IV.
Public finances

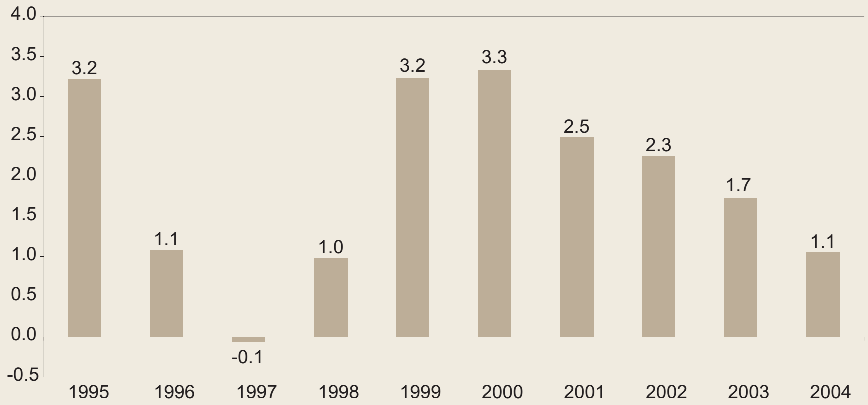
The trend towards consolidation of public sector accounts observed since 2001 continued in 2004, with a significant reduction in the fiscal deficit, which was equivalent to 1.1 percent of GDP, the lowest level since 1998. This performance was explained mainly by higher tax revenues associated with increased economic activity, improvements in world prices, the administrative measures designed to reduce tax evasion, and temporary tax measures introduced during the year. On the other hand, increased public spending was in accordance with the provisions of the Fiscal Transparency and Responsibility Act.

The overall balance of the non-financial public sector recorded a deficit of 1.1 percent of GDP, a figure 0.6 percentage points of GDP lower than in 2003, thus continuing the downward trend in the fiscal deficit, which began in 2001.

The lower fiscal deficit was mainly the result of an increase in the primary balance (from a surplus of 0.4 percent of GDP in 2003 to 1 percent in 2004); and, to a lesser extent, a reduction in interest payments on public debt from 2.2 to 2.1 percent of GDP in the same period.

The fiscal deficit of S/. 2,465 million, equivalent to US$ 754 million, was financed basically by foreign borrowing amounting to US$ 1,078 million. Disbursements amounted to US$ 2,474 million and included global bond offerings abroad and valued

GRAPH 16
NON-FINANCIAL PUBLIC SECTOR DEFICIT
(Percentage of GDP)



Source: MEF, Banco de la Nación, Sunat and others.

at US$ 1,295 million[1/], unrestricted loans from multilateral organizations amounting to US$ 863 million and resources for investment projects of US$ 315 million. Repayments amounted to US$ 1,348 million.

Income from privatization was US$ 114 million and included the sale of the government's US$ 67 million stake in the La Pampilla refinery (Relapasa) and treasury income from Las Bambas copper concession, which amounted to US$ 25 million, as well as installments from earlier privatizations.

Negative internal financing of S/. 1,528 million principally reflects the accumulation of deposits associated with global bond issues (to finance the 2005 budget) and net issues of sovereign bonds (placements minus those maturing) valued at S/. 1,191 million.

TABLE 31

NON-FINANCIAL PUBLIC SECTOR OVERALL BALANCE

	Millions of nuevos soles			Percentage of GDP		
	2002	2003	2004	2002	2003	2004
I. Primary balance	**- 214**	**927**	**2,400**	**-0.1**	**0.4**	**1.0**
1. Central government primary balance	**- 310**	**478**	**1,405**	**-0.2**	**0.2**	**0.6**
a. Current revenues	28,559	31,568	35,381	14.4	14.9	15.1
i. Tax revenue	24,062	27,405	31,144	12.1	13.0	13.3
ii. Non-tax revenue	4,498	4,163	4,238	2.3	2.0	1.8
b. Non-financial expenditure	29,241	31,451	34,165	14.7	14.9	14.6
i. Current	25,285	27,371	29,870	12.7	12.9	12.8
ii. Capital	3,956	4,080	4,295	2.0	1.9	1.8
c. Capital revenues	371	361	189	0.2	0.2	0.1
2. Primary balance of other entities	**97**	**449**	**996**	**0.0**	**0.2**	**0.4**
a. Rest of central government	127	216	350	0.1	0.1	0.1
b. Local government	207	333	325	0.1	0.2	0.1
c. State-owned enterprises	- 237	- 100	320	-0.1	0.0	0.1
II. Interest payments	**4,282**	**4,606**	**4,865**	**2.2**	**2.2**	**2.1**
1. External debt	3,515	3,763	3,951	1.8	1.8	1.7
2. Domestic debt	767	843	914	0.4	0.4	0.4
III. Overall balance (I-II)	**-4,495**	**-3,679**	**-2,465**	**-2.3**	**-1.7**	**-1.1**
1. Net foreign financing	4,144	2,928	3,604	2.1	1.4	1.5
(Millions of US$)	$1,183	$ 841	$1,078	2.1	1.4	1.6
a. Disbursements	$2,863	$2,101	$2,474	5.1	3.5	3.6
b. Amortization	$1,793	$1,187	$1,348	3.2	2.0	2.0
c. Others	$ 113	-$ 73	-$ 48	0.2	-0.1	-0.1
2. Net domestic financing	-1,152	570	-1 528	-0.6	0.3	-0.7
3. Privatization	1,503	181	389	0.8	0.1	0.2

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

1/ One in May of US$ 499 million and another in October of US$ 796 million, the latter one to finance the year 2005 budget.

1. Central government revenues

Central government **current revenues** amounted to S/. 35,381 million in 2004, an increase of 8.1 percent in real terms compared to 2003. This was 15.1 percent of GDP, reflecting a 0.2 percent improvement associated with an increase of 0.3 percent in tax revenue.

Broken down by tax, in GDP terms value added tax (IGV) was responsible for 0.2 percentage points, income tax accounted for 0.1 percentage points and the recently introduced financial transaction tax (ITF) for 0.3 percentage points. This improvement was offset by a fall in excise tax (ISC) revenue amounting to 0.2 percentage points of GDP after the rebate applied to fuels in response to increases in world oil prices.

Income tax revenue amounted to S/. 9,026 million, a figure 9.3 percent higher in real terms than in 2003. The improvement was due mainly to an increase in monthly withholding payments by companies (which grew in real terms by 17.4 percent), which was in turn the result of employing higher coefficients for estimating the tax (as companies

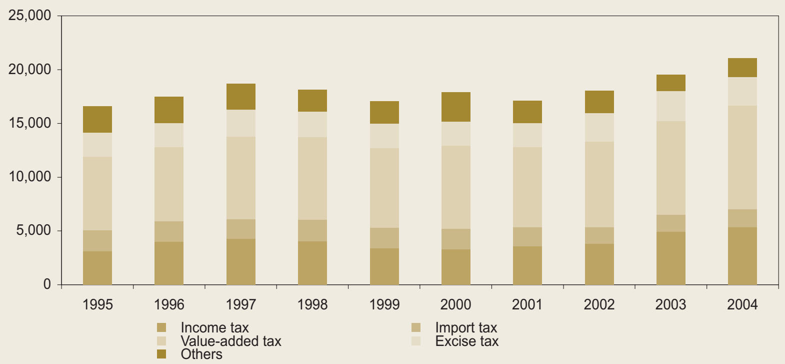
TABLE 32
FISCAL REVENUE COEFFICIENTS
(Percentage of GDP)

	Percentage of GDP		
	2002	2003	2004
Tax burden of the central government 1/	12.1	13.0	13.3
Fiscal burden of the central government	14.4	14.9	15.1
Fiscal burden of the consolidated central government 2/	16.2	16.7	16.8
Fiscal burden of the general government 3/	17.2	17.6	17.8

1/ Central government tax revenues.
2/ Including central government current revenues, contributions to the social security system and pension system, and own resources from the Consolidated Previsional Reserve Fund (FCR), the National Pension Savings Fund (Fonahpu), regulatory institutions and register offices.
3/ Fiscal burden of the consolidated central government and own resources of local government.

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

GRAPH 17
CURRENT REVENUES OF THE CENTRAL GOVERNMENT
(Millions of nuevos soles at 1994 prices)



Source: MEF, SUNAT and Banco de la Nación.

posted better results in 2003 than in 2002), increased economic activity, and better international prices (implying a higher contribution by mining and oil companies of around 70 percent). It should be pointed out that in fiscal year 2004 se the rate was increased from 27 to 30 percent, but this had no effect on withholding the payments which are calculated on the basis of tax paid in the previous year, therefore the impact of the rate increase will be felt from April 2005 onwards. Furthermore, in October 2004 the additional advance payment of income tax was declared unconstitutional and was therefore suspended, which affected the last two months of the year (it is estimated that the Treasury lost tax revenue of approximately S/. 150 million) and was replaced for 2005 by the Temporary Net Asset Tax.

Revenue from annual regularization was S/. 999 million (0.4 percent of GDP), a figure S/. 90 million lower than that of the previous year. Nevertheless, there was an increase of S/. 142 million (from S/. 261 to S/. 403 million) in regularization payments by mining companies resulting from higher metal prices.

Import duties rose 3.8 percent in real terms, although in GDP terms it remained stable (1.2 percent). It should be pointed out that the wider base due to by the increase in imports volume was offset by a reduction in tariffs applicable to 1,113 customs items for capital goods

TABLE 33

CENTRAL GOVERMENT REVENUES

	Percentage of GDP			Real % change		Percent structure		
	2002	2003	2004	2003	2004	2002	2003	2004
I. TAX REVENUE	**12.1**	**13.0**	**13.3**	**11.4**	**9.6**	**84.3**	**86.8**	**88.0**
1. Income tax	3.0	3.8	3.9	29.6	9.3	21.0	25.3	25.5
- Individual	1.1	1.2	1.2	12.5	4.5	7.9	8.2	7.9
- Corporate	1.6	2.0	2.2	33.1	17.4	11.1	13.6	14.8
- Clearing	0.3	0.5	0.4	75.3	-10.9	2.1	3.4	2.8
2. Import tax	1.2	1.2	1.2	0.4	3.8	8.7	8.1	7.8
3. Value-added tax (IGV)	6.3	6.7	6.9	9.4	10.8	44.2	44.7	45.8
- Domestic	3.8	4.0	4.1	10.3	8.6	26.3	26.8	26.9
- Imports	2.6	2.7	2.9	8.1	14.0	17.9	17.9	18.9
4. Excise tax (ISC)	2.1	2.1	1.9	5.8	-4.7	14.7	14.3	12.6
- Fuel	1.5	1.6	1.4	7.0	-6.7	10.5	10.4	9.0
- Others	0.6	0.6	0.6	2.6	0.5	4.1	3.9	3.7
5. Other tax revenue 1/	0.9	0.7	0.9	-20.4	47.3	6.1	4.5	6.1
- Exceptional solidarity tax (IES)	0.2	0.2	0.2	3.7	-8.6	1.4	1.3	1.1
- Government stocks tax (IAE)	0.2	0.0	0.0	-92.5	124.7	1.7	0.1	0.2
- Others	0.4	0.5	0.7	7.8	69.4	3.0	3.0	4.7
6. Tax refund	-1.5	-1.5	-1.5	4.4	5.4	-10.4	-10.0	-9.8
II. NON-TAX REVENUE 2/	**2.3**	**2.0**	**1.8**	**-9.5**	**-1.9**	**15.7**	**13.2**	**12.0**
III. TOTAL REVENUE	**14.4**	**14.9**	**15.1**	**8.1**	**8.1**	**100.0**	**100.0**	**100.0**

1/ Since 2001 includes the government stocks tax (IAE).
2/ Includes current transfers of public enterprises.
Source: MEF, Banco de la Nación, BCRP, SUNAT and Petroperú.

and raw materials for industry in December 2003 and to 109 items covering capital goods and raw materials for the agriculture & livestock sector in February 2004. This reduced the average tariff from 10.9 percent to 10.2 percent between 2003 and 2004. Another factor to be considered was the appreciation of Peru's currency during the year, which meant that the value of sol-denominated duties fell.

Revenue from **value added tax** recorded real growth of 10.8 percent or 0,2 percent of GDP. This improvement can be explained by a number of factors, including administrative measures designed to prevent evasion, the raising of the IGV rate from 18 to 19 percent in August 2003, and an increase in domestic demand. The first factor involved a system of detractions for labor intermediation, marine products and construction materials and a system of import duties in force from the second half of 2003. Similarly, in August 2004 new goods and services were included in the system of detractions, including a number of business services and real estate leasing.

In February 2004 several inputs for the agricultural & livestock industry were exempted of IGV in order to offset the elimination of public treasury notes used to pay duties applicable to the import and sale of these products; while in April a sales tax on hulled rice was created (at a rate of 4 percent for the first sale) to replace IGV.

BOX 4

MEASURES TO EXTEND THE TAX BASE TAKEN DURING 2004

Special emphasis was placed during 2004 on further implementing measures to extend the tax base introduced in the second half of 2002, aimed at preventing IGV evasion.

- **Withholding regime:** applicable to the suppliers of large purchasers, the latter being designated as withholding agents obliged to withhold 6 percent of the sale price in transactions with their suppliers. During fiscal year 2004 the list of withholding agents was updated by the tax authority. Measures were also introduced to facilitate the process of authorizing and issuing certificates of tax withheld. Gross revenue generated by this regime amounted to S/. 1422 million, similar to that of the previous year.

- **System of detractions:** aimed at sectors with a high incidence of evasion. This involves withholding a percentage of the sale price paid by purchasers when acquiring products included in the system, which is then deposited in an account on the supplier's behalf, to be used to pay taxes. In mid-August 2004 the list of goods included in the system was extended (fertilizers, leather and skins, fish oil, fishmeal, fish powder and pellets, crustaceans, mollusks and other invertebrates, and fishing vessels) and a number of services were incorporated into the system (rent, maintenance and repair of moveable property, movement of cargo and other business services). Detractions in this fiscal year amounted to S/. 1,228 million (the figure for 2003 was S/. 498 million) of which S/. 303 million corresponded to goods included during 2004.

- **Payment regime:** in contrast with the two previous schemes, the withholding agents are vendors designated as such by SUNAT, who add the tax to the sale price to intermediate users. Initially applied to the sale of liquid oil-based fuels, it was later extended to goods imports to which SUNAT adds the tax payable, and the percentage is based on the importer. At the end of August 2004 a payment regime for internal sales of moveable property subject to IGV was created (fuels were exempt) and this will come into force in January 2006, except for a group of goods (wheat, wheat flour, water and non-alcoholic beverages, beer, liquefied petroleum gas, carbon dioxide, ethylene polyterephthalate, various types of packaging and their closures) to which the regime applied from January 2005. Revenue from this system in 2004 amounted to S/. 432 million (in the previous year the figure was S/. 105 million).

In the three systems, the amount withheld or paid is a payment on account of tax payable by suppliers or purchasers, as the case may be. Later, they may use the amount withheld to pay their taxes or apply for it to be reimbursed. The amount withheld in excess and reimbursed amounted to S/. 94 million in 2004.

These measures ensured that agents who did not previously pay IGV now do so, thus incorporating them into the tax base.

Revenue from **excise tax** fell by 0.2 percent of GDP and 4.7 percent in real terms compared to 2003, a fact explained by tax relief on fuels (6.7 percent in real terms) which could not be offset by the increase in revenue from other goods (carbonated beverages, liquors, cigarettes and vehicles) which increased 0.5 percent in real terms.

The reduction of ISC on fuels was part of a strategy aimed at reducing the impact of higher world oil prices on consumers. The average reduction was 2 percent, although it should be mentioned that this only applied to liquefied petroleum gas, diesel fuel and kerosene, but not to gasoline.

Revenue from **other taxes** was equivalent to 0.9 percent of GDP, a figure 0.2 percent of GDP higher, due to the introduction in March 2004 of the financial transaction tax (ITF) at a rate of 0.1 percent, which meant additional treasury income of S/. 650 million (0.3 percent of GDP). This rate should be lowered to 0.08 percent in 2005 and 0.06 percent in 2006 before being eliminated altogether.

Finally, lower profit transfers by public companies and lower income from interest resulted in a reduction in non-tax income of 0.2 percent of GDP.

2. Central government expenditures

Central government **non-financial expenditure** rose 4.7 percent in real terms in 2004 to reach 14.6 percent of GDP. The increase occurred principally in non-financial current spending (a real change of 5.2 percent) due to wage increases and higher spending on goods and services. Capital expenditure increased for the second year in a row, this time at a rate of 1.3 percent in real terms.

Wage increases were awarded mainly to workers in the education, interior, defense and health sectors, the judiciary and the public prosecutor's department. In the education sector teachers contracted by the Ministry of Education received a special allowance for effective teaching (SD 056-2004-EF published on the 27th of April 2004) in two parts: S/. 70 in May and S/. 45 in August, at an estimated cost of

BOX 5

FINANCIAL TRANSACTION TAX (ITF) AND OBLIGATORY USE OF THE BANKS

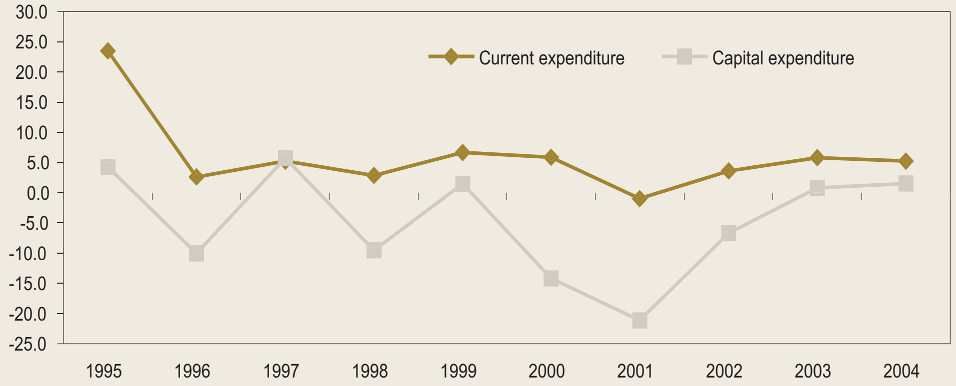
At the end of 2003, using powers to legislate on tax matters granted by Peru's Congress, the government promulgated Legislative Decree 939, the Elimination of Evasion and Informality Act, under which the financial transaction tax (ITF) was created and an obligation established to use certain means of payment through the banks for taxable transactions (obligatory use of the banking system).

These measures were an attempt to encourage the formalization of economic activity through the financial system (obligatory use of the banks), as well as to provide the tax authority with information on operations carried out in the financial system and generate further revenue for the State.

Nevertheless, because of the negative effects of the tax on financial intermediation and economic activity, a number of institutions were involved in drafting the measure from its initial stages. After approval (Leg. Dec. 939), it was modified through Legislative Decrees 946 and 947 and finally replaced by Law 28194, the Elimination of Evasion and Formalization of the Economy Act. The latest modifications had various objectives: to overcome claims that it was unconstitutional, reduce the negative effects of the ITF and improve its application. The main modifications are the following:

- A reduction in the rate from 0.15 to 0.1 percent for fiscal year 2004. For fiscal year 2005 the rate is 0.08 percent, during 2006 it will be 0.06 percent, and then it will be eliminated.
- Transfers between accounts belonging to the same holder are exempt, whether they are held at the same or different banks.
- Debit operations by financial leasing companies on payments to acquire assets for leasing were exempted.
- Regulations were established for rounding the tax up or down.

GRAPH 18
CENTRAL GOVERNMENT NON-FINANCIAL EXPENDITURE
(Real porcentual change)



Source: MEF and Banco de la Nación.

S/. 37 million a month from the second payment onwards. Military personnel and the police also received a special allowance in two parts: S/. 50 in July and the same amount in October, the estimated monthly cost being S/. 16 million (Law 28254 published on the 15th of June 2004 and SD 094-2004-EF published on the 20th of July 2004). Health sector workers benefited from a new salary scale for

TABLE 34
CENTRAL GOVERNMENT EXPENDITURES

	Percentage of GDP			Real % change		Percent structure		
	2002	2003	2004	2003	2004	2002	2003	2004
I. NON-FINANCIAL EXPENDITURE	**14.7**	**14.9**	**14.6**	**5.2**	**4.7**	**88.1**	**88.2**	**88.6**
1. CURRENT EXPENDITURE	**12.7**	**12.9**	**12.8**	**5.9**	**5.2**	**76.2**	**76.8**	**77.5**
a. Wages and salaries	4.5	4.6	4.5	6.0	4.8	26.9	27.1	27.3
b. Goods and services	3.5	3.5	3.5	4.4	8.0	20.7	20.6	21.3
c. Transfers	4.8	4.9	4.8	6.8	3.6	28.6	29.1	28.9
- Pensions	1.8	1.7	1.6	0.5	-2.1	10.7	10.3	9.6
- ONP-Fonahpu	1.0	1.0	1.1	6.7	9.7	6.0	6.1	6.4
- To Foncomun	0.7	0.8	0.8	8.8	7.2	4.4	4.5	4.7
- Royalties	0.1	0.2	0.3	72.1	36.5	0.9	1.5	1.9
- Others	1.1	1.1	1.0	7.0	-2.5	6.6	6.7	6.3
2. CAPITAL EXPENDITURE	**2.0**	**1.9**	**1.8**	**0.9**	**1.3**	**11.9**	**11.4**	**11.1**
a. Gross capital formation	1.7	1.7	1.6	0.0	4.8	10.3	9.9	9.9
b. Others	0.3	0.3	0.2	6.6	-19.8	1.6	1.6	1.2
II. INTEREST PAYMENTS	**2.0**	**2.0**	**1.9**	**3.7**	**0.8**	**11.9**	**11.8**	**11.4**
1. Domestic debt	0.2	0.2	0.2	-5.4	-5.1	1.5	1.3	1.2
2. External debt	1.7	1.8	1.7	4.9	1.6	10.4	10.4	10.2
III. TOTAL (I+ II)	**16.7**	**16.9**	**16.5**	**5.0**	**4.3**	**100.0**	**100.0**	**100.0**

Source: MEF, Banco de la Nación and BCRP.

hospital shifts (Law 28167 published on the 28th of January 2004) and obstetricians, nurses, and doctors received an extraordinary bonus, the cost of which is estimated at S/. 16 million a month.

In addition, salary increases were awarded during the year to medical, auxiliary and administrative personnel of the judiciary and Public Prosecutor's Department (S.D. 016-2004-EF), state university teachers (S.D. 020-2004-EF), state university personnel (S.D. 092-2004-EF), military personnel (S.D. 040-2004-EF and Law 28254), and administrative personnel of the education sector (S.D. 093-2004-EF).

Spending on **goods and services** increased 8.0 percent in real terms level to 3.5 percent of GDP, similar to the level in 2003. The ministries of defense and the interior accounted for around half of this increase.

Current transfers fell by 0.1 percent of GDP compared to 2003 although in real terms it increased by 3.6 percent. The higher transfers went to local governments because of higher revenue from municipal promotion tax and resources associated with the Municipal Compensation Fund (Foncomun) and the mining, hydroelectricity and forestry royalties; and to the Pensions Department (ONP) to pay pensions.

Capital spending amounted to 1.8 percent of GDP. Within this figure, gross capital formation

BOX 6

REFORM OF THE PENSIONS REGIME (L.D. 20530)

On the 23rd of December 2004, the government promulgated Law 28449 establishing new rules for the L.D. 20530 pensions regime, in accordance with the constitutional reform contained in articles 11º and 103º, as well as the first final and transitory provision of the Peruvian Constitution.

Then on the 3rd of June 2005, the Constitutional Court ruled that claims that the Constitutional Reform Act (Law 28389) was unconstitutional were unfounded, partially upholding claims objecting to the constitutional nature of Law 28449 concerning certain aspects of pensions payable to surviving spouses, and upholding the remaining new rules.

The purpose of the reform is to eliminate distortions generated by the L.D. 20530 regime. The proposed changes are aimed principally at making the National Pensions System (L.D. 19990) fairer, laying the foundation for a reform of the State and make good a regime that was financially unviable.

This reform applies to more than 295,000 pensioners and 23,000 working contributors to this pension regime. The pensions burden implied spending equivalent to approximately 10 percent of the public sector budget in 2004.

The reform, which closes the L.D. 20530 regime, should improve the quality of public spending by reducing State pension costs, thus freeing resources to be used in a more efficient manner. The reduction in this cost is based on:

- Assigning the administration of the pensions system to a single central entity.
- No longer increasing pensions in line with the salaries of active contributors to the scheme.
- Establishing a ceiling for pensions that exceed 2 UIT.
- Modifications to pensions for surviving spouses.

This measure will mostly affect pensioners receiving pensions that are higher than the maximum amount, who are less than 1 percent of all the pensioners covered by this regime. In contrast, it will directly benefit those pensioners receiving less than S/. 800, which represent approximately 26 percent of the total number of pensioners.

According to the Ministry of Finance, the cost of setting a minimum pension and pension increases in 2005 would be approximately S/. 129 million, and the 18 percent reduction in pensions that exceed the ceiling is estimated at S/. 8 million. In future, savings generated by modifications should be sufficient to cover the costs involved.

BOX 7

DECENTRALIZATION

In accordance with the Decentralization Enabling Act (Law 27783) decentralization consists of a preparatory stage followed by implementation in four stages; the first stage has already been completed and the second and third stages are underway.

- The preparatory stage, designed to be implemented between June and December 2002, consisted of approval by Congress of a series of regulations governing the process (the Regional Government Framework Act, the new Municipal Government Act, the Demarcation and Boundaries Act, and an Incentives for Regional Integration Act), while a new Executive Powers Act still remains to be approved.

- Later, in 2003 the first stage was implemented, consisting of the installation and organization of regional and local governments. The old Transitory Regional Administrations (CTARs) transferred their assets and liabilities to the new regional authorities. At the same time a start was made on transferring social programs and regional investment projects.

- At present the second stage (consolidation of the decentralization process) and third stage (transfer and assumption of sector competences) are being implemented with those regional governments that have successfully completed the process of accreditation of competences. In 2004 the regional governments accredited their competence in 717 sector functions to be transferred, representing 67 percent of the total of functions to be transferred to them, with tourism, handicrafts, fishing, manufacturing and agriculture being the sectors in which the most functions were accredited. The regional governments which have accredited the most functions are Puno, Piura and Cajamarca.

- The fourth and final stage will be the transfer and acceptance of sector competences in education and health.

amounted to S/. 3,822 million (1.6 percent of GDP), which implies real growth of 4.8 percent. These resources were directed at Ministry of Transport and Communications projects (S/. 995 million), various regional government projects (S/. 821 million), and the National Compensation and Social Development Fund (S/. 369 million), especially the Emergency Social Production Project (A Trabajar Rural).

Financial spending amounted to 1.9 percent of GDP, slightly lower (by 0.1 percentage points) than in 2003 because of the appreciation of Peru's currency, which reduced the value in soles of the country's debt repayments.

Interest due on external debt rose from US$ 1,070 million in 2003 to US$ 1,150 million in 2004, explained basically by an increase in bonds maturing (US$ 121 million), which was partially offset by lower debt payments due to international institutions. Interest on internal debt fell from S/. 469 million in 2003 to S/. 460 million in 2004.

3. Private investment promotion process

During 2004 privatizations valued at US$ 398 million took place, which in turn generated investment commitments of US$ 1,185 million. These included the sale of shares in Relapasa, the awarding of concessions for Yuncan hydroelectric power station, the Olmos project, and the Las Bambas mining project.

Cash income for the government amounted to US$ 114 million, which were used in the following manner: US$ 66.5 million for the National Public Savings Fund (Fonhapu), US$ 44.5 million for the Treasury and US$ 3 million for the Fiscal Stabilization Fund.

4. Public debt

At the close of 2004, dollar-denominated public debt amounted to US$ 30,936 million, a figure US$ 2,040 million higher than in 2003, reflecting an increase in external debt (US$ 1,698 million) and internal debt (US$ 342 million).

TABLE 35

PRIVATIZATIONS AND CONCESSIONS: 2004

(Millions of US$)

	Date	Buyer	Sale value	Investment projects
1. Central Hidroeléctrica de Yuncán	Feb 6.	Energía del Sur (ENERSUR)	204.5	-.-
2. La Pampilla Refinery (RELAPASA)	Mar 23 .	Public sale offer	70.9	-.-
3. Las Bambas Mining Project	Aug 31.	Xstrata AG.	121.0	1,000.0
4. Olmos Project	May 17.	Constructora Norberto Odebrecht	-.-	185.0
5. Sale of real properties and minor assets		Several buyers	1.4	-.-
TOTAL			**397.8**	**1,185.0**

Source : Proinversión.

The total public debt to GDP coefficient, a measure of the fiscal vulnerability of the Peruvian economy, fell from 47.5 to 45.1 percent. The reduction in this coefficient is explained in part by a lower borrowing requirement associated with the primary surplus generated by the non-financial public sector, as well as the combined effect of lower foreign and domestic interest rates and increased economic activity.

It should be pointed out that because of the depreciation of the dollar against the yen and euro, as well as against the nuevo sol, the debt expressed in dollars has increased by US$ 807 million.

External debt

External public debt amounted to US$ 24,466 million, which represents 79 percent of total public debt. This year disbursements of US$ 2,535 million were made, including US$ 62 million to Cofide, and US$ 1,389 million in debt repaid (including an acquittance of US$ 26 million). Most of these payments (US$ 2,158 million) were freely available while US$ 371 million were committed to investment projects.

The freely available disbursements came mainly from global bond issues in the international market, valued at US$ 1,295 million (nominal value US$ 1,299 million). Thus on the 26th of April bonds worth US$ 500 million were issued having a maturity of 12 years and earning interest at 8.375 percent with a spread of 395 basis points, and on the 6th of October an issue worth 650 million euros was made, equivalent to US$ 796 million, having a maturity of 10 years and earning interest at 7.5 percent with a spread of 355 basis points.

The bond issues were complemented by disbursements from multilateral organizations of US$ 862 million, including US$ 362 million from the Corporación Andina de Fomento, of which US$ 183 million were destined for infrastructure programs and social development, US$ 109 million for increasing competitiveness, social investment and governance and US$ 70 million for other projects. The Inter-American Development Bank disbursed US$ 300 million for the Competitiveness and Fiscal Reform programs (US$ 200 and US$ 100 million respectively) and the World Bank provided US$ 200 million, of which US$ 100 million were destined to the 4th Social Reform Program with the rest going to the 2nd Structural Adjustment Lending, Decentralization and Competitiveness Program.

Lending for investment projects were channeled through the central government and public companies and were aimed at the following sectors: economic infrastructure (US$ 181 million), social infrastructure (US$ 96 million) and productive sectors (US$ 87 million). The projects consuming

TABLE 36

PUBLIC DEBT STOCK 1/

	Millions of US$			Percentage of GDP		
	2002	2003	2004	2002	2003	2004
A. PUBLIC DEBT	**26,502**	**28,896**	**30,936**	**46.9**	**47.5**	**45.1**
I. FOREIGN PUBLIC DEBT 2/	**20,715**	**22,768**	**24,466**	**36.6**	**37.5**	**35.6**
CREDITS	16,291	17,138	17,522	28.8	28.2	25.5
Multilateral Organizations	7,044	7,358	7,875	12.5	12.1	11.5
Paris Club	8,188	8,658	8,508	14.5	14.2	12.4
Suppliers	946	1,034	1,070	1.7	1.7	1.6
Commercial Banks	11	5	4	0.0	0.0	0.0
Latin America	62	50	42	0.1	0.1	0.1
Eastern European Countries 3/	40	32	23	0.1	0.1	0.0
BONDS	4,424	5,630	6,944	7.8	9.3	10.1
II. DOMESTIC PUBLIC DEBT	**5,787**	**6,128**	**6,470**	**10.2**	**10.1**	**9.4**
1. LONG TERM	**5,266**	**5,511**	**5,813**	**9.3**	**9.1**	**8.5**
CREDITS FROM BANCO DE LA NACIÓN	937	968	929	1.7	1.6	1.4
1. Central Government	911	895	871	1.6	1.5	1.3
2. Local Government	26	73	58	0.0	0.1	0.1
TREASURY BONDS	4,330	4,542	4,884	7.7	7.5	7.1
1. BCRP Capitalization Bonds	93	65	12	0.2	0.1	0.0
2. Financial System Support Bonds	730	682	637	1.3	1.1	0.9
3. Debt Exchange Bonds 4/	213	183	152	0.4	0.3	0.2
4. Sovereign Bonds	550	768	1 149	1.0	1.3	1.7
5. Caja de Pensiones Militar-Policial Bonds	34	34	34	0.1	0.1	0.0
6. Pension Recognition Bonds	2,710	2,810	2,899	4.8	4.6	4.2
2. SHORT TERM	**521**	**618**	**657**	**0.9**	**1.0**	**1.0**
TREASURY BILLS	0	58	0	0.0	0.1	0.0
CREDITS FROM BANCO DE LA NACIÓN 5/	249	196	265	0.4	0.3	0.4
FLOATING DEBT	272	364	392	0.5	0.6	0.6
B. PUBLIC TREASURY LIQUID ASSETS AND ONP	**3,457**	**3,547**	**3,994**	**6.1**	**5.8**	**5.8**
PUBLIC TREASURY	**739**	**975**	**1 545**	**1.3**	**1.6**	**2.2**
ONP - CONSOLIDATED FUND OF RESERVES	**2,719**	**2,573**	**2,450**	**4.8**	**4.2**	**3.6**
C. NET PUBLIC DEBT (A-B)	**23,045**	**25,349**	**26,942**	**40.8**	**41.7**	**39.2**

1/ Preliminary.
2/ The external debt includes medium and long term debt of COFIDE. excludes loans to balance of payments.
3/ Former Soviet Union countries. Includes the Republic of China.
4/ D.U. No 068-99.
5/ Includes Public Treasury overdrafts in the Banco de la Nación and the credit to the Instituto Nacional de Defensa Civil.
Source: MEF, Banco de la Nación, ONP and COFIDE.

most foreign borrowing included highway rebuilding (Olmos, Corral Quemado, Chamaya-Jaen-San Ignacio, among others), local road building and rural road maintenance, which are the responsibility of the Ministry of Transport and Communications. Foreign borrowing was also spent on irrigation infrastructure and land tenure, improvements to secondary education, support for reform of the health sector, implementation of the integrated financial administration system for local

TABLE 37
PERUVIAN GLOBAL BONDS FINANCIAL CONDITIONS

	Date	Maturity date	Term	Amount (in millions)	Coupon	Price	Yield	Spread
Global 2012	06-feb-02	21-feb-12	10 years	US$ 1,423	9.125%	97.732%	9.481%	455
Global 2008	25-nov-02	15-jan-08	5 years	US$ 500	9.125%	99.073%	9.350%	612
Global 2015 (I)	30-jan-03	06-feb-15	12 years	US$ 500	9.875%	98.455%	10.100%	610
Global 2015 (II)	03-mar-03	06-feb-15	12 years	US$ 250	9.875%	103.125%	9.430%	547
Global 2033 (I)	21-nov-03	21-nov-33	30 years	US$ 500	8.750%	99.099%	8.836%	375
Global 2016	26-apr-04	03-may-16	12 years	US$ 500	8.375%	99.813%	8.400%	395
Global 2014	06-oct-04	14-oct-14	10 years	EU 650	7.500% 1/	99.658%	7.550%	355

1/ Corresponds to the interest rate of the euro-denominated bond.

governments, as well as social development projects and those aimed at children under three years of age (Wawa Wasi), which are the responsibility of MINDES, among others.

Public debt falling due amounted to US$ 1,389 million, a figure US$ 161 million higher than in 2003. The principal creditors were the Paris Club and multilateral agencies to which US$ 723 million and US$ 571 million were paid respectively.

New medium-and-long term loans were made during 2004 amounting to US$ 2,384 million. Of this total, US$ 796 million were used to pre-finance part of the public sector requirement for 2005. Loans from the IDB (US$ 351 million), BIRF (US$ 254 million) and CAF (US$ 437 million) were agreed, repayable in periods in excess of 5 years.

Internal debt

Internal debt amounted to US$ 6,470 million, US$ 342 million higher than the balance in December 2003, resulting both from net public sector liabilities and the effect of the appreciation of Peru's currency, which increased the value of this debt when expressed in dollars (by some US$ 255 million).

Transactions which increased internal debt included a net issue of sovereign bonds valued at S/. 1,090 million (issue of S/. 2,494 million and redemption of S/. 1,404 million), making the balance of these liabilities at the close of 2004 S/. 3,770 million.

It should be mentioned that from the first sovereign bond issue in 2001, the Treasury has been able to extend maturities, thus covering the public sector

TABLE 38
SOVEREIGN BONDS PLACEMENTS
(Millions of nuevos soles)

	Amount	Maturity (years)			Term (years)		
		Min.	Max.	Average	Up to 3	4 to 10	More than 11
2001	1,200	1	3	2yrs 5m	100%	0%	0%
2002	733	1	7	2yrs 7m	93%	7%	0%
2003	1,712	1yr 3m	10yrs 11m	3yrs 3m	66%	30%	4%
2004	2,494	1yr 6m	20	6yrs 9m	23%	64%	13%

borrowing requirements without exchange rate risks, and at the same time providing the domestic capital market with sol-denominated liquid assets with longer maturities. The following table shows that the maturity of bond issues has risen from 3 years in 2001 to 20 years in 2004.

The implementation of the Market Makers program in 2003 has played an important part in this development, as it has enabled financial institutions to participate in a secondary market for Treasury bonds, thus increasing liquidity and demand. This has been reflected in lower rates of return on these securities. Thus, between 2001 and 2004, yields on 3-year Treasury bonds have fallen from 11 to 6 percent.

The progressive increase in sovereign bond maturities enabled the Treasury to conduct two bond exchange operations in 2004. In August bonds valued at S/. 192 million maturing in October were exchanged for new issues maturing in February 2011, and in December 2004 bonds worth S/. 444 million, maturing in January 2005, were exchanged for others maturing in August 2011 and October 2024.

Net public debt

At the close of 2004, net public debt was US$ 26,942 million, equivalent to 39.2 percent of GDP, a figure lower by 5 percentage points of GDP than that for 2003.

The concept of net public debt is used internationally as the best indicator of the public sector's net liability position. In our case, this indicator incorporates treasury liquid assets and the Consolidated Reserve Fund (FCR), which is used to cover future debt repayments.

In 2004 these assets amounted to US$ 3,994 million, of which US$ 1,545 million belong to the Treasury and include deposits arising from pre-financing the following year's budget, as well as the Fiscal Stabilization Fund, while the FCR contains liquid assets equivalent to US$ 2,450 million, to cover bonds maturing in the future.