation of the Multiannual Sectoral Strategic Plans. Additionally, the Fiscal Bulletin —to be published monthly starting next July— will provide the fiscal information needed to monitor compliance with the Multiannual Macroeconomic Framework and the Fiscal Responsibility and Transparency Law, both at the aggregate level and by function and expenditure program. This information will also be available from the Economic Transparency website.

The creation of an information system intended to allow public monitoring and evaluation of government policies will contribute significantly to strengthening democracy and promote active citizen participation in public sector decisions that will directly affect the nation's destiny.

APPENDIX

Table A
AGGREGATE SUPPLY AND DEMAND
(Percent changes)

	1999	2000	2001	2002	2003	2004
I. GLOBAL DEMAND (1+2)	**-1,6**	**3,6**	**2,3**	**5,3**	**5,9**	**6,2**
1. Domestic demand	-2,6	2,9	1,1	4,6	5,7	5,8
a. Private consumption	-0,2	4,1	3,0	5,0	5,4	5,4
b. Public consumption	3,6	6,0	-5,9	-1,0	1,0	1,0
c. Gross domestic investment	-11,8	-2,2	-1,8	5,6	8,9	9,5
Fixed Gross domestic investment	-11,9	-4,7	-2,0	8,1	9,1	10,6
- Private	-16,3	-1,6	-0,1	9,7	10,0	11,8
- Public	7,2	-15,4	-9,4	0,8	4,9	4,6
2. Exports	5,4	8,0	9,5	9,4	6,7	8,1
II. GLOBAL SUPPLY (3+4)	**-1,6**	**3,6**	**2,3**	**5,3**	**5,9**	**6,2**
3. Gross Domestic Product	1,4	3,6	1,5	5,0	5,5	6,0
4. Imports	-17,1	3,6	7,1	7,4	8,2	7,2

Sources: BCRP and MEF

Table B
GENERAL GOVERNMENT REVENUES
(Millions of nuevos soles)

	1999	2000	2001	2002	2003	2004
CURRENT REVENUES	**26 824**	**29 122**	**29 220**	**30 830**	**32 829**	**34 687**
CENTRAL GOVERNMENT	**25 333**	**27 515**	**27 665**	**29 190**	**31 082**	**32 841**
TAX REVENUES	21 873	22 664	24 238	25 567	27 265	28 364
Income Tax	5 071	5 130	5 670	5 170	5 689	6 390
Import duties	2 848	2 913	2 846	2 714	2 736	2 726
Value Added Tax (IGV and IPM)	11 029	11 996	12 403	14 314	15 926	17 466
Excise Taxes (ISC)	3 446	3 421	3 740	4 388	4 741	5 125
Other	1 579	1 873	2 521	2 322	1 860	751
Certificates	-2 101	-2 669	-2 942	-3 340	-3 687	-4 094
NON-TAX REVENUES	3 460	4 851	3 427	3 623	3 817	4 477
OTHER ENTITIES	**1 491**	**1 607**	**1 555**	**1 640**	**1 747**	**1 846**
CAPITAL REVENUES	**539**	**535**	**59**	**253**	**273**	**296**
TOTAL REVENUES	**27 363**	**29 657**	**29 279**	**31 083**	**33 102**	**34 983**

Sources: INEI, BCRP, MEF, SUNAT and Customs

Table C
GENERAL GOVERNMENT EXPENDITURES
(Millions of nuevos soles)

	1999	2000	2001	2002	2003	2004
NON-FINANCIAL EXPENDITURES	**29 098**	**30 379**	**28 932**	**29 286**	**30 457**	**31 701**
Of which:						
Projects under execution	4 754	3 642	2 428	2 480	2 951	3 467
New investments	556	973	607	620	738	867
INTERESTS	**3 674**	**4 073**	**4 194**	**4 393**	**4 631**	**4 917**
TOTAL EXPENDITURES	**32 772**	**34 452**	**33 126**	**33 679**	**35 089**	**36 618**

Sources: BCRP and MEF

Table D
OVERALL PUBLIC SECTOR DEFICIT/SURPLUS
(Millions of nuevos soles)

	1999	2000	2001	2002	2003	2004
GENERAL GOVERNMENT	**-5 409**	**-4 795**	**-3 647**	**-2 596**	**-1 986**	**-1 636**
REST	**121**	**-1 146**	**597**	**401**	**74**	**-15**
TOTAL	**-5 288**	**-5 941**	**-3 050**	**-2 195**	**-1 912**	**-1 651**
FINANCING	**5 288**	**5 941**	**3 050**	**2 195**	**1 912**	**1 651**
EXTERNAL	-111	2 280	2 159	737	159	-67
DOMESTIC [1/]	5 399	3 661	891	1 458	1 753	1 718

[1/] Includes use of revenues from privatization.
Sources: BCRP and MEF

Table E
PROJECTION OF THE PUBLIC DEBT SERVICE
(Millions of U.S. dollars)

	Loans Disbursed		Pending Disbursements		Total	
	Domestic	External	Domestic	External	Domestic	External
2000	279	1 788	0	0	279	1 788
2001	398	1 830	5	29	404	1 859
2002	389	1 907	7	118	396	2 025
2003	407	2 039	56	232	463	2 271
2004	413	2 069	0	344	413	2 413
2005	313	2 053	0	448	313	2 502
2006	228	2 005	0	535	228	2 541
2007	237	1 990	0	660	237	2 650
2008	163	1 920	0	775	163	2 695
2009	150	1 859	0	877	150	2 737
2010	66	1 702	0	955	66	2 657
2011	54	1 787	0	1 003	54	2 790

Note:	**External Debt**	**Domestic Debt**
	(Balances in millions of U.S. dollars)	
2001	19 808	1 910
2002	20 009	1 670
2003	20 053	1 346
2004	20 035	1 046

Sources: BCRP and MEF

Multiannual Macroeconomic Framework 2002-2004

Communication No. 005-2001-EF/90.02

Lima, May 15, 2001

Dr. Javier Silva Ruete
Minister of Economy and Finance
Lima

In compliance with article 11 of Law No. 27245 (Fiscal Responsibility and Transparency Law), I am pleased to submit the opinion of the Board of Directors of the Central Reserve Bank of Peru (BCRP) regarding the 2002-2004 Multiannual Macroeconomic Framework (MMF) detailed in Communication No. 055-2001-EF/10 of April 30. The said technical opinion includes an assessment of the MMF's consistency with the BCRP's balance of payments and foreign reserve forecasts, and with its monetary policy.

It should be stressed that, in a year in which newly elected Executive and Legislative branch authorities will take office, the dissemination and discussion of the policies contained in the MMF would contribute to reducing uncertainty concerning the conduct of economic policy. It is also worth noting that Law No. 27245 establishes that the content of this framework can be modified in order to assure consistency with the public sector budget.

Objectives

It is relevant to emphasize the objectives of the MMF:

a. **To adopt policies that favor high and sustained output growth rates**, in order to increase employment and reduce poverty. The objective is to raise the GDP growth rate to 5-6 percent, which would involve creating 350 000 jobs per year and reducing the poverty level from 54 to 44 percent over the next five years.

b. **To keep the inflation rate within a 1,5-3,0 percent range** in order to maintain monetary stability and promote investment.

c. **To reduce external vulnerability** by limiting the current account deficit to a ceiling of 3 percent of GDP, defending an adequate level of net international reserves, implementing adequate policies concerning the management of the government's financial assets and liabilities, and strengthening of the financial system.

Output

The BCRP agrees with the average 5,5 percent real growth rate of GDP for 2002-2004 foreseen by the MMF. GDP growth would be based on exports and investment, which would increase by 8,1 percent and 10,1 percent on average per year, respectively. Additionally, private consumption would grow 5,3 percent annually. This forecast is based on a predictable policy scenario oriented towards promoting growth —structural reforms— and maintaining macroeconomic equilibria. Thus, the increase in the domestic demand for goods and services will be in line with that of domestic output, and therefore the external accounts would not be deteriorated due to demand pressure.

AGGREGATE DEMAND AND SUPPLY
(Percent variations in real terms)

	2000	2001	2002	2003	2004	Average 2002-2004
I. Aggregate supply	**3,7**	**2,3**	**5,3**	**5,9**	**6,2**	**5,8**
1. Producto Bruto Interno	3,6	1,5	5,0	5,5	6,0	5,5
2. Importaciones [1/]	4,2	7,1	7,4	8,2	7,2	7,6
II. Aggregate demand	**3,7**	**2,3**	**5,3**	**5,9**	**6,2**	**5,8**
3. Domestic demand	2,8	1,1	4,6	5,7	5,8	5,4
a. Private consumption	4,1	3,0	5,0	5,4	5,4	5,3
b. Public consumption	5,6	-5,9	-1,0	1,0	1,0	0,3
c. Gross domestic investment	-2,5	-1,8	5,6	8,9	9,5	8,0
Gross fixed investment	-5,2	-2,0	8,1	9,1	10,6	9,3
-Private	-1,8	-0,1	9,7	10,0	11,8	10,5
-Public	-16,8	-9,4	0,8	4,9	4,6	3,4
4. Exports [1/]	9,2	9,5	9,4	6,7	8,1	8,1

[1/] Goods and services

The BCRP estimates that the attainment of high and sustained growth rates requires general policies geared to stimulate all private sector economic activities. In order to achieve that objective, the following guidelines are proposed:

a. Reform of the State. Public sector actions must be oriented towards productive growth and equalization of access opportunities for all citizens. Therefore, it would be recommendable:

   i. To unify the Ministries' scope in terms of market search and elimination of barriers to investment.

   ii. To consolidate social ministries' criteria and programs to fight poverty, raise the quality of life and increase health coverage.

   iii. To complete the privatization process and promote concession contracts in order to increase infrastructure development.

   iv. To orient decentralization towards improving expenditure targeting and public management, without affecting fiscal prudence.

   v. To implement a comprehensive dissemination system for government procurement

b. To stimulate international competitiveness and economic integration with the rest of the world. This would involve:

   i. Reducing tariffs. Peru's tariff level —one of the highest in Latin America— reduces competitiveness and discourages investment. Tariff reductions must be transparent in order to avoid uncertainty originated in profitability shifts and minimize effective protection dispersion among economic sectors.

   ii. Using Peru's advantageous geographic position to encourage multinational activities and promote distribution of goods and services to the rest of the region.

c. To promote the development of the capital market, which is fundamental for long-term financing. Implementation of an active public debt management would set a benchmark for private-sector debt issues.

d. To take actions to guarantee property rights and contract fulfillment. In particular, the government must strengthen the Judicial Branch, provide a stable regulatory framework that would favor investment flows, and reinforce the independence of public-service regulatory organizations.

e. To conform labor market legislation to international standards, in order to ensure that companies' hiring policies will not be hampered by the presence of artificial layoff costs.

f. To foster the development of medium and small enterprises. This policy is essential for job generation, and would involve promoting technical assistance centers which would provide information on legal, accounting, tax and electronic commerce aspects, among others.

In line with MMF forecasts, the Bank estimates that the 5,5 percent average annual rate of growth in 2002-2004 will be based on a 6,7 percent rate of growth of primary sectors and a 5,2 percent rate of growth of non-primary sectors.

GROSS DOMESTIC PRODUCT
(Percent variations in real terms)

		2001	2002	2003	2004	Average 2002-2004
I.	**Agriculture & livestock**	**1,6**	**4,2**	**5,0**	**5,0**	**4,7**
II.	**Fishing**	**3,5**	**4,2**	**3,2**	**2,7**	**3,3**
III.	**Mining and hydrocarbons**	**12,0**	**11,0**	**8,0**	**14,0**	**11,0**
IV.	**Manufacturing**	**0,2**	**5,8**	**6,0**	**6,0**	**5,9**
	Primary	*3,0*	*4,7*	*5,0*	*4,4*	*4,7*
	Non-primary	*-0,6*	*6,1*	*6,3*	*6,5*	*6,3*
V.	**Construction**	**-5,4**	**6,5**	**7,5**	**8,0**	**7,3**
VI.	**Commerce and services**	**1,5**	**4,3**	**5,1**	**5,3**	**4,9**
VII.	**AGGREGATE GDP**	**1,5**	**5,0**	**5,5**	**6,0**	**5,5**
	Primary sectors	***5,0***	***6,5***	***5,9***	***7,8***	***6,7***
	Non-primary sectors	***0,8***	***4,6***	***5,4***	***5,6***	***5,2***

a. The Bank foresees a 4,7 percent average increase in the **agriculture and livestock sector**, due mainly to higher agriculture activity (5,5 percent), which in turn would reflect an increase in private investment. The latter would allow improvements in productivity and diversification of export-oriented products. A significant output increase is expected in sugar cane, yellow corn, coffee and other agricultural products for export. Among the guidelines and policy actions for this sector, the following should be mentioned:

   i. Reduction of barriers on the commercialization level, which would involve expanding the road infrastructure, stimulating export-oriented growth, strengthening domestic production and commercialization chains, developing information systems related with markets and crops, and enforcing sanitary regulations and product certification.

   ii. Completion of the titling program and promotion of a water market by means of the introduction of private use rights.

   iii. Promotion of an unsubsidized private financing and insurance system.

   iv. Development of forestry by means of transparent procedures in the award of concession contracts.

b. According to BCRP forecasts, **fishing sector** growth —a moderate 3,3 percent on average— would be due to greater catches of fish for direct human consumption. Among frozen seafood items, a gradual recovery in catches of shrimp —lately affected by the *white stain* virus— is expected. A slight growth in fishing for industrial consumption is foreseen, since anchovy catches would remain at their year-2000 level (9,3 million tons). Canned and frozen items would show greater dynamism as a consequence of a modernization and diversification process. Among policy actions, the following would be expected:

   i. Adoption of a transferable individual quota system, which would rationalize catches and prevent over-investment.

   ii. The government will refrain from using public resources in the financial restructuring process.

   iii. Promotion of marine cultivation.

c. The average rate of growth of the **mining and hydrocarbons sector** in 2002-2004 is estimated at 11,0 percent, due to higher dynamism in the mining sector. The latter would reflect the beginning of operations of projects such as Antamina (copper, zinc and silver), la Zanja and Tantahuatay (gold), Cerro Lindo (silver, zinc and copper), Cerro Corona (gold, copper), Tambo Grande (copper, zinc, gold and silver) and Minas Conga (copper and gold). Additionally, companies such as Yanacocha, Southern, Volcán and Shougang would undertake scale expansion works. Regarding the hydrocarbons sector, the Camisea project will begin operations in the year 2004. Specific policy actions for this sector would include the establishment of clear conflict-resolution procedures regarding land property.

d. The Bank estimates a 5,9 percent growth rate for the **manufacturing sector**. Primary activities would grow by 4,7 percent due to the expansion of the fishing and sugar industries. It is worth mentioning that the expansion of the non-ferrous refined metals sector would reflect the expansion of the Ilo refinery (Southern Peru Copper Corporation) and the beginning of the Tintaya oxide project. Non-primary industries would grow 6,3 percent as a consequence of higher non-traditional exports, the demand from other productive sectors and the expansion of domestic demand. Among the specific policy actions for this sector, the following should be mentioned:

   i. Greater incorporation into export markets, and actions oriented towards the elimination of non-tariff barriers to Peruvian products in foreign markets.

   ii. Measures against smuggling, under-valuation and dumping.

   iii. Promotion of information systems, and development of the domestic market by means of enhanced links between manufacturing and other sectors.

e. In the opinion of the BCRP, the evolution of the **construction sector** (7,3 percent) will be based on higher private investment and increased housing construction. The following policies would be required:

   i. Promote concession contracts for infrastructure facilities such as ports (Paita, Chimbote, Ilo), airports (Trujillo, Cusco, Arequipa), roads and public services (water supply).

   ii. Develop a secondary market for mortgages and property titles.

   iii. Include domestic-currency financing among *Mivivienda*'s operations.

f. According to BCRP forecasts, growth in the **trade and service sectors** —an annual 4,9 percent rate on average— would be based on the dynamism of telecommunications, lodging and education activities, as well as on greater provision of services to companies. In order to stimulate development in this sector, the following policies are needed:

i. Establishment of standards for the identification and promotion of tourist activities.

ii. Proper regulations for public and freight transportation, in order to ensure adequate provision of services.

Trade balance

BCRP forecasts confirm that the **trade balance** would increase from zero in the year 2001 to a US$ 510 million surplus in the year 2004, due to the excess of export growth (11 percent on average) over import growth (9 percent on average).

a. **Exports** would rise from US$ 7 594 million in 2001 to US$ 10 289 in 2004. In particular, non-traditional exports would increase 12 percent, to US$ 3 158 million, in response to actions oriented towards enhancing competitiveness. In the case of traditional exports, mining products would experience the highest rates of growth, the most dynamic items being copper (16 percent) and zinc (12 percent), due to the beginning of operations of the Antamina project in the second half of 201. Cerro Lindo (zinc) and Conga and Quellaveco (copper) would start operations in 2003 and 2004, respectively. The expected 5 percent average rate of growth of gold exports would reflect the operations of current projects, plus Conga and Tambogrande (2004). In 2002-2004 the export volume would grow by 8,6 percent, whereas export prices would increase 1,8 percent.

b. **Imports** would rise form US$ 7 594 million in 2001 to US$ 9 779 million in 2004, due to an 11 percent average growth rate for capital good imports. The latter would reflect investment levels consistent with a high and sustained growth scenario. From 2002 to 2004, the import volume would increase 8,1 percent, whereas import prices would grow by 0,6 percent.

TRADE BALANCE
(Millions of U.S. dollars)

		2001	2002	2003	2004	Percent variation			Average % var.
						2002	2003	2004	2002-2004
I.	**Exports**	**7 594**	**8 444**	**9 271**	**10 289**	**11,2**	**9,8**	**11,0**	**10,7**
	1. Traditional products	5 101	5 725	6 261	6 930	12,2	9,4	10,7	10,8
	Mining	3 435	3 977	4 407	4 955	15,8	10,8	12,4	13,0
	Oil and derivatives	305	288	289	305	- 5,7	0,3	5,7	0,0
	Agriculture	227	254	289	327	11,9	13,8	13,2	13,0
	Fishing	1 134	1 206	1 276	1 343	6,3	5,8	5,2	5,8
	2. Non-traditional products	2 275	2 533	2 820	3 158	11,3	11,3	12,0	11,6
	3. Other	218	186	190	201	- 14,6	2,0	5,4	- 2,8
II.	**Imports**	**7 594**	**8 201**	**8 995**	**9 779**	**8,0**	**9,7**	**8,7**	**8,8**
	1. Consumer goods	1 552	1 698	1 858	2 041	9,4	9,4	9,9	9,6
	2. Intermediate goods	3 704	3 934	4 318	4 588	6,2	9,8	6,2	7,4
	3. Capital goods	2 242	2 470	2 715	3 039	10,2	9,9	11,9	10,7
	4. Other	96	99	104	111	1,3	5,0	6,3	4,2
III.	**Trade Balance**	**0**	**242**	**276**	**510**				

Balance of payments

The medium-term forecasts included in the MMF are consistent with the improvement of external sector vulnerability indicators.

a. Exports of goods and services would increase 8,1 percent on average in real terms. In terms of GDP, these exports would rise from 16,9 percent of GDP in 2001 to 18,5 percent of GDP in 2004.

b. The current account deficit of the balance of payments would stabilize below 3 percent of GDP over this period.

c. Long-term capital inflows to the private sector would finance 70 percent of the current account deficit. Investments would be oriented towards the mining, telecommunications and energy sectors. Apart from the projects mentioned above and Southern Peru Copper Corporation's new investments, additional external funding is foreseen for ongoing mining projects such as Yanacocha, Tintaya and Cajamarquilla. In this scenario, long-term capitals would increase from US$ 1 255 million in 2002 to US$ 1 571 million in 2004.

d. Net International Reserves (NIR) would stabilize at a level equivalent to 12 months of imports and 162 percent of foreign short-term debt plus amortization payments in 2002-2004.

e. Public external debt as a percentage of GDP would decrease from 35 percent to 29 percent, and the overall external debt would decrease from 50 percent to 41 percent, between 2001 and 2004. Additionally, the ratio of public external debt to exports of goods and services would fall from 2,1 to 1,6.

f. The overall and non-financial public sector's external debt service, relative to exports of goods and services, would decrease from 39 to 32 percent, and from 22 to 20 percent, respectively, between 2001 and 2004.

In 2002-2004, private capital inflows required would amount to US$ 1 400 million per year. This would result in a US$ 1290 million increase in NIR.

BALANCE OF PAYMENTS
(Millions of U.S. dollars)

		2001	2002	2003	2004
A.	**Current account balance**	**-1423**	**-1585**	**-1757**	**-1954**
	(% of GDP)	*-2,6*	*-2,8*	*-2,8*	*-2,9*
B.	**Financial account**	**1638**	**2405**	**2107**	**2073**
	i. Non-financial public sector	563	225	81	-18
	Disbursements	1349	1080	1126	1173
	Amortization	-786	-855	-1045	-1191
	ii. Private	583	844	1356	1991
	Long term	1048	1255	1206	1571
	Rest	-465	-411	150	420
	iii. Privatization [1/]	492	1337	670	100
C.	**NIR flow**	**215**	**820**	**350**	**120**

[1/] Payments made by non-residents

Fiscal policy

The BCRP expresses its agreement with the commitment to a prudent fiscal policy as a necessary condition to avoid output volatility and promote investment. The fiscal policy laid out in the MMF — which considers the limits on the overall fiscal deficit and public expenditure growth established by the Fiscal Responsibility and Transparency Law— would contribute to achieving high and sustained growth rates. Additionally, the suggested shift in budget priorities would contribute to reinforcing the fight against poverty and providing the basic structural conditions for growth.

CONSOLIDATED PUBLIC SECTOR DEFICIT/SURPLUS
(Millions of nuevos soles)

		2001	2002	2003	2004
I.	**Primary balance (=1-2+3)**	**1 096**	**2 274**	**2 706**	**3 227**
	(Percentage of GDP)	***0,6***	***1,1***	***1,2***	***1,3***
	1. General Government current revenues	**29 224**	**30 919**	**32 837**	**34 654**
	(Percentage of GDP)	***14,8***	***14,7***	***14,4***	***14,1***
	2. Ga General Government non-financial expenditures	**28 985**	**29 285**	**30 463**	**31 692**
	(Percentage of GDP)	***14,7***	***13,9***	***13,4***	***12,9***
	3. Other operations	**856**	**639**	**332**	**264**
II.	**General Government interests**	**4 145**	**4 366**	**4 693**	**4 982**
III.	**Deficit/Surplus**	**-3 050**	**-2 093**	**-1 988**	**-1 755**
	(Percentage of GDP)	***-1,5***	***-1,0***	***-0,9***	***-0,7***
Note 1: Deficit financing (=-III=a+b+c)		**3 050**	**2 093**	**1 988**	**1 755**
	a. External financing	2 018	824	298	- 67
	(Millions of U.S. dollars=i+ii-iii)	$563	$225	$81	-$18
	i. Freely disposable disbursements	$850	$500	$500	$550
	ii. Disbursements earmarked for projects	$499	$580	$626	$623
	iii. Amortization	$786	$855	$1 045	$1 191
	b. Privatization	1 978	4 893	2 466	370
	(Millions of U.S. dollars)	$550	$1 337	$670	$100
	c. Domestic financing	- 946	-3 624	- 776	1 452
Note 2: Public budget (Billions of nuevos soles)		**34**	**35**	**37**	**38**
	Non-financial expenditures	27	27	28	29
	Financial expenditures	7	8	9	9

The fiscal policy presented in the MMF respects the limits established by the Fiscal Responsibility and Transparency Law, —a maximum deficit of 1,5 percent of GDP in 2001 and 1 percent from 2002 onwards. Additionally, public expenditure annual growth must not exceed 2 percent in real terms.

Fiscal actions would focus on revenues, expenditures and financing.

a. In line with the MMF, BCRP forecasts consider a tax reform that would aim at reducing taxes that affect productive factors and eliminating exemptions and special regimes. The latter could be efficiently replaced by direct budget allocations.

   i. Extraordinary Solidarity Tax (IES): The rate would be reduced from 5 to 3 percent by 2003 and to zero by 2004. The current rate increases labor costs, favors informality and encourages elusion. Current collections amount to S/. 1 100 million (0,5 percent of GDP).

   ii. Tariffs: The average tariff level would be reduced by 1 percent annually to 8 percent by 2004. The cost in the first year would be US$ 100 million. Tariffs impose a significant burden, especially on the production of tradable goods.

   iii. Elimination of tax exemptions: The Peruvian tax system includes a number of exemptions and benefits. In particular, the government aims at eliminating tax benefits for the Amazon region (VAT and excise taxes on fuel); increasing the excise tax on vehicles entering the country through export processing and commercial free zones (CETICOS) to 10 percent (the regular tariff for imported new cars); eliminating the excise tax exemption for electricity companies; and rationalizing VAT exemptions. These measures would result in additional collections amounting to S/. 800 per year.

   The announced measures would not only have an effect on tax collection, but would also improve private sector efficiency and stimulate economic activity. General government current revenues would increase by 3,5 percent on average in real terms, but would decrease as a percentage of GDP from 14,7 percent to 14,1 percent in 2002-2004.

   Income tax collections would decrease by 0,4 percent of GDP as a consequence of a 10 percent point reduction since 2002 and reinvestment tax credit discounts in 2001. It should be noted that these changes would be partially offset by changes in fourth[1]- and fifth-category[2] income tax retention rates and improved control of third-category[3] income tax deductions.

Additionally, Value Added Tax benefits would be rationalized and administrative improvements would increase collections by 0,1 percentage point of GDP on average in 2002-2004.

b. Given the requirements established by the Fiscal Responsibility and Transparency Law for the year 2002, General Government expenditures must remain at the same level as in the current fiscal year. In 2003 and 2004 expenditures would increase 2 percent in real terms (public consumption 1 percent and public investment 5 percent).

   Disciplined expenditure management implies a budget redistribution that would focus on the most needed segments of population. This will be possible as long as additional concession contracts result in lower infrastructure expenditures.

   Private investment generated by this process would amount approximately to US$ 2 500 million, including US$ 1 100 million in roads, US$ 450 million in the Olmos hydro-energetic project, US$ 530 million in ports and airports and US$ 200 million in electric transmission lines.

   The public sector budget would increase from S/. 34 000 million in the current fiscal year to S/. 35 000 million in 2002, S/. 37 000 million in 2003 and S/. 38 000 million in 2004. Non-financial expenditure would remain at S/. 27 000 in 2002, but would increase to S/. 28 000 million and S/. 29 000 million in the following two years.

c. The financing strategy would be oriented towards financing the average fiscal deficit in 2002-2004 (US$ 530 million) as well as foreign and domestic debt amortization payments (US$ 1030 million and US$ 198 million, respectively). The BCRP considers the following scenario:

   i. Foreign debt disbursements would amount to US$ 1 126 million per year on average. Therefore, a pro-active approach would be necessary, involving the adoption of several market options to improve the maturity profile. An adequate public debt management would result in lower interest rates and longer-term financing options.

   ii. Disbursements earmarked for investment projects would amount to US$ 610 million on average. Additionally, freely disposable disbursement requirements —amounting to US$ 516 million— would be provided by multilateral organizations or raised by selling bonds in the international market. The latter option assumes that economic policy would increase investor certainty and therefore reduce perceived risk.

   iii. Sales of Treasury bonds in the domestic market amounting to US$ 150 million in 2002, US$ 450 million in 2003 and US$ 500 million in 2004, would stimulate the development of the domestic capital market.

   iv. It is essential to accelerate the privatization of state-owned assets and the award of concession contracts. This would contribute to greater economic efficiency and provide low-cost resources while the country gains continuous access to international capital markets.

      Thus, privatization of assets —mainly electricity companies (US$ 1 780 million) and Petroperú's production units— would generate resources amounting approximately to US$ 2 100 million in 2002-2004. These resources would accrue to the Treasury (US$ 1 150 million), the Public Saving Fund (US$ 660 million) and the Fiscal Stabilization Fund (US$ 300 million). Altogether, the privatization process would contribute to improving efficiency

[1] Independent workers.
[2] Dependent workers.
[3] Industry and trade.

and competitiveness, and would generate investments by approximately US$ 2 200 million.

PUBLIC TREASURY: USES AND SOURCES OF FOREIGN-CURRENCY FUNDS
(Millions of U.S. dollars)

	2001	2002	2003	2004
USES	**1 813**	**1 926**	**2 178**	**2 359**
External debt	1 760	1 890	2 143	2 322
Share subscriptions	53	36	35	37
SOURCES	**1 813**	**1 926**	**2 178**	**2 359**
Disbursements	850	500	500	550
Privatization	379	636	494	370
Purchases of U.S. Dollars	175	460	545	650
Current revenues in U.S. Dollars	179	181	189	289
Domestic bonds	230	150	450	500
Note:				
Revenues from privatization	550	1 337	670	100
Of which: Public Treasury	318	677	402	68

Monetary policy

Fiscal prudence is consistent with **the objective of monetary policy of achieving inflation rates similar to those of industrial economies**. Inflation would decrease from 3 percent in 2001 to a 1,5-3 percent range from 2002 onwards. The rate of growth of the monetary base consistent with this objective would be similar to that of nominal GDP. Financial intermediation is expected to recover (credit to the private sector would increase to 26 percent of GDP by 2004).

MONETARY INDICATORS: 2001-2004

	2001	2002	2003	2004	Average 2001-2004
Nominal percent variation					
Monetary base	6,0	6,5	7,0	7,0	6,8
Total liquidity	5,8	6,0	8,1	8,1	7,4
Credit to the private sector	5,0	9,0	10,0	8,5	9,2
As percentage of GDP					
Total liquidity	24,5	24,4	24,3	24,3	24,3
Credit to the private sector	25,6	25,8	26,1	26,3	26,1

The foreseen domestic interest rate decline would require not only monetary stability, but also a significant country risk reduction. The current 780-basis-point spread between Brady bond yields and the interest rate on three-month U.S. Treasury bills is expected to decrease to 200-300 basis points. Peruvian securities would thus be eligible for an investment-grade credit rating.

Concerning the development of the domestic capital market, the issuance of long-term securities denominated in domestic currency would reduce dollarization, as well as the foreign exchange and liquidity exposure of firms and households, thus contributing to interest rate reduction.

Summing up, the policies laid out in the MMF would lead to macroeconomic stability and high and steady growth rates, which are essential to increase employment and reduce poverty.

Sincerely,

Germán Suárez Chávez
President
Central Reserve Bank of Peru

APPENDIX

MACROECONOMIC ASSUMPTIONS: 2001-2004

	2001	2002	2003	2004
Gross Domestic Product				
Annual percent variation in real terms	1,5	5,0	5,5	6,0
Billions of nuevos soles	196,9	211,0	227,5	246,4
Billios of U.S. Dollars	55,0	57,7	61,8	66,6
Exchange rate				
Average	3,58	3,66	3,68	3,70
End of period	3,63	3,67	3,69	3,71
Inflation				
Average	3,0	2,7	2,0	2,0
Accumulated	3,0	2,0	2,0	2,0
Trade balance (Millions of U.S. dollars)				
Exports	7 594	8 444	9 271	10 289
Imports	7 594	8 201	8 995	9 779