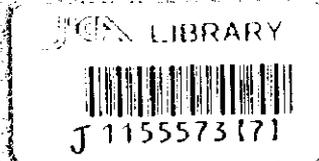


The Country Study for Japan's Official Development Assistance to the Republic of Peru

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November 1998



The Committee on the Country Study  
for Japan's Official Development Assistance  
to the Republic of Peru

Organized by  
Japan International Cooperation Agency

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This Report is based on the discussions and findings of the Committee on the Country Study for Japan's Official Development Assistance to the Republic of Peru organized by the Japan International Cooperation Agency (JICA). Opinions expressed in the report are those of the members of the Committee and do not necessarily reflect those of JICA and its affiliated organizations.

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## Preface

In the 1980s, hyperinflation raged in the Republic of Peru, producing economic collapse that lowered per-capita income to the level of the 1950s. The First Fujimori Administration promoted economic liberalization, focusing on trade and direct foreign investment liberalization, lifting of price controls, privatization, and a more flexible labor market. It urgently and directly implemented various social measures, aimed at supporting the extremely poor. Economic recovery was remarkable, and as a result, inflation moderated, per capita real income increased, and public peace and order were restored.

Following this remarkable recovery, Peru then had to sustain and develop its stabilized economy and address the alleviation of poverty. Its greatest challenge is social development, as it needs further strengthening of the foundation for good governance and participatory development. In Peru, topographic and climatic conditions, as well as ethnic diversity, have produced considerable regional gaps and gender disparity. Its informal sector is much larger than that in other countries. In the Andean highland, most farmers operate on a very small scale. Poverty is thus a very serious problem in Peru, and long-lasting, steady efforts will be needed to address these problems.

Peru, having taken emergency measures to cope with its economic and social crisis in the first half of the 1990s, is now considered to have reached the stage to carry out economic and social development from a long-term viewpoint. A Study Committee was organized in April 1996, to study the basic direction of Japan's ODA for the Republic of Peru at this stage. Accumulated experience in dispatching personnel was indispensable for the Committee's study, especially on priority areas. The murder of Japanese experts in the Vegetable Cultivation Technique Center in July 1991 resulted in a gap of five years in the relationship between Japan and Peru, during which economic and social conditions in Peru changed greatly. It was very difficult for the just-organized Study Committee to analyze the prevailing conditions and define the basic direction of assistance.

In this situation, the Committee made steady progress in its study activities, through efficient use of experience and knowledge of the members who had conducted research on Peru's economy and society, and it conducted field surveys, although only for a short time. The Committee's activities were, however, interrupted by the hostage-taking incident at the Japanese Ambassador's residence in Lima in December 1996. After the incident was resolved and public peace and order had been restored, the Japanese Government dispatched a general study team on economic cooperation in February 1998. The Study Committee held its last open study meeting in the end of May, and compiled this report.

I would like to express my gratitude to the members of the Committee, and for the cooperation extended by the Japan International Cooperation Agency, the divisions concerned of the Ministry of Foreign Affairs, and the task force. I am deeply grateful to the organizations concerned of the Government of the Republic of Peru, the Japanese Embassy in Peru, and the JICA Peru Office, for their positive support.

I hope this report will be utilized in JICA and the ministries and organizations concerned, to deepen economic cooperation and friendship between Japan and Peru.

August 1998

Akio Hosono,  
Chairman  
Committee on the Country Study  
for Japan's Official Development Assistance  
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# 1. Internal and External Conditions in Peru

## 1.1 The land and people<sup>1</sup>

Facing the Pacific Ocean, Peru is situated on the western side of central South America. Its territory covers about 1,280 thousand square kilometers, making the nation 3.4-fold larger than Japan. It has the fourth largest area in Latin America, following Brazil, Argentina, and Mexico. It is divided roughly into three topographic regions by the Andes extending north and south: costa (coastal desert), sierra (the Andes) and selva (tropical rain forest). Costa, a desert belt extending along the Pacific coast, occupies about 10% of the territory. Here people engage in agriculture in oases developed at the mouths of 50 or so rivers fed by snowmelt from the Andes and their villages have developed further into cities. Sierra, occupying about 30% of the territory, extends north and south along the Andes. People in this region, which has various altitudes and diversified climate conditions, engage in a variety of agriculture and stock-farming. The western system of the Andes is a dry region without rain, while the valleys and heights at altitudes between 2500 meters and 4000 meters in the eastern have a dry season and a rainy season. The region is studded with a number of villages of indigenous Indios who have developed advanced agriculture (potatoes) and animal husbandry (llamas and alpacas). Selva, occupying 60% of the territory, is a high-temperature, rainy region extending from the eastern slopes of the Andes to the region where the Amazon rises. Farming is conducted in comparatively high altitude areas, while low-altitude wetlands are sparsely populated and covered with thick forests having a variety of vegetation.

Peru is blessed with natural resources. The open sea, where the Humboldt Current (a cold current) from the south and the Equatorial Current (a warm current) cross each other, is one of the most famous and important fishing grounds in the world. Catches here were the world's largest in the beginning of the 1970s, and Peru was the largest exporter of fish meal, which accounted for 56% of the world's exports (1970)<sup>2</sup>. Peru is a major exporter of mineral resources, such as copper, silver, tin, lead, zinc, molybdenum, and tungsten<sup>3</sup>. The country also has abundant energy resources, including natural gas.

The population of Peru, at about 24 million (as of July 1996), is the fifth largest among Latin American countries, following Brazil, Mexico, Colombia, and Argentina. 52 % of the people live in costa, and 33% live in the "departamento" (translation, "department") of Lima, the nation's capital. About 36% of the people live in sierra, and 12% live in selva. The population has increased by 3.5 times in the last 50 years. That of costa increased by more than fivefold, while that of sierra just doubled. The proportions of people living in these regions were 34% and 60% in 1940, but the population of costa came to account for half of the total population in the 1960s as many people moved to costa. The proportion of urban people now exceeds 70%. In the 1970s, the people of Peru were said to consist of about 50% indigenous people, about 40% mestizos (mixed blood of indigenous people and white), and a little more than 10% white, people of Oriental ancestry, and others<sup>4</sup>. According to the

<sup>1</sup> Sources include Shigeo Osonoi (1995) pp. 2-7, Espinoza (1991) pp. 8-13, the home page of the Peruvian Embassy in Tokyo (<http://www.teleserve.co.jp/embassy/embassy/per/index-j.htm>), and so forth.

<sup>2</sup> Paredes (1991), p. 53, Table 1-3.

<sup>3</sup> According to the "Data Book of the World 1997," Peru's positions in the world's mineral outputs were as follows: copper, ninth place (1994); silver, third place (1993); tin, fourth place (1994); lead, fourth place (1994); zinc, fourth place (1994); molybdenum, fifth place (1994); tungsten, sixth place (1993).

<sup>4</sup> According to Psacharopoulos (1994) p. 27, Table 3.3, and p. 166, the population of indigenous people was 9.3 million at the beginning of the 1970s, accounting for 47% of the total population. According to data of the Peruvian Embassy in Tokyo

household survey in 1994 (by sampling), just over 80% of the people spoke Spanish, and just less than 20% spoke Quechua or Aymara, which are indigenous languages. It is said that in the cities, only several percent of the people speak indigenous languages, while in rural regions of sierra about half of the people speak them<sup>5</sup>.

Per-capita GNP was 2,410 US dollars in 1996 (World Bank Atlas method). Peru is classified as a lower middle income country by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD).

## 1.2 Heritages from the past and attainments of reforms

### 1.2.1 Political, economic, and social conditions until 1990

The modern history of Peru is characterized by political and economic instability. Administration established through democratic procedures was replaced by a military council; then it was succeeded by another civil government, which was again superseded by a military government. This occurred repeatedly (Table 1-1).

Table 1-1 List of Governments (1945 to the present)

President	Govt. system	Period
Bustamante y Rivero, José Luis	Civil	1945.7.28-1948.10.27
Odría Amoretti, Manuel Apolinario	Military	1948.10.27-1950.5.10
Noriega Agüero, Zenón	Provisional	1950.5.10-1950.7.28
Odría Amoretti, Manuel Apolinario	Civil	1950.7.28-1956.7.28
Prado Ugarteche, Manuel	Civil	1956.7.28-1962.7.18
Pérez Godoy, Ricardo	Military	1962.7.18-1963.7.3
Lindley López, Nicolás	Military	1963.7.3-1963.7.28
Belaunde Terry, Fernando	Civil	1963.7.28-1968.10.3
Velasco Alvarado, Juan	Military	1968.10.3-1975.8.29
Morales Bermúdez Cerruti, Francisco	Military	1975.8.29-1980.7.28
Belaunde Terry, Fernando	Civil	1980.7.28-1985.7.28
García Pérez, Alan	Civil	1985.7.28-1990.7.28
Fujimori Fujimori, Alberto Kenya	Civil	1990.7.28-1992.4.5
Fujimori Fujimori, Alberto Kenya	Emergency national reconstruction	1992.4.5-1995.7.28
Fujimori Fujimori, Alberto Kenya	Civil	1995.7.28-2000.7.28

Source: prepared based on Cuánto (1996), p. 391, and other material.

As expansive macroeconomic policies produced a crisis condition in the international balance of payments, the Government took belt-tightening measures for economic stabilization, and financial expansion caused macroeconomic instability again. These policy changes were repeated. During this period, people's well-being continued to worsen from a peak in the mid-1970s. Terrorism, excessive in rural regions, broke public peace and order and worsened

(<http://teleserve.co.jp/embassy/embassy/per/index-j.htm>), indigenous people accounted for 47%, mestizos 40%, white people 12%, and others 1%.

<sup>5</sup> Cuánto (1996), p. 446.

economic conditions, and rural poverty accelerated migration of people to cities, thus increasing social instability.

### (1) Political and economic conditions

While Latin American neighbors were promoting import substitution industrialization after the 1940s, Peru practiced a laissez-faire economy through the 1950s. The exploration and export of mineral resources were dependent on foreign capital, and the export of agricultural products and fish meal<sup>6</sup> financed the import of manufactured products. The Government seldom made economic interventions, with very lenient economic regulations.

Law for the Industry Promotion, established in 1959, seemed to mark a turning point for import substitution industrialization in the Peruvian economy. The National Planning Agency was established in 1962, and the first Belaunde Administration, inaugurated in 1963, started import substitution industrialization, promoting infrastructure-building on a large scale. But its taxation reform for building a fiscal foundation came to a deadlock, producing an economic crisis. This led to the military coup of October 1968. On coming to power, General Velasco took a strategy focused on growth within the country. He enforced extensive regulations on economic activities and nationalized enterprises run with foreign capital, mainly in the mining sector. In parallel with this, he implemented protective measures for workers in the private sector, and promote their participation in business management. In addition, he carried out, in 1969, the most radical agrarian reform in Latin America. External debts became large with the positive promotion of public investment and the expansion of national enterprises. National income and employment opportunities increased amid favorable international economic conditions in the first half of the 1970s. With worsened terms of trade in 1974, however, foreign countries reduced their funds coming into Peru, due to anxiety about the Government and a fiscal scale that had already become too large. This brought another economic crisis. General Morales Bermúdez, Prime Minister of the Velasco Administration, took power in August 1975, in an internal coup. He made efforts to restore favorable relationships with international institutions and domestic civil power. With the recovery of trade terms from 1978 to 1979, he promoted economic stabilization and partial liberalization. Progress was made in changing to a civil government, in parallel with this, and a constituent assembly election was held in 1978. The constitution established in 1979 emphasized a mixed economy and the role of the state in economic activities, expressly stipulated an agrarian reform, prohibited large-scale land tenure, and mentioned labor stabilization. During this period, however, per-capita income continued to decline, and inflation was accelerating.

The second Belaunde Administration, which came to power in 1980, promoted trade liberalization. Its expansive fiscal and monetary measures, however, brought an annual inflation rate of more than 100% in 1983, causing a considerable decline in people's income, which was in part because of natural disasters caused by El Niño. External debt negotiations brought debt rescheduling and new funds coming into the country, but debt service payments soon became delayed. García Pérez took power after a presidential election in July 1985, in the first such victory for his political party, the American Popular Revolutionary Alliance (APRA)<sup>7</sup>. The García Administration faced annual inflation rate approaching 200% and per-

<sup>6</sup> Between 1964 and 1971, Peru was the world's largest producer of fish meal, which accounted for 1/4 of the country's exports.

<sup>7</sup> One of the oldest organizations in Latin America, promoting reforms in Peru based on the general public.

capita income that had declined to the level of the latter half of the 1960s. The administration tried to control inflation by freezing prices, and to raise fiscal funds for economic activation by limiting the debt service ratio to 10%. In mid-1987, however, it became clear that this policy could not be maintained, resulting in accelerated inflation, a depletion of foreign currency reserves, and a rapid expansion of deficits in the public sector. In 1988, the fiscal deficit accounted for 16% of the GDP, and the monthly rate of inflation reached 21%. Although the Government tried to reshape the economy by raising prices of major items, except wages, in September 1988, inflation further accelerated, with an annual rate of more than 1000%, and the Peruvian economy failed. During the period between 1987 and 1990, production and real wages declined by 20% and 75%, respectively.

## (2) Social conditions

The Velasco Administration's social reform, focused on radical agrarian reform, could not change the traditional structure of Peruvian society, deeply rooted in its history. Political and economic instability caused people to move rapidly from impoverished rural regions to cities. Guerrilla activity and terrorism prevailed, with a rapid decline of Government competence, and the outskirts and old sections of cities became slum quarters, disturbing public peace and order.

Terrorism by sierra-based Sendero Luminoso and the urban-based Tupac Amaru Revolutionary Movement (Movimiento Revolucionario Tupac Amaru: MRTA) became violent in proportion to the economic failure and declining Government competence. Coca (the source of cocaine), widely cultivated in the Huallaga Valley, provided funds for Sendero Luminoso. Narcotic exports were estimated to value at least one billion dollars annually, reaching 4% of the GDP.

The population increased at an annual rate of as high as 2.6%, even in the latter half of the 1980s, increasing from about 10 million in 1960 to 20 million in 1985. It almost doubled in 25 years. Urbanization was also rapid, and the proportion of the urban population increased from 52% in 1965 to 69% in 1988. Concentration of the population in Lima, the capital, was especially considerable, with more than 40% of the urban population living in the city. The Lima population increased from 1,680,000 in 1961 to 6,500,000 in 1990. About two-thirds of these people, or their children, were said to have moved from rural regions over the past 40 years. The background of this was poverty in rural regions. Although small-scale farmers were given farmlands in Velasco's agrarian reform, 53.8% of the target farmlands were in costa, where there were a number of large-scale owners engaged in export agriculture. For sierra, where most farmers were small-scale, the area of target farmlands was small, and the reform was limited to a comparatively small scale. Among people from rural regions, only a few were employed in manufacturing, a modern urban industry, and the others formed a so-called urban informal sector, engaged in very-small-scale peddling, stall-keeping, keeping of open-air eating places, and very-small-scale home industry.

In Peru, long economic stagnation deepened rural poverty, causing a large number of rural people to move to cities. This produced slums quarters in cities and formed an informal sector. This widened socioeconomic gaps and made them complicated. Among Latin American countries, Peru is still classified as a country with a considerable disparity of wealth.

## 1.2.2 Economic liberalization by the Fujimori Administration

President Fujimori, inaugurated in July 1990, declared Peru's return to the international financial community and economic rehabilitation, and enforced economic adjustment policies immediately after taking office. On August 8, 1990, he revised the price and rate systems, raising gasoline price by 32 times, and took stringent measures, including price liberalization. A substantial raise of fuel prices, among others, directly affected people's lives, raising the monthly rate of inflation to 400% in August. The people, aware that only drastic reforms could rebuild the national economy, hardly opposed such drastic measures, which were called "Fuji shocks." Following price liberalization, he started structural reforms one after another, such as trade deregulation, a large reduction of customs duties, and administrative reform by promoting recommended retirements.

Fujimori's economic liberalization measures became full-fledged from March 1991 and thereafter. In addition to the liberalization of trade and direct foreign investments, these measures included the abolition of price controls and extensive reforms focused on privatization and a more flexible labor market. In November 1991, he issued a number of mandate administration laws (hereinafter referred to as administration laws) in his efforts to accelerate his structural reform for promoting private investment and expanding employment opportunities. Some were, however, revised or abolished, as the Congress became increasingly antagonistic toward the president, holding his reforms in a deadlock. Laws were established for the necessary areas, under the Emergency and National Reconstruction Government (Gobierno de Emergencia y Reconstrucción Nacional), started on April 5, 1992, and the principles of the structural reforms were confirmed in the new constitution accepted by a public vote in October 1993<sup>8</sup>.

The price system, which had been distorted by the previous government's indiscriminate granting of subsidies and price controls, was corrected, in a large-scale price adjustment and liberalization. The determination of major prices was left to the market mechanism. Exchange was unified and liberalized, and a floating exchange rate system was adopted. The abatement of inflation stabilized the rate of currency to the dollar. Interests, foreign currency deposits, and remittances of profits were also liberalized, the Bank Nationalization Act established by the García Administration was abolished, and the New Bank Act was enforced.

For trade, import regulations, such as bans and limitations on import items, were removed, and exceptions (except for some agricultural products) were abolished. Tariffs were levied at two rates: 15% and 25%. In 1993, 15% was levied on more than 90% of imports, with the average tariff rate being 16%. Peru has a very open trade system among Latin American countries. The Fujimori Administration's reforms included harbor reform and the establishment of Superintendencia Nacional de Aduanas (SUNAD, National Superintendent of Customs).

Direct foreign investment was also liberalized. Revisions of the Foreign Capital Act (by Administration Law No. 662 "Law for the Promotion of Foreign Investment," Administration Law No. 757, and Laws Nos. 25570 and 26120) ensured domestic and foreign investors the principle of nondiscrimination and freedom of activity. Aiming to guarantee direct foreign investments, Peru joined the World Bank's Multilateral Investment Guarantee Agency

<sup>8</sup> Provisions on economic systems include freedom of private economic activities (Article 58), free competition (Article 59), principle of equal opportunities (Article 61), free trade (Article 63), free exchange of currencies (Article 64), equitable external and internal investment, free economic activities with foreign currency (Article 63), and consumer protection (Article 65). For main points of the new constitution, refer to Shigeo Osonoi (1994)

(MIGA), for multilateral investment, and the United State's Overseas Private Investment Corporation (OPIC), for bilateral investment. For settlement of investment disputes under the World Bank arrangements, Peru joined the International Centre for Settlement of Investment Disputes (ICSID).

Removal of the regulations in government-controlled areas, except for those pertaining to national security, enabled the private sector to participate in economic activities and resources development (Administration Law No. 757). It was stipulated (Administration Law No. 758) that the private sector should be encouraged to participate, through entrustment by the Government, in the construction of infrastructure, such as roads, public undertakings, public transport, environmental conservation, welfare, education; public services concerning energy, communications, and road lamps; and the management of public facilities, such as amusement facilities.

A legal framework for privatization was built by Administration Law No. 674 of September 1991 "Law for the Promotion of Private Investment in State-owned Companies" (the so-called Privatization Act). The Government organized the Comisión de Promoción de la Inversión Privada (COPRI, the so-called Privatization Commission) and the Comisión Especial de Privatización (CEPRI, Special Commission for Privatization) for major enterprises. Rationalization, such as personnel reductions, was carried out, and privatization was started in mid-1992. In parallel with this, new laws were enforced in relevant areas. They included the General Mining Act (June 1992) and the New Fishery Act (December 1992). At the end of 1994, the government created Fondo de Promoción de la Inversión Privada (FOPRI, the Fund for Private Investment Promotion), aiming to encourage the participation of domestic capital in privatization.

Major enterprises privatized by the end of 1996 included HIERROPERU(iron mine), AEROPERU(Airline), Petromar (submarine oil), Cerro Verde (copper mine), ENTEL-CPT (telecommunications), and ELECTROLIMA(Lima Electric Power Corporation). On April 22, 1997, the number of state asset and enterprise units exceeded 100, with the total income from privatization reaching 7 billion dollars. Investments in privatization projects are estimated to reach 7.7 billion dollars by the year 2000. Privatization of the Oil Corporation has already been started, and the Government plans to privatize other enterprises, such as Centromin, as early as possible. Profits from privatization are incorporated into special accounts, for appropriation for social aid, debt repayments, and public investment in infrastructure.

Concessions have been rapidly expanded. The tax-free shop and the parking lot of the international airport have been entrusted to the private sector for six years. In mining the government-controlled mining fields have been opened to the private sector, with fees charged, and there have been many applications for concessions. The participation of foreign capital in privatization has raised the balance of foreign investments considerably.

In agriculture, the public corporations monopolizing the distribution of rice and the import and distribution of agricultural materials<sup>9</sup> were reorganized. The Agricultural Investment Promotion Act (July 1991) made it possible to buy and sell farmlands freely and arrange a mortgage, and thus a market mechanism was introduced in farmland ownership.

Labor legislation was revised, based on the Employment Promotion Act, and the Labor Stabilization Act, which had rigidified the labor market and lowered the proportion of full-time workers under the Velasco military government and following governments, was relaxed.

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<sup>9</sup> ECASA and ENCI

Administration Law No. 728, of November 15, 1991, eased dismissal conditions to a considerable extent. Measures were taken for easier employment adjustment in enterprises, to increase competitiveness, making it possible to employ workers based on economy, skill, and economic rationality, such as productivity, or making it possible to change personnel annually at a fixed rate of 5%. It was approved to extend the period of trial employment for new employees from the usual three months to one year, as necessary, and contractual employment came to be widely approved. The Labor Community<sup>10</sup> was revised, based on Administration Law No. 677, with workers' right to participate in the management and ownership of enterprises being deleted, which was confirmed by the 1993 constitution<sup>11</sup>. In 1992, various laws were established to abolish indexation in wage revision, limiting Government intervention in the settlement of labor-management disputes and strengthening the role of the independent arbitration agency, and collective bargaining on controlling workers' right to strike.

In social welfare, Administration Law No. 688 allowed the Instituto Peruano de la Seguridad Social (IPSS, Social Insurance Agency) to use private insurance and pension services as supplements, to promote its efficiency. With deletion of the provisions on social security provided by the Agency in the 1993 constitution, the Government introduced the Chilean pension system, in which workers could choose private pensions. In June 1993, Administradoras de Fondos de Pensiones (AFP) were established, to operate Sistema Privado de Pensiones (SPP, private pension system), and eight private companies began operation (they were reorganized to six later). In June 1994, Oficina de Normalización Provisional (ONP) came to manage official pensions provided by IPSS, leaving only health insurance services as the function of the Agency.<sup>12</sup>

### 1.2.3 Social measures by the First Fujimori Administration

The First Fujimori Administration took social measures focused on urgent and direct support for the extremely poor, in parallel with large-scale price liberalization, especially for public utilities charges.

In August 1990, it formulated an emergency social program as an interim measure (August to December 1990). Intended for the extremely poor, for whom the impact of economic adjustment was considerable, it included measures to support them in aspects of nutrition, health, and temporary employment. Humanitarian aid was also extended from the international community. The Government's first comprehensive social measure was the national plan for the relief of infants 1992-1995 (Plan Nacional de Acción por la Infancia 1992-1995), announced in November 1992. Through this plan, the Government aimed to coordinate measures by organizations concerned with saving infants from worsened nutrition and health conditions. In June 1993, the Government formulated its national strategy on poverty alleviation (Estrategia Nacional de Alivio a la Pobreza), in preparation for the Consultative Group Meeting (CG Meeting). This strategy was aimed, for the period of 1993 through 1995, at strengthening cooperation among government agencies, NGOs, and overseas aid organizations; improving nutrition, health, and education for the extremely poor; and

<sup>10</sup> The Velasco military government intended to promote workers' participation in business management by encouraging industrial communities, consisting of workers, to acquire up to 50% of stocks, based on the General Industry Act of 1970. This participatory system was developed into labor communities, and extended to mining, fishery, and communications.

<sup>11</sup> For labor reforms, refer to Verdera (1993).

<sup>12</sup> For main points of social security reforms in Peru, refer to Mesa-Lago (1994) pp. 133-135.

promoting productive activities, in order to reduce the negative impact of economic adjustment policies on the extremely poor

In August 1991, the Government established the national fund for social development compensation (Fondo Nacional de Compensación y Desarrollo Social: FONCODES), and started financial assistance for welfare services, social and economic infrastructure building, and production activities, as direct support for the extremely poor. In February 1992, the Government created the national food aid program (Programa Nacional de Apoyo a la Alimentación: PRONAA), to provide food aid for the urban poor and rural people. In June 1992, the Ministry of the Presidency was reestablished, as the central administrative agency controlling social assistance programs, infrastructure-building and regional development. The Government also organized the inter-ministerial commission on social affairs (Comisión Interministerial de Asuntos Sociales), as an organization in charge of coordination among the ministries concerned, analysis of social affairs, and policy-making. The commission, conducted by the President of the Council of Ministers, involved the Ministry of the Presidency, the Ministry of Economy and Finance, and the social development-related ministries.

#### 1.2.4 Attainments of the First Fujimori Administration

Under the policy of economic liberalization and stabilization, the Peruvian economy attained remarkable recovery, with a considerable decline of inflation (Table 1-2). During the first two years of the Fujimori Administration, the rate of economic growth declined, affected

Table 1-2 Macroeconomic indicators (1988-1996)

	1988	1989	1990	1991	1992	1993	1994	1995	1996
Real GDP growth rate (%)	-8.3	-11.7	-5.4	2.8	-2.5	6.5	12.9	6.9	2.8
Per capita real GDP growth rate (%)	-9.9	-14.1	-6.7	1.1	-3.1	4.6	11.2	5.2	
Inflation rate (Note 1) (%)	1,722.3	2,775.3	7,649.7	139.2	56.7	39.5	15.4	10.2	11.8
Unemployment rate (Lima metropolitan area) (%)	7.1	7.9	8.3	5.9	9.4	9.9	8.8	8.2	8.0
Public sector fiscal deficit (Note 2) (ratio to GDP, %)	-9.7	-8.4	-6.4	-1.9	-2.6	-2.1	2.1	-1.3	2.3
Export of goods (fob, million dollars)	2,731	3,533	3,321	3,406	3,661	3,516	4,598	5,591	5,897
Import of goods (fob, million dollars)	-2,865	-2,286	-2,922	-3,595	-4,002	-4,123	-5,596	-7,761	-7,897
Balance of current account (million dollars)	-1,657	-240	-1,066	-1,320	-1,907	-2,145	-2,539	-4,298	-3,605
Foreign currency reserves (million dollars)	-317	546	682	1,933	2,425	2,910	6,025	6,693	8,862
External debts outstanding (million dollars)	20,006	20,799	22,141	25,446	26,612	27,482	30,226	33,515	33,545
Income from privatization (million dollars)	0	0	0	2	212	127	2,840	1,276	1,751

Sources: BCRP, Memoria-1995, Nota Semanal No. 11, 21 de Mayo de 1997, INEI materials, World Bank, Global Development Finance, and so forth

Note 1: Increase rate of consumer price index (as compared with the preceding year at the year end).

Note 2: The financial sector is not included.

by belt-tightening measures for economic stabilization, but the rate of inflation was reduced from more than 7000% in 1990 to as low as double digits in 1992 and afterward. Foreign money also began flowing in. In 1993, the Peruvian economy began to recover. It marked annual real GDP growth rate of 9%, on average, for three years until 1995, and per-capita real income increased at an annual rate of 7%, on average, during the same period (GDP basis). These were produced by Government efforts to restore public peace and order, with a further decline of inflation (to about 10%) resulting from economic stabilization, and also by expanded investment, including foreign investments, as economic liberalization measures improved private business conditions. Increased exports also made some contribution. As per-capita income increased and the rate of consumption increase in underdeveloped regions exceeded that in metropolitan areas, income gaps seemed to reduce. With the restoration of public peace, Japan and the United States stopped advising their citizens against visiting Peru, which resulted in a considerable increase of tourists. In the public sector, the Government made efforts to reduce its fiscal deficit, through increased revenues from an expanded tax base and reduced expenditures, and through the privatization of public enterprises, and as a result Government savings accrued. The increasing external deficits were almost covered by inflowing private capital. The Fujimori Administration's efforts at external debt repayment brought application of the Brady Plan, with cooperation of the donor community, and rescheduling was realized in the Paris Club. Its relationship with the international financial community became normalized. Foreign currency reserves continued to increase rapidly, exceeding 9 billion dollars in February 1997.

These were the first products of the Fujimori Administration, which continued political and economic reforms, maintained economic stability, promoted economic liberalization, and restored public peace and order. They gave the people positive expectations for improved living conditions in the future and political and social stability in the present.

The Fujimori Administration was apparently producing results in social development. Table 1-3 shows changes of the proportions of the poor and the extremely poor, with the total population as 100%.

Table 1-3 Proportion of the poor to the total population

	1991	1994	1995
Proportion of the poor (%)	55.3	49.6	45.3
Proportion of the extremely poor (%)	24.2	20.2	19.3

Source: INEI.

Notes: The population of the poor is the sum of the population of the extremely poor and that of people not extremely poor.

The figures for 1991 are based on the household survey in October and November 1991, involving 2,252 households. Surveying, however, was not conducted for the rural regions in costa, and selva.

The figures for 1994 are based on the household survey from June to August 1994, involving 3,544 households.

The figures for 1995 are based on the fourth quarter household survey (INEI), involving 19,785 households.

These figures, though not directly comparable with each other, show a reduction of poverty. The number of the poor was still large in 1995, with 45.3% of the total population (23.5 million) being too poor to satisfy their basic needs, and 4.5 million people (19.3% of the population) being extremely poor, without satisfying basic nutritional needs.

## 1.3 New international environment for Peru

### 1.3.1 Economic globalization

For Peru, the international environment has been changing greatly. The most important factor is the materialization of a global economy. The transition to a market economy in socialist countries, the promotion of positive liberalization in many developing countries formerly under protectionism, the conclusion of the GATT Uruguay Round, and global liberalization with the establishment of the World Trade Organization (WTO), as well as regional liberalization in many places through regional integration, are expanding trade and investment on an unprecedented scale. Capital movements are active in diversified forms, and advanced telecommunications are strongly influential.

This trend of globalization has made it possible for developing countries, including Peru, to participate actively in the world economy, and such participation in turn provides them with development opportunities. The international environment is changing greatly in this sense.

Globalization, however, causes intense competition in the world market, as a matter of course. This means that a country without sufficient competitiveness could be left behind, because of delayed participation in the world market.

The internationalization of capital markets and the diversification and expansion of international capital movements make it possible for a country to utilize these in its economic development. At the same time, inappropriate measures for capital movements could produce economic instability.

Liberalization for globalization has great effects on a domestic economy. They can bring unemployment or widen income gaps in the short term.

Globalization provides very important opportunities for developing countries, including Peru. At the same time, it requires taking on various challenges to benefit the domestic economy through it. Globalization is the most important challenge in the new international environment. It will be a great task to be faced, with many inherent difficulties.

#### Box 1 Asian monetary and financial crisis and Peru

The Asian monetary and financial crisis, which originated from the devaluation of the Thai baht in July 1997, had little impact on financial aspects of the Peruvian economy. This was attributable to steady reform in the financial sector, a very small proportion of short-term private debts outstanding to external debts, a small extent of the dissemination of monetary and financial systems, and ample liquid foreign currency reserves in the central bank.

The crisis, however, has been adversely affecting some sectors of the economy. Economic stagnation in Asian countries is accelerating declines of international commodity prices. Lowered prices of Peru's major exports, such as copper, gold, and zinc, are reducing export values of these products, producing negative effects on Peru's foreign currency acquisition. Industrial manufacturers, especially in the apparel industry, among others, are expected to be exposed to intensified competition with low-priced Asian products.

Although the present monetary and financial crisis in Asia appears to have only a slight impact on the Peruvian economy overall, it emphasizes the necessity of efforts for a sounder financial sector and improvement of export competitiveness, in the situation of financial and capital globalization.

### 1.3.2 Progress in regional integration

Latin America has long experience in regional economic integration. Communities include the Latin American Free Trade Association (LAFTA, or ALALC in Spanish), which began operating the year following the signing of the Montevideo Treaty in 1960, the Central American Common Market (CACM, or MCCA in Spanish), which was established in the same year, the Andean Community (ANCOM, or Andean Group), established later, and the Caribbean Community (CARICOM). They made every effort for trade liberalization in their respective communities, but failed to realize the anticipated result, without attaining regional integration, like the European Union (EU).

From the end of the 1980s to the 1990s, Latin American integration entered a new period, quite different from that in the 1960s. First, while the regional communities established in the 1960s aimed to expand import substitution industrialization from the national basis to regional levels, maintaining high customs duties, the main purpose of the new integration was to open the member countries' liberalized markets further to one another, aiming at export-oriented economic development, and to improve their international competitiveness through competitions in free, wide-area markets or in respective regional economies created by this regional integration.

Second, the new integration set more realistic goals and systems than that in the 1960s, as the latter started with overly-idealistic goals, impeding flexible integration, as a result.

Third, the recent integration is many-sided and complicated. This is caused by the very realistic approaches it takes. Many bilateral agreements have been concluded, with a view to advancing integration where possible, and the Latin American Integration Association (Asociación Latino-Americana de Integración: ALADI, LAFTA was reorganized into ALADI in 1980), the Andean Community, the Central American Common Market, and the Caribbean Community have been active again toward regional integration. Brazil, Argentina, Uruguay, and Paraguay established Mercado Común del Sur (MERCOSUR, the Latin American Southern Common Market), which Chile and Bolivia joined later. Mexico, Venezuela, and Colombia organized the G3. Central American and Caribbean countries established the Association of Caribbean States (ACS); and Canada, the United States, and Mexico concluded the North American Free Trade Agreement (NAFTA). Negotiations have also started to establish the Free Trade Area of the Americas (FTAA). More extensive economic integration is thus under way, involving a large number of sub-regions.

The Andean Group (Andean sub-regional integration), organized in 1969, is most important for Peru. The Group comprises Peru, Bolivia, Colombia, Ecuador, and Venezuela. These five countries, signing the Quito Treaty in 1995, decided to reorganize systems and institutions, including the secretariat of the Cartagena Agreement, with a view to conducting institutional reforms for the promotion of regional integration. They decided to develop these reforms into the Andean Integration System. They had a meeting to build a legal framework at the end of 1995, and completed their study for reorganization in 1996, toward establishment of a new organization, the Andean Community in 1997.

The five countries, however, have considerably different ideas regarding the levels of common external tariffs, and this affects the process of integration.

In January 1995, MERCOSUR started working, and Chile and Bolivia joined as associate members in 1996. Other Andean countries are studying participation as associate members in the market. It is highly possible that Peru and other countries will join the Latin American wide-area economic bloc, in which Brazil and Argentina are leaders.

In December 1994, an Inter-American Summit was held by 34 American countries (except Cuba), including the United States, Canada, and Latin American and Caribbean countries. They decided to create FTAA and complete negotiations for this purpose by 2005. The summit adopted a paper entitled "Declaration on Principles-Partnerships for Development and Prosperity: Democracy, Free Trade, and Sustainable Development in the Americas." An "action plan" was also adopted for this purpose.

According to these papers, the Free Trade Area of the Americas is intended to expand and deepen economic integration in the Western hemisphere<sup>13</sup>, based on sub-regional and bilateral arrangements existing in the Americas, and to integrate the existing agreements. The papers also advocate promoting productive investment in the Americas, strengthening the mechanism for investment protection, and promoting development of the capital market and its stepwise integration, from the standpoint that investment is an important engine for growth.

It can be said that the FTAA is aimed at regional integration through trade and investment liberalization in the Americas. The "action plan" includes capital market development and liberalization, infrastructure-building, cooperation in the energy sector, infrastructure-building for telecommunications and information, technological cooperation, and cooperation in tourism promotion. Ministerial conferences on trade have already been held in the United States and Colombia, and one is scheduled in Brazil. Another Inter-American summit is being held in Chile in 1998.

Peru had been eager to participate in the Asia-Pacific Economic Cooperation Conference (APEC), and the APEC Vancouver Conference in November 1997 decided to accept Peru in 1998.

Peru has thus participated in diversified regional integration initiatives, whose specific progress will provide Peru with new opportunities.

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<sup>13</sup> It means the countries in the Americas. It is often used in Western literature, in referring to countries situated in the Western hemisphere from the viewpoint of the European continent.

## **2. Basic Perspective on Peru's Development**

### **2.1 Viewpoints of the international community on development**

#### **2.1.1 People-centered development**

Since the end of the Cold War, there has been a new trend in the international community regarding desirable international cooperation for developing countries. The spotlight of attention has been focused on serious problems, such as widened wealth disparity behind economic growth, education and medical service for those who have been left behind, and environmental pollution due to industrialization, with experiences in international cooperation thus far being taken into account. The UN Conference on Environment and Development was held in 1992 in Rio de Janeiro, and the International Conference on Population and Development in 1994 in Cairo. In 1995, the World Summit for Social Development in Copenhagen announced that an economy should be oriented toward people-centered development, for more effective satisfaction of human needs. In other words, emphasis has been placed on "people-centered development." This idea has been accepted widely in the international community, providing the basis of development.

"People-centered development" aims to widen options for people's participation in development and expand access to income-earning and employment opportunities, education and health services, as well as sanitary and safe living conditions. It has been confirmed again that an improved economic level is a means of realizing "people-centered development," and it includes greater equality in the distribution of economic benefits.

#### **2.1.2 Sustainable development**

The term "sustainable development" has been widely used since it was put forward in the World Commission on Environment and Development (Brundtland Commission) in 1987. Focusing on the necessity of improving environmental management, it has contributed to raising people's awareness of compatibility between development and environmental conservation. From the environmental viewpoint, "sustainable development" not only satisfies the needs of the present generation but also improves their well-being without endangering the needs of future generations. It pertains to the viewpoint of thinking about development in the context of time passing.

#### **2.1.3 DAC's New Development Strategy (Shaping the 21st Century: The Contribution of Development Co-operation)**

In this context, the Development Assistance Committee (DAC) of the OECD adopted, in May 1996, its "Development Strategies" (formally entitled "Shaping the 21st Century: The Contribution of Development Co-operation), which analyzed the experiences in development assistance over the past 50 years and described its role in the past and for the future in the international community.

The paper proposes "new global partnerships," in which developing countries are ultimately responsible for their own development, and donors and recipients are jointly responsible for shared objectives of development. The paper announces that the goal of development is to improve all people's living, based on the idea of "people-centered

development," and it suggests measurable goals, as follows. The paper expects their attainment in fixed periods of time.

- (i) A reduction by one-half in the proportion of people living in extreme poverty, by 2015.
- (ii) Universal primary education in all countries, by 2015.
- (iii) Elimination of gender disparity in primary and secondary education, by 2005.
- (iv) A reduction in the infant and under-five mortality rates by two-thirds of the 1990 level, by 2015.
- (v) A reduction in the maternal mortality rate by three-fourths of the 1990 level, by 2015.
- (vi) Access to reproductive health services for all individuals of appropriate ages, by 2015.
- (vii) Current implementation of national strategies for sustainable development in all countries, by 2005, to ensure that current trends in the loss of environmental resources, such as forests and fisheries, are reversed by 2015.

This development strategy was approved in the OECD Ministerial Council Meeting in May 1996 and welcomed by the G7 in the Lyon Summit in June of the same year.

## **2.2 Framework for development**

### **2.2.1 People-centered, sustainable development**

The word "people" in "people-centered development" as mentioned above can be regarded as not only the present generation but also future generations. It can be said, therefore, that the foundation of "people-centered development" does not exist where "sustainable development" has not been attained. The Study Committee regards "people-centered, sustainable development" as the final goal of development.

It is possible, from this viewpoint, to divide a country's development into four areas, as mentioned in Fig. 2-1 below; namely, environmental conservation, economic development, social development, and governance<sup>14</sup>, closely related to these. Ideal "people-centered, sustainable development" can be realized where progress is made simultaneously in both sustainable economic growth and social development, under appropriate conservation of the environment, supported by good governance and participatory development. The Study Committee thinks that the realization of "people-centered, sustainable development" depends on progress in each area and a balance among the four areas.

Development can be subjected to various changes over the passing of time. The middle row of each area in Fig. 2-1 mentions main factors describing changes in it. Environmental conservation becomes possible through people's consent on environmental management, system-building, and progress in how to improve the environment. Economic growth can be sustainable through a changing structure of production and supply capacities capable of meeting internal and external demands (industrial sophistication), with economic entities' participation in an efficient market economy system under an appropriate macroeconomic balance. Social development advances by capacity-building for people through improved educational, health, and medical systems. It removes latent social discriminations, ensures all

<sup>14</sup> The World Bank defines governance as the "manner in which power is exercised in the development of a country's economic and social resources for development" (World Bank (1994), p. xiv). DAC defines it, based on the World Bank definition, as the "use of political authority and exercise of control in a society in relation to the management of its resources for social and economic development" (OECD, 1995).

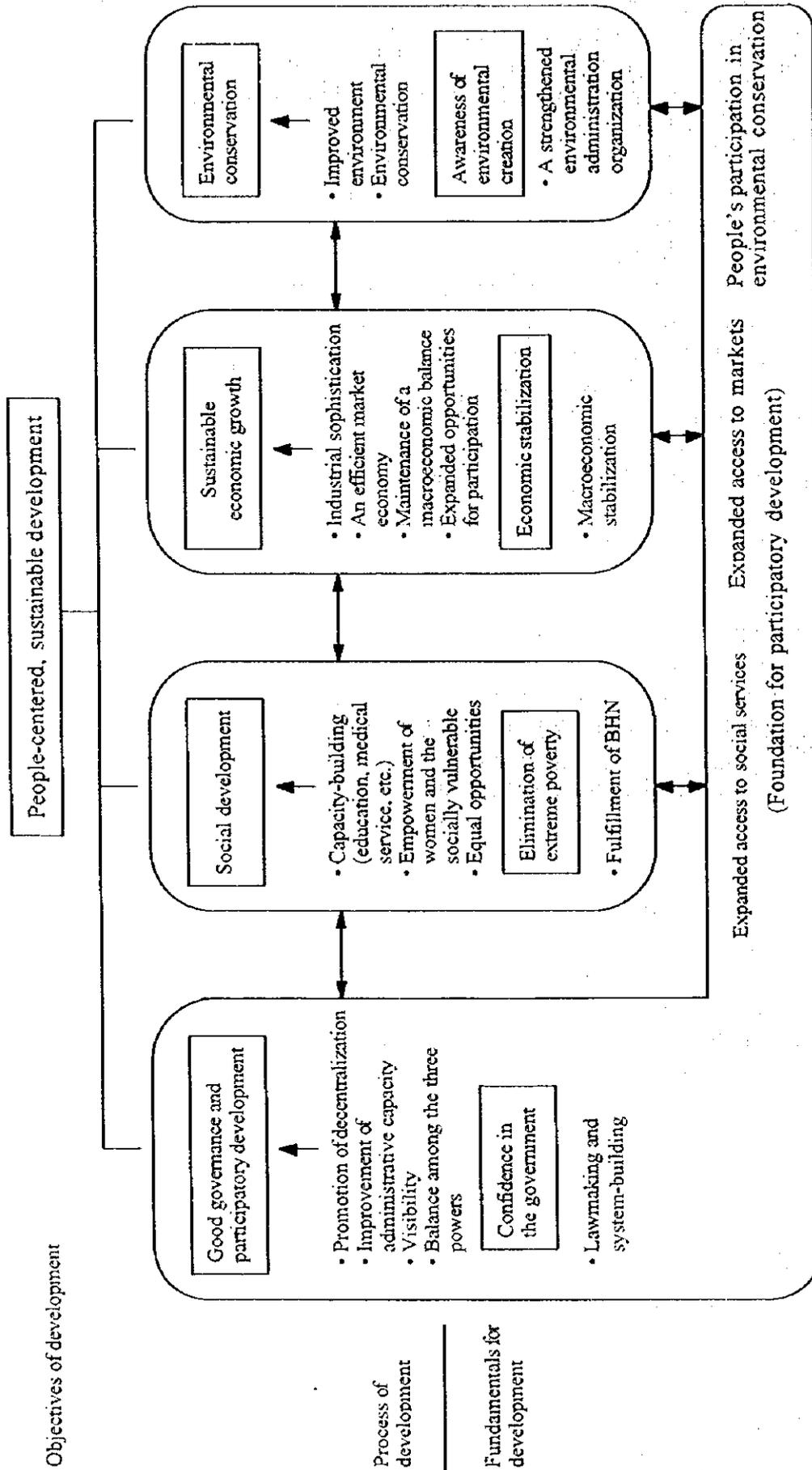
people equal opportunities, and gives consideration to the empowerment of those who are in socially disadvantageous positions. Governance is closely related to the realization of environmental conservation, the allocation of economic goods and services, social participation, and the way people enjoy various services. It comprises the national system, consisting of legislation, judicature, and administration; its visibility and accountability, as well as the degree of decentralization. Where these factors of governance are improved and, working properly and effectively, come to be recognized and accepted widely, people are encouraged to participate in development, greatly affecting progress in environmental conservation, economic growth, and social development.

Fundamentals must be satisfied as the starting point of development, so that interactions and desirable circulation and progress in development will be created as mentioned above. The starting point of sustainable economic growth is economic stability, which requires the restoration of a macroeconomic balance. For instance, sustainable growth cannot be realized under hyperinflation. Social stability requires a reduction in the proportion of the extremely poor, by continuously satisfying basic human needs (BHN). Even in a well-established institutional framework, with equal opportunities being provided, people are apt to be caught in a vicious circle of poverty, if they do not have basic capabilities, such as for maintaining health with adequate nutrition, or acquiring knowledge through education. The starting point of environmental conservation is the basic awareness that the environment is a precious resource that must be maintained and managed. It cannot be realized by a small number of people. It requires educational activities in communities and official framework-building for environmental management.

The situation in which fundamentals of these three areas of development are in the process of building can be regarded as when basic laws and the institutional framework are working to a certain extent. In other words, people's confidence in their government supports the functioning of basic arrangements, such as laws and systems. Their confidence is in turn reinforced by development in these three areas through interactions with each other.

The lowest row of Fig. 2-1 shows the foundation for participatory development. "People-centered, sustainable development," the final goal, can be achieved through the participation of many people in development, and their enjoyment of benefits from it. People's participation demands a situation in which they are given access to social services and markets and opportunities to join environmental conservation activities, under a well-established physical and institutional infrastructure that assures participation. These are indispensable in the process development, and provide a basic means of satisfying the requirements for development.

Fig. 2-1 Framework for Development



\* "Good governance" and "participatory development" are prerequisites for and objectives of development.

\* In defining "good governance and participatory development" in "framework for development," "Study on Participatory Development and Good Governance" (March 1995, JICA) was used as a reference.

## **2.2.2 A country and regional individuality**

In reviewing the present conditions and challenges in development in a country or a region according to the development framework mentioned above, it should be noted that the direction of development, challenges in it, and its process depend on the country's or the region's socioeconomic structure, built on its history and culture; natural resources it possesses, and its geographic conditions. Its individuality determines periods required for development; that is, short, medium, or long term, and interactions and reliance with each other in the four areas mentioned in Fig 2-1. In postwar development in Japan, for example, political stabilization and institution-building were promoted, with reforms after World War II as the starting point, while social development was addressed in the process of economic growth. Japan's postwar development policy was focused mainly on the sophistication of its industrial structure, and then environmental problems were addressed intensively, as they became serious in the process of growth.

Top priority is often given to BHN, from a humanitarian viewpoint, in least-developed countries or regions. There, the satisfaction of BHN is indispensable for autonomous economic development, in addition to the modernization of their political and economic systems and public institution-building. In countries or regions faced with political instability, civil war, or a serious refugee problem, top priority must be given to political stabilization. As challenges differ from country to country, or from region to region, it is necessary to pay attention to the development procedure, how to evaluate the results, and the shifting priority of development issues. It is very important, in considering development in individual countries and regions, to understand their problems with respective historical and cultural backgrounds.

## **2.3 Basic perspective on Peru's development**

### **2.3.1 Present conditions of development in Peru**

The First Fujimori Administration (August 1990 to July 1995) took emergency measures against the crisis condition produced in the 1980s, as a result of an accumulation of structural factors in politics, economics, and society, that had interacted with each other for the previous 30 years. In 1990, per-capita income (real GDP basis) was as low as that in 1960. Unpaid external debts were accumulated, and the García Government's declaration of a virtual moratorium severed Peru from the international financial community, resulting in a stoppage of inflowing external funds. Internally, the proportion of the poor was increasing and people's living conditions were worsened, making the informal sector much larger than that in other Latin American countries. Peruvian society comprised a large number of small groups by occupations, regions, social strata, and so forth. It was characterized by complicated interests and dependence among these groups, which could produce serious social rifts. Peru's civil society in its germinal stage was becoming weak. The Government had lost people's confidence, in a decline of its competence, institutional weakness, and corruption. People had no confidence in the existing political parties either.

Amid these political, economic, and social conditions that found the national system in a crisis situation, the Fujimori Administration exerted strong leadership in taking daring reform measures, and it produced considerable results while achieving political stability. It built up a new political system based on the constitution it established in 1993, and restored public

peace and order by virtually sweeping out terrorists. In macroeconomics, the administration successfully abated inflation through the reestablishment of fiscal and financial discipline. Aiming to achieve economic stabilization, it built a basic framework for a market economy, to change from an economy dependent on state intervention to one that operates under a market mechanism. Socially, the administration worked to reduce poverty by directly assisting the extremely poor, to satisfy their basic human needs. This greatly helped these people recognize that their living conditions had been improved, giving them hope for the future and positive expectations toward the Fujimori Administration. Peru has taken its first step toward environmental conservation, with the assistance of international aid organization. In light of the framework defined in Fig 2-1, it can be said that Peru already has fundamentals for a full-scale development process toward "people-centered, sustainable development." Emerging from implementing emergency measures for the crisis situation in overall politics, economics, and society in the first half of the 1990s, Peru is now making efforts for long-lasting, steady development.

In advance of the next chapter (Development Issues in Peru), progress in fundamentals in the four areas mentioned in Fig 2-1 can be evaluated as follows. Although Peru faces a number of challenges to sustain economic growth, with some uncertainty in employment and income distribution, economic development has made the most remarkable progress in the four areas of development. As Peru has just started addressing environmental conservation, there are a number of challenges, including framework-building for government regulations on mine development by the private sector. With the establishment of laws and systems, people have increased confidence in the Government, but coordination of overlapped undertakings and services among the administrative agencies concerned is still insufficient. It is therefore important to enhance their administrative capacities on the whole, so that they can work systematically. Another challenge is to make the parliamentary system work sufficiently, and it is urgently needed to build an effective judicial system and develop human resources for it. In short, though the starting point for good governance and participatory development has already been prepared, the foundation is still fragile. The greatest challenge exists in the area of social development. The government, thinking that it takes generations for capacity-building and empowerment to bear fruit, has been providing assistance for future generations, placing top priority on education for pregnant women and mothers, and infant nutrition and health, while continuing efforts to alleviate extreme poverty. Long-lasting steady efforts will be needed in solving the poverty problem, which is thought to be rooted in Peru's history, society, and culture.

### 2.3.2 Basic perspective on future development

Long-term development in Peru should be oriented toward "people-centered, sustainable development." Policy efforts need to be focused on promoting social development, because poverty alleviation is the largest and most urgent challenge in Peru. For many people, a means of income-earning and employment opportunities are not sufficiently ensured, to say nothing of options for participation. They cannot even enjoy either health and education or sanitary and safe living conditions, which are objectives of "people-centered development."

The United Nations Development Programme (UNDP) mentioned "income poverty" and "capability poverty" in its *Human Development Report 1996: Economic Growth and Human Development*. It regarded poverty not just as a level of income but as pertaining to overall living in many ways. It emphasized the importance of developing three capabilities.

The first was capability to be well-nourished and healthy, focusing on nutrition for children under the age of five. The second was capability for healthy reproduction. The third was capability to be educated and knowledgeable, focusing on the role of women in households and communities. Top priority must be given to improving these capabilities, to cut the vicious circle of poverty. From this viewpoint, continuous political measures seem to be needed for reducing "capability poverty" in Peru.

Here, the importance of "good governance and participatory development" must be emphasized. According to a recent household survey, there are distinct gaps in Peru according to ethnic groups, education levels, and regions. These gaps partially originate in cultural and social factors that cannot be explained by capability differences. They are thought to have produced an immense gap that cannot be removed with the market adjustment mechanism. In a situation in which a large capability gap exists, people are required to reduce it by learning through productive activities and their relationships with the whole society, in the progress of social development. People must be given various opportunities that encourage them to participate in productive and social activities. If the market mechanism cannot offer sufficient opportunities, they must be created by administrative agencies, NGOs, and communities. Continuous promotion of this activity requires a stabilized structure of governance rooted in the community. As individuality differs from region to region, or from stratum to stratum, there are no universal models. A stable, participatory mechanism must therefore be created through positive activities of organizations and individuals engaged in the promotion of participation, an understanding of deeds prevailing in the target stratum, and trials and efforts.

Efforts to expand economic rewards (sustainable growth) are required at the same time. Growth of modern industries must continue, sustained by macroeconomic stability and improved business conditions. Participation must be guaranteed for those who have acquired capability to participate in extensive employment and business opportunities offered by the market. In Latin America, trade and capital liberalization and regional economic integration are advancing, with relationships among corporations becoming increasingly close beyond national boundaries. Peru's modern export sector must not be left behind in this trend of liberalization. It should not neglect improving technologies and managerial capability, developing products and production technologies, and opening new markets. It should promote industrial sophistication from the regional viewpoint beyond national boundaries, by promoting cooperation among domestic businesses and strengthening positive relationships with overseas enterprises. To this end, a national-economic foundation must be gradually formed to support these modern industries. This broad-based foundation provides employment opportunities and stimulates domestic consumption and investment.

In realizing sustainable growth, which is a precondition for social development, proper environmental management and conservation are needed to make it possible to effectively use the rich natural resources and the natural environment that Peru is blessed with. It is important to improve people's awareness of environmental creation, to address institution- and capacity-building in administrative bodies, and to take budgetary measures. Environmental conservation is often difficult to address through the market. There are many challenges in participating in environmental conservation, such as monitoring by citizens and official monitoring.

### 3. Development Issues in Peru

#### 3.1 Challenges in economic development

##### 3.1.1 Addressing by the Government

Economic stabilization and liberalization measures taken by the Fujimori Administration successfully abated inflation and brought macroeconomic stability. Restored public peace and order have been contributing to continuing economic growth since 1993. At the inauguration of the Second Fujimori Administration, the president declared that Peruvians had already acquired capability of acting not only out of urgent necessity but also by setting long-term goals, backed by these economic and social results. Economic goals included continuing growth, poverty reduction (reduction by half in the proportion of the extremely poor), and increased employment opportunities. He mentioned infrastructure-development for attaining these goals, with exports as an engine for growth. In May 1996, Prime Minister Pandolfi said that the medium-term rate of GDP growth would be maintained at 5 to 6% until 2000.

In these conditions, the Government reached agreement with the International Monetary Fund (IMF), in July 1996, on the building of a medium-term economic policy framework, in order to receive an extended fund of 358 million U.S. dollars for the three years from 1996 to 1998. According to the agreement, policy goals included controlling the inflation rate, continuing economic growth, and strengthening measures to alleviate poverty. Medium-term macroeconomic goals were as follows.

Table 3-1 Medium-term Macroeconomic Goals: 1996-1998

	1995	1996	1998
Consumer price index (term-end)	(10.5%)	9.5 - 11.5%	Industrialized country level
GDP growth rate	(6.9%)	3 - 4.5%	6% or more
Public sector income and expenses (except privatization income and expenses: ratio to GDP)	-2.6% (-2.6%)		Nearly balanced
Basic budget balance	0.3% (0.3%)		2.0%
Total investment/GDP	24% (24.2%)	Increased private investment in the mining and energy sector	25.5%
Internal savings/GDP	16.5% (17%)	Government savings accounting for 2/5 of the increase	20.5%
External savings/GDP	7.2% (7.2%)		5% or less

Note: Figures in parentheses show actual values.

Source: Prepared from central bank data.

In order to attain these macroeconomic goals, the Government must control disorder caused by political and social instability, through continuous efforts to reduce the proportion of the extremely poor; increase expenses for education and health and medical services, and strengthen social safety nets. The Government must reduce the inflation rate to reach the industrialized country level by 1998 (according to the IMF, consumer price indexes should be reduced to 4% at the term end). It must maintain the investment rate, through an expected considerable increase in investments in mining and energy, accompanying progress of

economic liberalization; through the liberalization of foreign investments; and through privatization; and it must raise the rate of GDP growth to 6% or more. Although current account deficits are expected in the balance of payments for the time being, the private sector will be capable of self-financing through the expected export of mineral and agricultural products. Accumulated debts will be rescheduled in consultation with the Paris Club, based on agreement with the IMF, and debts to foreign commercial banks will be reduced in accordance with the Brady Proposal and covered by concessional loans from international donors.

In order to attain these economic goals, the Government will strengthen its tax collection efforts and rationalize its spending. It will complete the privatization of public mining and energy enterprises by 1998. It will also establish regulatory and supervisory agencies for electric power, oil, gas, and harbor services, in order to strengthen the Government's regulatory and supervisory capacity. It will further modernize the financial sector, and complete its pension reform. Private investments will be promoted by the establishment of regulations relative to the farmland law, the introduction of a market mechanism in water rights, and the improvement of urban land tenures.

These show that policy goals can be attained through economic stabilization and liberalization, increased economic efficiency, and the provision of favorable conditions for private businesses by building an economic infrastructure, including roads.

### **3.1.2 Considerations in economic development**

The improvement of business conditions for private enterprises has made considerable progress thus far, and it must be maintained. Continued growth needs continued creation of investment opportunities. It must be further studied as to if this is possible only through the improvement of business conditions.

A first question is, Do private industries, especially modern industries, have the capacity to sufficiently respond to improved business conditions? The exploration of mineral resources, such as copper, zinc, iron, and silver; oil and gas development, represented by the Camisea Project; tourism; and agriculture and fishery in costa, are all expected to attract internal and external investments. For sustained growth, it is important for these leading industries to increasingly attract sustained investment. It is also important for this to bring the development of industries that manufacture non-traditional exports and that process primary products, with the leading industries serving as an engine. To this end, the private sector needs capacity-improvement so that it can, as an organization, carry out managerial and technological reforms, and relationships among enterprises must be developed into an efficient system. It will be necessary to pay attention to Peru's economic and social diversity originating from occupations, regional differences, social strata, and cultural factors. Attention must be paid to low levels of education, the supply-demand relation in employment, and an inadequate infrastructure, which factors still contribute to social diversity.

Second, short-term macroeconomic stabilization and economic liberalization are important, certainly, for providing a better business environment, and they are expected to encourage investments in industries that have comparative advantage and that can provide high-efficiency investment opportunities. On the other hand, monetary tightening to abate inflation, has produced high interest rates. Increasing inflows of foreign capital, attracted by high interest rates, have contributed greatly to counterbalancing the current account deficit, but on the other hand they have raised exchange rates. These give negative effects to businesses

that operate through domestic investments (small- and medium-scale businesses, among others), except mining and tourism, which are capable of self-financing with inflows of foreign investments or export incomes, and part of agriculture and fishery. Employment is also greatly affected. Higher exchange rates cause domestic demand to lean toward exports, and to restrain internal investment. They even impede the diversification of exports. Desirably, development should be export-oriented, with diversified products, in order to realize continued growth. It is important to be well aware of unfavorable effects of macroeconomic stabilization on long-term growth, and to take measures as necessary.

Third, measures must be taken to create employment opportunities in a short or medium term, within the framework of a free market economy. Mining, having comparative advantage, and export-oriented agriculture could create enclaves, limiting recipients of the benefits, if organizational and institutional capacities remain low in other private industries. Small- and medium-scale businesses should be promoted, for the creation of employment opportunities, and production in the informal sector should be supported. (Details will be given in 3.2, Challenges in social development, regarding the creation of employment opportunities for the poor.)

Fourth, the development of provincial areas, which have remained less developed amid concentration of the population into the metropolitan area, can create employment opportunities and incomes, through the formation of clusters (integrated industries) focused on regional special products. It is desirable that regional development be promoted in accordance with a definite vision. This requires due consideration of regional conditions and relationships with other regions (connections between people, traffic, information, and public and private institutions). Regional development promotes the integration of domestic markets isolated geographically, and makes it possible for a large number of people to participate in the national economy. It represents a significant challenge in realizing sustainable economic development.

Fifth, the infrastructure, whose rehabilitation the Fujimori Administration has promoted since 1990 in the areas of traffic, communications, energy, and water supply, needs further improvement -- the mentioned systems should be further modernized, for continued economic growth in Peru. In mining it is urgently necessary to improve the infrastructure for transport and shipping in mining and prospecting minerals. In agriculture, infrastructure investment is urgently needed to construct large-scale irrigation facilities in costa, and to reduce transport charges in sierra and selva. The present administration places priority on building an infrastructure that directly benefits the poor. The Government will have to provide a highly effective infrastructure that encourages production by the poor.

These challenges in economic development show the importance of Government measures to encourage the participation of the private economy. Unfortunately, however, the central and local governments are not yet equipped with sufficient capacity to implement them. The Government of Peru must focus its efforts on top priority areas for the present. External assistance, therefore, plays a very significant part in administrative capacity-building, technology transfer, technical advice, human resources development, and infrastructure-building.

### 3.1.3 Issues by area

#### (1) Infrastructure

In 1990, Peru's infrastructure was very poor, because of insufficient maintenance and improvement amid the Government's financial failure due to the economic crisis, and because of destruction by terrorists. Roads in good condition, for example, accounted for only 8% of the total length of 70,000 kilometers. Only 32% of the locomotives were operable, and deterioration of the runways of Lima International Airport and harbor facilities was considerable. Urban traffic was inefficient and unreliable. Only 55% of the country was electrified, with per-capita consumption of electric power being less than one-half of the Latin American average. Nationwide, the rate of the spread of water supply was 68% (the rate of water leaks was 31%, and that of unaccounted-for water was 16%), and the rate of spread of sewerage systems was 42%. An outbreak of cholera in 1991 necessitated urgent construction of waterworks and sewerage systems<sup>15</sup>.

The First Fujimori Administration, giving priority to infrastructure rehabilitation, implemented emergency programs with the assistance of the World Bank and the IDB. President Fujimori declared that his second administration would focus on the building and modernization of a social infrastructure needed in regional development, to contribute to poverty alleviation, while supporting economic activities in Peru, which has just begun steady social and economic growth. The Government plans to introduce private funds in infrastructure-building. In Peru, where gaps between rural and urban regions are considerable, it is anticipated that investment in not-so-profitable areas could be left behind. Further study will therefore be needed on the Government's role in infrastructure-building.

#### (2) Agriculture

Peru, blessed with favorable climatic conditions, biodiversity, and rich natural resources, has great potential in the development of agricultural products for exportation. The Fujimori Administration intends to reduce the Government's over-expanded role, and place importance on energies of the private sector, with a view to improving the efficiency of agricultural production and increasing its profitability and competitiveness.

The agrarian reform in 1969 gave possession of large plantations to Production Cooperative Associations, and banned tenures by private corporations. In 1991, the Law for Agricultural Investment Promotion allowed the selling and buying of farmlands and the offering them as security. The Land Act of 1995 removed all regulations on private possession of farmland, making it possible for large-scale enterprises to engage in agricultural business. The Land Registration Program, which defines legal relationships of land tenures in rural regions, is under way and expected to encourage private investment in agriculture. The preparation of an environment in which agricultural producers can be financed on the security of their lands, is in progress.

Regions that have export potential are concentrated in the 100%-irrigated costa, but selva and sierra also produce vegetables, fruits, and grains that can be important exports; for example the former produces camu camu and palmito (stalk of young palm trees) which are rich in vitamin C, rice and yellow corn; and the latter produces quinoa and kiwicha which are

<sup>15</sup> Data on infrastructure depend on those of the Ministry of Transport (1996).

rich in protein.

Peru's major challenges in costa agriculture, as a production sector, include increased production of main crops and diversified agricultural production, to meet the increased and diversified demand for food accompanying the increase in population. Promoting the production of export crops is another challenge. It is necessary to establish and execute appropriate laws and systems (the Land Law, the Water Utilization Law, the new Agricultural Cooperative Law, an appropriate legal framework to protect agricultural products from pests and diseases, law on the reorganization of agencies of the Ministry of Agriculture, and preferential tariffs). It is also necessary to promote quality and technology improvement, the rehabilitation of irrigation facilities, and such infrastructure-building as agricultural product centers, in an environment-attentive manner.

In Sierra, a center of indigenous civilization, intensive agriculture was developed long ago, and many indigenous people remain. It now has, however, a number of less-developed areas, with irrigation covering only 20% of its farmlands. Most of the inhabitants work in very small-scale farming, hardly producing enough crops to meet their own food needs. Comprehensive rural development (to improve their living conditions) is an important challenge not only for poverty eradication but also agricultural development. In sierra, it has various purposes, such as security of employment and environmental conservation (prevention of soil deterioration, management of small rivers, forest conservation, etc.). Consideration should be given to these, as well as to improving production efficiency. In selva, agricultural development could extend slash-and-burn farming and promote deforestation. It is important to be environment-attentive in commercializing agricultural products, and farmers must be provided with access to markets.

### (3) Fisheries

The biggest problem in the Peruvian fishery is its special feature in terms of industrial

#### Box 2 El Niño

El Niño is the current that raises the water temperature in the sea area ranging from the offing of Peru and Ecuador to the central Pacific, almost along the equator. Occurring at certain intervals, it has greatly affected Peru. The impact of the El Niño Current in 1997 is said to have been the greatest in this century in scale and in raising the water temperature, causing damage in many places. In Peru, the Current caused torrential downpours from December 1997, and resulting floods killed at least 350 people and affected 150,000. According to statistics up to the end of March 1998 by the Ministry of Construction, 7352 kilometers of roads, which accounted for 10% of the national road network, was made impassable, and 87 bridge piers were destroyed.

In April 1998, President Fujimori announced

- 1) A downward revision, from 6%-7% to 5%, in the rate of economic growth in 1998, and
  - 2) An upward revision, to 9% - 2 points higher - in the rate of inflation,
- as Peru's infrastructure was damaged by natural disasters seemingly caused by the El Niño Current.

Countries provided emergency financial and material assistance for Peru, suffering from floods seemingly caused by the Current. In February 1997, the Japanese Government provided emergency goods, such as blankets and tents, equivalent to 15 million yen, and grant aid for disaster relief equivalent to 100,000 dollars. It provided emergency goods equivalent to about 35 million yen in total in January and March 1998.

structure. Of the total catch, anchovies and sardines account for 93%. It places too much importance on non-food processing, namely, the processing of fishery resources to fish meal for export. The fishery can be affected greatly by a change in fishery resources, over-fishing, and natural phenomena, such as the El Niño Current, which impede its steady development. Recovery and growth of the fishery in 1996 seemed largely due to the calming down of El Niño. In 1997, however, the Current warmed again, stirring apprehension about its impact on the fishery. As the catch of anchovies and sardines, and fish meal processing, are thought to be at a critical level, the fishery could become stagnant again, as it was from the 1970s to the late 1980s, if the current fishery structure remains unchanged.

The Ministry of Fisheries places importance also on the promotion of freshwater fish cultivation in inland sierra and selva. Freshwater fish cultivation in rivers and artificial ponds has been very important for the poor in rural regions, as it provides them with nourishment and opportunities to earn incomes.

The fishery is a potential sector for the Fujimori Administration, which regards it as a foundation for Peru's development and its stable development is essential. The most important challenge could be comprehensive development of the fishery, including improvement of its current special character, the promotion of fishery diversification, the development of marine products, the promotion of marine product processing, and environmental conservation.

#### (4) Mining and energy

Peru is famous for its mineral resources. Before the inauguration of the present Government, however, non-ferrous metal mine development was unstable, and mining was likely to be stagnant. The Fujimori Administration, recognizing the importance of mining, took various measures, such as the privatization of state-operated enterprises and the special mining company (a public corporation), and the selling of mines to foreign companies, in accordance with its open economy policy. In 1992, it promulgated the General Mining Law (positive assistance for large-scale mines and protective measures for small- and medium-scale mines), simplified and expedited mining registration procedures, and decided to provide a stabilized environment for investments. With this as a turning point, mine exploration became active, and major U.S. non-ferrous companies began investing in large mine development (Cyprus, Asarco, Magma Copper, and Cominco of the United States). The development of existing small- and medium-scale mines, however, has made less progress. As they play an important part in continuing growth of regional economies and stabilization of regional communities, and their existence and development are very significant for regional economic development, appropriate measures are needed. A basic plan is needed to develop promising medium- and small-scale mines and build infrastructure for exploring new mines.

Oil and natural gas, though of high potentials, were in an adverse trade balance in 1994, in actual results. The Government, expecting development by foreign capital, bases its policy on privatization, and it has decided to strengthen oil refineries, to meet domestic demand. The gas field Shell discovered in Camisea, Cuzco is estimated to have the largest reserves in Peru (305.8 billion cubic meters in gas, or 725 million barrels in liquefied gas). Private-sector-led LPG exploitation, the construction of thermoelectric power stations, and the laying of pipelines to Lima are planned. Once environmental problems are solved and unfavorable geographic conditions are cleared, it can not only meet domestic demand but also make Peru a gas exporter.

## (5) Manufacturing

Peru's manufacturing, which reached 22% in the ratio to GDP in 1993 and employed 11% of Peruvian workers, is characterized by few, high-value-added products, a large informal sector, and a very large proportion of small and micro businesses<sup>16</sup>.

The present Government, aiming at macroeconomic stabilization and market reform, apparently intends to develop industries that have comparative advantages in a market mechanism, based on private energies and economic liberalization. Amid economic globalization and regional economic integration, a few Peruvian manufacturing companies are strengthening their technical and capital cooperation with foreign companies, in order to take part in the world market. For most manufacturing companies, however, the speed of liberalization is much faster than their qualitative changes, and many of them could drop out of markets, failing to keep up with global competition and economic liberalization.

In the processing of agricultural and marine products, in which Peru has a comparative competitive edge, technical competence and productivity must be improved, and managerial and market development capacities must be strengthened. Some industries fail to make the most of special characters of materials of good quality. This is true of the textile and apparel industry, for instance. Very-long-fiber cotton, such as pima cotton and Tanguis cotton, has potential for being accepted in markets of industrialized countries as high-quality products, but their potentials have not been fully brought out in production technology, product development, and market creation. Peripheral equipment, machines, and instruments suitable for regional industries should be developed for manufacturing companies, especially those engaged in the processing of primary products that enable them to participate in the world market. Such a new manufacturing industry would not only support advanced industries but also build a foundation for qualitative changes in traditional local industries, and development of Peru's national economy.

The development of manufacturing must not be confined to Lima and its periphery. There are local industrial groups, comprising a certain accumulation of small enterprises, in Cuzco (tourism and related industries), Cajamarca (livestock products), Juliaca (commerce), Ayacucho (commerce), and Piura (folkcraft and agricultural products). The development of these groups will not only produce increased incomes and create employment opportunities in their respective regions, it will also stimulate regional economies through newly obtained information on markets, products, management methodologies, etc., of other regions, and thereby contribute greatly to the development of Peru's manufacturing industry.

The role of the public sector is important in developing manufacturing industries. It must improve the business environment from various aspects, and build an appropriate financial system and a technical and information support system, in addition to improving the law system.

## (6) Small and micro businesses

According to the third national economic census (III Censo Nacional Económico), conducted from 1993 to 1994, 90.4% of 236,000 enterprises employed four or less workers,

<sup>16</sup> The Micro and Small Business Promotion Act (Ley de Promoción de Microempresas y Pequeñas Empresas, Decreto Legist. 705), enforced in November 1991, gave a legal definition of micro businesses for the first time. The Law expressly classifies businesses employing less than 10 workers, with gross sales not exceeding 12 times the minimum taxation unit (about 9,700 dollars in 1994), as micro businesses. It classifies businesses employing less than 20 workers, with gross sales not exceeding 25 times the minimum taxation unit (about 20,200 dollars), as small businesses. It expressly mentions legal support, export assistance, the establishment of industrial developments, the simplification of registration and approval procedures (toward formalization), accounting requirements, and simplified tax systems (unified taxation), which are intended to promote and develop micro and small businesses.

and enterprises employing less than 20 workers accounted for 97.7% of the surveyed enterprises. Workers employed in enterprises having less than 20 workers accounted for 43.3% of the workers (totaling one million) of the surveyed enterprises. As agriculture, forestry, fishery, roadside stall-keeping, and services, such as taxi drivers, were not included in the census, enterprises that engage in production and service in Peru were thought to be mostly of a very small scale. In addition most of them, not formally registered, constituted the informal sector. These small and micro businesses, concentrated in cities, including Lima, have been accepting people from rural regions for the past 30 years.

An increase of latent demand among citizens has animated small and micro businesses, as found in Gamarra in the Lima metropolitan area, with the abatement of inflation and the recovery of public peace. They are active in meeting increasing broad-based demands. But they are expected to reach a turning point, confronted by competition with low-priced imports, as trade liberalization increasingly covers commodities of a wider range. As small and micro enterprises mostly belong to the informal sector, they cannot benefit from official frameworks in financial and managerial aspects aimed at improving quality of merchandise, technical levels, and productivity. There are thus great restrictions in their further development.

Formalizing the informal sector is an important, unavoidable challenge not only to expand the taxation base but also to develop the national economy in Peru. Informal-sector businesses are expected to develop as those that expand and connect regional economic activities and support advanced, modernized enterprises. Informal-sector businesses remain informal as a consequence of economic rationality. Formalization is impeded by an insufficient basic infrastructure, in addition to complicated legal and administrative procedures and increased labor cost for formalization. The Government is building the basic infrastructure and simplifying and improving the law system and administrative formalities. It must continue its efforts to improve business conditions. The Government must also provide steady financial assistance for the managers and employees of these small and micro enterprises, as well as build a framework to support improvement of their skill and technology, and know-how in business management and marketing.

## (7) Tourism

Peru, possessing excellent natural environments and historic heritages, has rich tourist resources. In 1988, 359,000 people visited Peru, and the sum they spent accounted for 10% of the total value of exports of that year. The economic unrest and intensified terrorism that followed reduced visitors to Peru to 217,000 people in 1992. The number of visitors, however, began increasing with the restoration of public peace, reaching 480,000 in 1995. Income from tourism that year was 520 million dollars. The year 2000 is expected to see one million tourists, making tourism an important, growing industry. Tourism development, as a means of regional development, is also expected to contribute to poverty alleviation and the reduction of regional gaps.

The Government of Peru places importance on tourism promotion, as an important means of economic growth, alongside agriculture, fisheries, the development of energy, mining and manufacturing. Much is expected from tourism in employment creation and foreign currency earning, which are now very important for Peru.

Economic stagnation for a long period, however, has greatly delayed the establishment of a tourist infrastructure and service systems. There are a number of problems awaiting

solution in promoting tourism; namely, the securing of public peace, the building of a tourist infrastructure (roads and airports, among others) and tourist facilities (accommodations, etc.), the development and conservation of tourist resources (discovery of historic heritages and natural resources), the development of tourist goods (folk crafts, special products, etc.), and the improvement of tourist services (personnel training).

As the promotion of participatory tourism development<sup>17</sup> contributes to the activation of communities and people's social capacity-building, it should be regarded as part of regional development.

## 3.2 Challenges in social development

### 3.2.1 Addressing by the Government

The Second Fujimori Administration has decided to focus efforts on poverty alleviation and social development. It emphasizes the problems of poverty and employment, aiming to reduce the proportion of the extremely poor to 50% by 2000. In May 1996, Prime Minister Pandolfi published the Government's intensified policy efforts to invest in social development, including infrastructure-building. Major objective are mentioned in Table 3-2.

Table 3-2 Major Objectives of Social Development

	1991	2000
Proportion of the extremely poor	22%	11%
Illiteracy rate	11%	9%
Infant mortality rate (per 1000 live births)	55 persons	34 persons
Chronic undernourishment in infants	48%	34%
Maternal mortality rate (per 100,000 nursing mothers)	261 persons	100 persons or less

Source: A speech by Prime Minister Pandolfi.

Table 3-3 shows major social programs among various social measures now under way in Peru.

The Ministry of the Presidency is primarily responsible for the government's social development policies and controls the agencies that implement major social development projects. The second Fujimori Administration, placing top priority on poverty alleviation, has prepared a poverty map that divides the country into about 1800 districts (distrito), in order to formulate measures most suitable for each district. The map is intended to identify regional characteristics and define priority measures for poverty alleviation. Extreme poverty shown in this map has been specified by indexing such basic living conditions as nutrition, education, housing, and access to safe drinking water and sewerage systems. Poverty is viewed from two aspects. First, the mean indexes identify districts of extreme poverty, showing that measures need to be taken for the whole region that includes these districts. Second, they identify districts (perhaps mainly in urban regions) in which the poor are concentrated. This is applicable to a district having a large number of the extremely poor, despite its not being classified as an extremely poor district on an average level.

<sup>17</sup> Refer to Box 6 "Kuntur Wasi and regional development - regional promotion as a means of poverty alleviation," as an example of participatory tourism development

In the poverty map, light blue shows districts of extreme poverty, on average, red shows districts in which the extremely poor are concentrated, and dark blue shows districts having both of the above characteristics. When viewed in this manner, there are 419 districts needing urgent measures, with the population of the extremely poor reaching 2.67 million. The poverty map shows that districts in extreme poverty are scattered all over the country, needing measures appropriate for their respective conditions.

The Ministry of the Presidency has formulated the Strategy for Fighting Extreme Poverty 1996-2000 (Una Estrategia Focalizada de Lucha contra la Pobreza Extrema, 1996-2000). It mentions, as priority measures for poverty alleviation, support for the extremely poor through nutrition aid, family planning, etc.; social infrastructure-building that includes schools, medical institutions, and waterworks and sewerage systems; and economic infrastructure-building that includes traffic networks, small-scale irrigation facilities, and small-scale electrification works. For these purposes the Government plans to spend 2.7 billion U.S. dollars for the above period, which includes tax revenue and assistance from aid organizations.

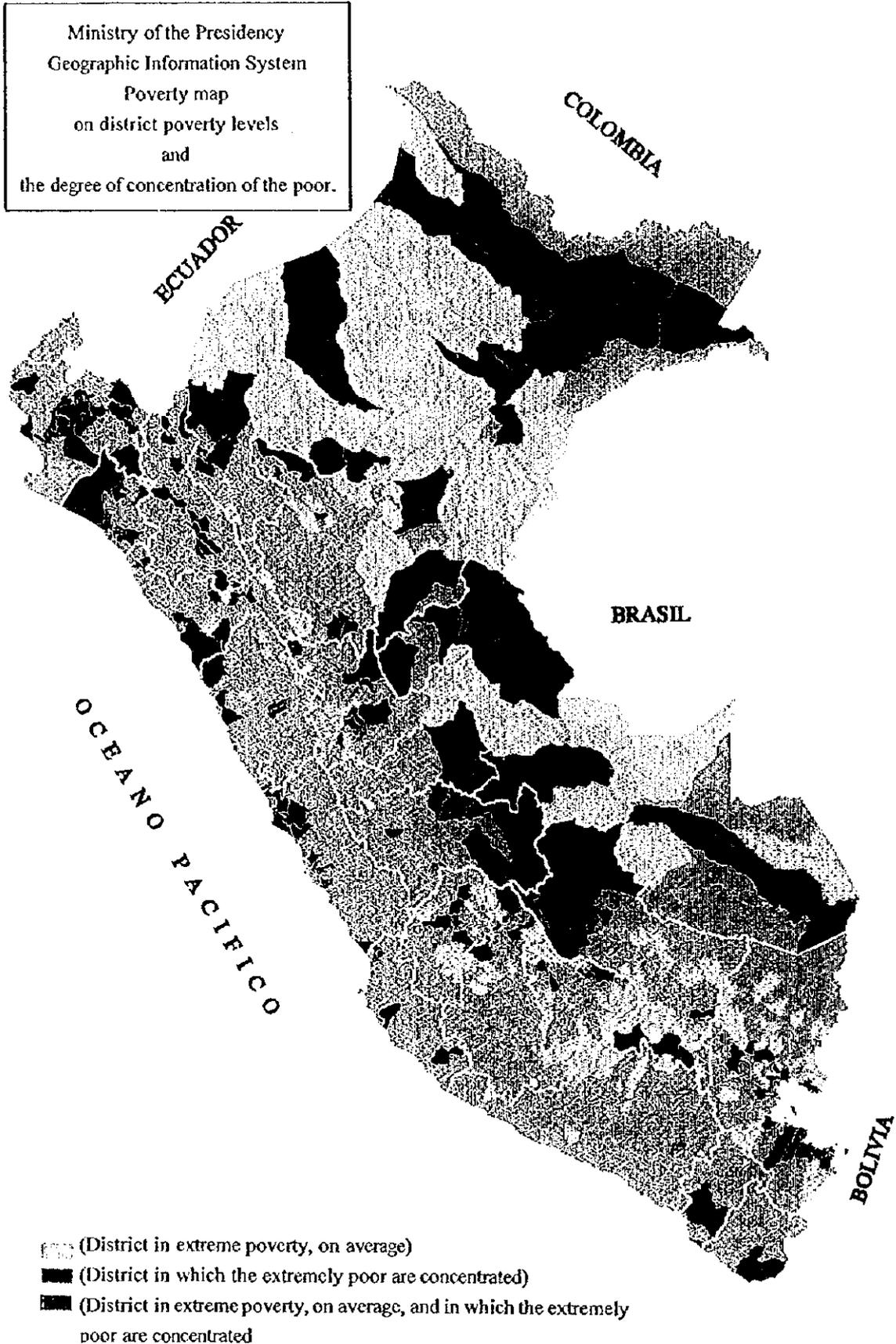
The strategy for poverty alleviation is shown in Fig 3-2. Measures for poverty reduction are classified into emergency measures and foundation-building to increase employment and raise incomes. It focuses on expanding broad-based support systems, basic infrastructure-building, and the establishment of systems and institutions.

Table 3-3 Peru's Major Social Programs

Program	Contents
Basic Social Spending Improvement Program	Strengthened primary preventive measures in medical services, qualitative improvement of preschool and primary education, and judicial dispute settlement on the regional level.
FONCODES (National Social Indemnity Development Fund)	Financing projects formulated to meet beneficiaries' proposals. Support in infrastructure-building for education, medical services, nutrition, and sanitation, and economic infrastructure-building for agriculture, stock-farming, and traffic.
FONAVI (National Housing Fund)	Financing housing and basic infrastructure-building. The program includes Banco de Materiales, community facilities construction planning, and financing on security.
INADE (National Development Agency)	It implements large-investment projects, such as hydroelectric power generation, in poor regions, as a main agency implementing emergency social investment programs.
INFES (National Education and Health Institute)	Infrastructure-building for education and medical services.
PANFAR (Nutrition Supplementary Program for High-Risk Groups)	Improvement of nutrition and health for expectant and nursing mothers, children under five, and preschoolers.
PRONAMACHS (River Basin Water Management and Soil Project)	Technical guidance on the management and utilization of natural resources. Production infrastructure-building in isolated regions. Improvement of the living environment. Soil conservation.
PRONAA (National Food Aid Program)	Direct food assistance, and improvement of nutrition for the extremely poor. Emergency assistance services.
School Breakfast Program (Desayunos escolares)	Supplement of nourishment for public primary school children.
One Cup of Milk Program (Programa del vaso de leche)	Provision of milk for children of poor families.
Resettlement Assistance Program (Programa de apoyo al repoblamiento)	Assistance for people who have been forced by terrorists to migrate.

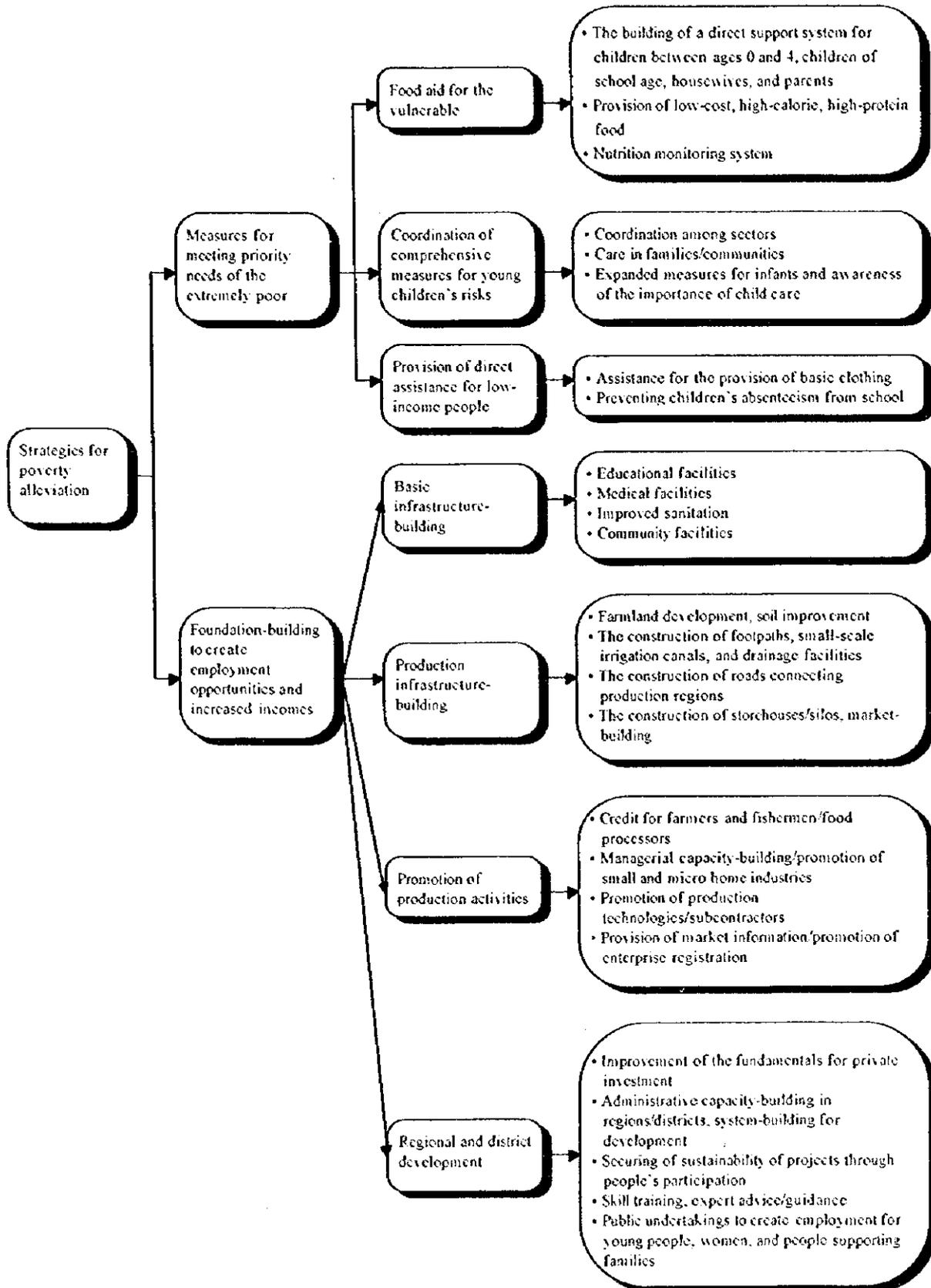
Source: Apoyo-UNICEF, "Perú Políticas Sociales 1995 - Guía de Consulta Rápida," p. 22.

Fig. 3-1 Poverty Map



Source: Ministerio de la Presidencia (1996a)

Fig. 3-2 Strategies for Poverty Alleviation



Source: Prepared from part of Ministerio de la Presidencia (1996b).

### **3.2.2 Economic recovery and social development**

Economic recovery and continued growth are important for social development and for solving social problems. Social development cannot be realized without growth.

Peru cannot, however, eliminate its social difficulties and solve its poverty problem, among others, only by recovering growth in a short or medium period of time. A very long time will be needed, for the following three reasons, for Peru to recover growth and consequently expand employment opportunities and solve its poverty problem while increasing production through expanded employment.

First, poverty is very serious in Peru. Second, the population has been increasing at a high rate. People born in the last 15 years will mostly join the labor market soon, and about 600,000 babies are born annually. It is necessary, therefore, to create jobs for at least 300,000 new workers every year. Third, there is the possibility that recovered and continued growth will not always formalize the informal sector, which is very large in Peru, and raise incomes, without appropriate institutional and socioeconomic measures.

Amid these circumstances, social development in Peru should be addressed with a combination of several approaches.

One approach is to solve the poverty problem and realize social development with expanded employment and increased incomes in a stabilized market economy and economic growth and development sustainable for a long period of time. In this approach, it is of critical importance to develop human resources from a medium- or long-term perspective by providing education and skills that enable people to meet new employment opportunities created in a growing economy.

A second approach is to implement effective poverty-reduction and social measures for the extremely poor and low-income people, who cannot wait for the long-term effects produced by the first approach. It is urgently necessary, among other needs, to satisfy the BHN of the extremely poor, and provide nourishment for infants, so that they can grow up safe and sound.

A third approach, which is essential for the extremely poor as well as small-scale farmers and the urban informal sector, is to enable people to participate in the newly established market economy positively and with high capabilities. This is indispensable to achieving poverty reduction and social development simultaneously with economic growth and production expansion. It is very important in the full utilization of the new market economy system established through the economic reforms from 1990 and thereafter.

### **3.2.3 Considerations in social development**

In studying social development in Peru, the following points must be taken into consideration.

The first is the diversity of Peruvian society. It has produced remarkable regional gaps, especially between rural regions and cities, and gender disparity. This is shown in, for example, infant mortality rates, nutrition, and illiteracy rates. In rural regions, 83 out of 1000 infants die, which is double the proportion in cities. The national rate of illiteracy is 11%, with that in cities being 7%, and that in rural regions is as high as 30%. Gender disparity is also considerable. The rate of male illiteracy is 6%, as a national average, while it is only 3% in cities and 17% in rural regions. Female illiteracy, on the other hand, reaches 17%, as a national average, with 10% in cities and as high as 43% in rural regions. As will be mentioned

later, these regional gaps in social development indicators reflect the uneven distribution of low-income people, particularly the extremely poor. The agencies concerned, such as FONCODES, pay special attention to this, by making a poverty map. This should be given due consideration in defining priorities in social development in Peru.

The second point is that Peru's informal sector is much larger than that in other countries. This is closely related to urban living conditions and infrastructure.

The third point is the great differences among costa, sierra, and selva in environmental conditions, such as topography and climate, and in infrastructure and resulting production conditions. It is a serious problem that coconuts are grown in some areas of rural regions. These differences have produced different social and poverty problems, necessitating a social development methodology most suitable for each region.

### 3.2.4 Issues by sector

#### (1) Education

The rate of school enrollment was 88% in primary education and 46% in secondary education in 1992<sup>18</sup>. Though the average rate is not low, that in rural regions remains low, showing a need to improve access to education. A large proportion of students either stay in the same class or leave school without graduating. Qualitative improvement of primary education is needed, as it has been pointed out that children do not acquire basic ability of reading, writing and arithmetic, despite that they complete a primary education course. The adult illiteracy rate was 11% (6% in males and 17% in females) on average in 1995<sup>19</sup>, while it was 30% in rural regions and 7% in cities. In particular, a large proportion of rural women were illiterate. These problems in education are attributable to not only socioeconomic factors, such as poverty, but also insufficient educational appropriations, insufficient capacity in educational administration, inadequate infrastructure, insufficient textbooks and teaching materials, an insufficient number of qualified teachers, and poor quality of teachers.

Improving and expanding education are an urgent issue for the Fujimori Administration, which places importance on education. Qualitative improvement of primary education would be most important, among others. It should raise the proportion of children who complete the primary education course, and ensure that they are equipped with basic attainments when they graduate from school. Specifically, it includes teacher training, the provision of textbooks and teaching materials, and improvement of teaching methodologies, including bilingual education. Then it becomes necessary to spread secondary education. This involves construction and rehabilitation of the school infrastructure, the development of qualified teachers, and the provision of textbooks and teaching materials. In addition, vocational training is needed, from the viewpoint of stabilized employment and poverty alleviation. It must be intended to develop human resources capable of effectively meeting the demands of the labor market. It is also necessary to strengthen educational administration, through adequate appropriations, system-building, and the fostering of administrative officials.

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<sup>18</sup> UNESCO (1996)

<sup>19</sup> World Bank (1996)

## (2) Health care

The Ministry of Health has been addressing health problems under the principle of "equity, efficiency, quality." It has been expanding services for the poor, promoting modernization of the health sector and its administrative reform, defining priorities in health problems that await solution, and improving the quality of people's living.

A current problem is that health indicators are lower than those of other low-income countries in Latin America. In 1992, the infant mortality rate was 64 per 1000 live births, the maternal mortality was 280 per 100,000 live births, and daily nutritional intake was 1,883 calories<sup>20</sup>. The numbers of doctors and nurses, with respect to the population, are smaller than the Latin American average, and medical institutions and personnel are concentrated in the metropolitan area, thus widening regional gaps. Although the total fertility rate shows a tendency to decline, an increase of pregnant teenagers is conspicuous, showing the insufficient extension of family planning. The AIDS problem is increasingly serious. It is necessary to reduce the under-five mortality and maternal mortality rates; improve nutrition, especially for infants, children, expectant and nursing mothers (including breast-feeding); improve services, especially for rural people and the poor; improve the quality of living overall, and strengthen health administration.

In the circumstances, Peru's challenges in development include maternal and child health and the extension of family planning, first of all. They involve services, such as nutrition aid and perinatal care, and the extension of information on and knowledge of family planning and AIDS, as well as reliable means of family planning. Second is the improvement of living conditions. In cities, it is necessary to implement measures to control environmental pollution resulting from industrialization, and sanitary infrastructure-building. In rural regions, it is necessary to build the living infrastructure, including waterworks and sewerage systems. Third is modernization of the health sector. It is necessary to establish a referral system focused on expanding primary health care, and to strengthen administrative capacity, which enables cost-effective activities.

## (3) Women in development (WID)

In cities, gender disparity has been reduced to a certain extent, but women are still unfavorably treated in access to education and medical services. The rate of illiteracy is as high as 43% among rural women, and the maternal mortality rate is among the highest in Latin American countries. Domestic violence against women is frequent. There is a great gap even among women. While 19% of women have received higher education, 18% of them are illiterate. In 1993, women engaged in economic activities accounted for 29.7% of the total working population. Their wages, however, were 87% of those for men per unit working hour (1994). Women often endure less favorable conditions than men.

The Government has been addressing the gender problem, by formulating programs to improve women's position, organizing the Committee on Women's Rights, and establishing the Domestic Violence Act. Further efforts are needed.

First, education needs to be expanded, especially for women. This is important because education favorable affects not only women themselves but also their children. The provision of school meals and the construction of schools in places children can walk to will

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<sup>20</sup> Data for 1992. UNDP (1996)

raise the rate of school attendance. The quality of teachers also needs improvement. It is necessary to improve living conditions through vocational training for women and the extension of skill for life improvement. Another challenge is to improve maternal and child health and reproductive health services.

Regarding WID, efforts are needed to raise awareness of such issues as education, child labor, life improvement, and women's status. It is also necessary to address the problems of children and indigenous people, who are both socially vulnerable, to reduce child labor and improve living and the social infrastructure in the region inhabited by indigenous people.

### **3.3 Good governance and participation**

#### **3.3.1 Restructuring the role of the Government**

Restructuring the role of the Government was an urgent necessity for Peru, confronted with a reduced administrative capacity and administrative disorganization amid the crisis in the 1980s.

President Fujimori carried out economic stabilization and structural reform programs immediately after his inauguration in 1990, aimed at changing the direction of economic policy of the preceding administration. In April 1992, he took a series of emergency measures, including suspending the constitution, closing the congress, and suspending the functioning of the courts, in order to promote more vigorous national reconstruction. He established an emergency national reconstruction government<sup>21</sup>. The Government stopped regular legislative functions until the opening of the new congress on December 30, 1992, resulting from the Democratic Constituent Congress election. This was overwhelmingly supported by the people<sup>22</sup>, though accusations were made by the international community. The Government made every effort for structural adjustment toward economic liberalization.

This process also redefined the role of the Government. The constitution approved by the plebiscite in October 1993 is quite different from the old one, in that it pursues a people-led, efficient, small government. It defines a framework for a market economy. This appears as "freedom of private economic activity" (Article 58), "the principles of free competition and equal opportunities" (Articles 59 and 61), "free trade" (Article 63), and "free exchange of currencies" (Article 64). Although the old constitution (of 1979) also had provisions on "freedom of private initiatives," it was restricted by the state so that such freedom would be in harmony with social benefit. The inviolability of possession also had to be in harmony with social benefit (Article 124). These restrictions were removed in the 1993 constitution, which provides a framework for a freer market economy.

Regarding public services, the old constitution stipulated that basic necessities were to be provided by the state (Article 18). The new constitution, however, limits areas in which the Government plays a leading role, to employment, welfare, education, security, social services, and basic infrastructure (Article 58). This, stating expressly its orientation toward a people-led, small government, confines the role of the Government to issues that cannot be addressed

<sup>21</sup> President Fujimori maintained that his emergency measures were justifiable because the two powers of legislation and judicature were at a crisis of "institutional destruction" and "no longer working." He intended to carry out drastic reforms and "build an efficient, democratic, and affluent society," by breaking down the "rotten, old systems." Source: Shigeo Osonoi (1995).

<sup>22</sup> The public-opinion census immediately after these emergency measures showed that more than 80% of the people supported the president, which was the highest for the Fujimori Administration. Source: Shigeo Osonoi (1995).

in the framework of a market economy.

In terms of a political system, it is noteworthy that people's opportunities to participate in policy-making have been opened in more diverse ways. Plebiscites and the right to claim dismissals from public offices have been established as systems. And an ombudsman system has been introduced. Regarding the judicial system, the constitution ensures the National Judicial Assembly independence in appointing and promoting judges, to avoid intervention by administrative agencies. It introduces the judiciary under democratic sovereignty (Article 138). It legalizes the public election of judges of public peace courts and high courts (Articles 154 and 152), providing the people with opportunities of plebiscites for, and participation in, the appointment of judges. Major differences between the old constitution and the new one are given at the next page. (See Table 3-4)

In compliance with these policies, agencies aimed at a planned economy and protectionism were disorganized. They included the National Trade Agency (ICE: in charge of management of non-tariff barriers and export subsidies), the National Planning Agency (INP: in charge of medium- and long-term development planning), and the National Institute for Cooperatives (Instituto Nacional de Cooperativas, INCOOP). The four development banks, which had been financing agriculture, industry, mining, and housing at preferential interests with the assistance of state subsidies, were also disorganized. Daring measures for personnel reductions, administrative reforms, and rationalization have realized a small central government. New agencies have been established and old ones have undergone reforms, and certain results have been produced in economic stabilization, poverty reduction, and economic liberalization in a short period of time. Among them, the National Tax Administration Agency (Superintendencia Nacional de Administración Tributaria: SUNAT), SUNAD (customs house), FONCODES, the National Institute for Competition and Intellectual Property Rights Protection (Instituto Nacional de la Competencia y de Protección de la Propiedad Intelectual: INDECOPI), and COPRI were included.

### 3.3.2 Challenges for public sector reform

The most important role of the Government for the future of Peru is the building of a framework for a market economy. It must elaborate a system in which a market mechanism works fairly, and set rules for this purpose. It becomes necessary to inspect and punish activities against consumer protection. The development of a sound market economy is important for building a foundation for people's participation in production and consumption.

Second, the Government must support areas in which it is difficult to introduce a market economy, in order to provide the people with services of appropriate qualities and prices. This does not mean that the slimmed government gives up its role of supervising public services; rather it supervises them so that they can be extended to the people at appropriate qualities and prices. In other words, the Government is required to provide, in addition to the building of basic social infrastructure, efficient and fair public services, including health services and education for the people. This not only satisfies people's basic needs but also indirectly supports freedom of their activities and the working of the market mechanism.

Table 3-4 The changing role of the state in the economy  
A comparison of the 1979 and 1993 constitutions

	1979 constitution	1993 constitution
Political and administrative system	Article 138: Economic and financial administration of the central government is guided by the annual budget approved by Congress. Local and regional governments have their own budgets.	Article 77: The budget guides the activity of the state. Its programming and execution respond to criteria of efficiency, basic social needs, and decentralization. The budget is consolidated.
Economy	<p>Article 111: The state formulates the economic policies and social development plans that regulate the activities of the public sector.</p> <p>Article 112: The state guarantees economic pluralism.</p> <p>Article 116: The state promotes and protects the free development and autonomy of businesses and cooperatives.</p> <p>No equivalent exists.</p> <p>Freedom of private initiatives is respected. It is, however, regulated by the Government so that it will be in harmony with social benefit.</p> <p>Article 124: The inviolability of possession is in harmony with social benefit.</p> <p>Article 136: Foreign enterprises are subjected to domestic laws without limitations.</p> <p>Article 115: Foreign trade is free within the range defined by law from the viewpoint of social benefit and national development.</p> <p>Article 88: Imperialism, colonialism, and neocolonialism is kept out.</p> <p>Article 178: Foreign trade relations are aimed at the establishment of fair, international economic order.</p> <p>Article 122: The state stimulates mining activity.</p>	<p>No equivalent exists. Eliminates the concept of central planning.</p> <p>Article 60: The state recognizes economic pluralism. Only when authorized by a specific law, and in case of high public interest can the state become involved in subsidiary business activity.</p> <p>No equivalent exists. Eliminates the promotion of cooperatives.</p> <p>Article 65: The state defends the interest of consumers and guarantees the right to information on goods and services provided by the market, in particular for the health and security of the population.</p> <p>Article 70: The inviolability of possession is recognized as a right.</p> <p>Article 63: Domestic and foreign investments comply with the same terms and conditions.</p> <p>The provisions claiming economic nationalism have been deleted.</p> <p>No equivalent exists. Mining is no longer subject to special treatment.</p>
Public services	Article 18: The basic necessities are provided by the Government.	<p>The provisions of the same meaning have been deleted.</p> <p>Article 58: Areas where the Government play a leading part include employment, welfare, education, security, social services, and basic infrastructure.</p>

Source: Prepared from World Bank (1994b), Table-1, and Shigeo Osonoi (1994).

The Government itself needs reform, in order to play its new part. It is indispensable for a small government to improve laws, systems, and administrative capacity, in order to formulate and implement efficient and effective policies. The judicature is another part the Government should play for the future development of Peru. It is also important, in promoting people's participation, to establish reliable judicial institutions and provide the people with easy access to judicial services.

Free economic activity, the satisfaction of social needs, and improvement of the judicial system, which are to be assured by the Government, provide the foundation for participatory, people-centered, and sustainable development. Challenges for realizing these include the proper operation of market economy rules and regulation systems, their dissemination among the people, the provision of public services, such as education, health services, and infrastructure, law and institution establishment to provide efficient social services for the poor, administrative capacity-strengthening, and transfer of power from the central Government.

Institutional reforms by the Fujimori Administration are characterized by systems established as necessary, according to priorities in the then-socioeconomic policy (increased tax receipts, a reduction of social cost in structural adjustment, privatization, free competition, the protection of intellectual property rights, etc.)<sup>23</sup>. In a situation in which integrated, comprehensive system-building has made little progress, coordination among the administrative services depends on the President's leadership. Under these circumstances, the following two points must be mentioned as basic challenges in Peru's administrative reform.

The first challenge is to develop the administrative reforms carried out thus far by successive governments into a system. It is necessary to establish administrative organizations and systems that can remain independent even if political power changes. The second is to change the national administrative organization, which has lost people's reliance because of its declining capacity and institutional inefficiency during the crisis in the 1980s, into a new one equipped with new capacity and efficiency, in a short period of time.

Specifically, the followings remain to be addressed. The first is medium- and long-term institutionalization of agencies created outside the central Government's ministries (newly established agencies and existing ones given independence). Regarding social reform programs, for example, it has been decided that urgently necessary social assistance will be extended through FONCODES and other agencies under the control of the Ministry of Presidency, as rationalization programs have produced few results in the Ministry of Education and the Ministry of Public Health (rationalization programs: measures for enhancing efficiency in undertakings and improving personnel capacity). The heads of these agencies are generally appointed from among those who have long experience in private business management, and they are entrusted with independent operation, without interventions from other ministries. This has been very effective in providing and operating a safety net in a short period of time, but the problem of medium- and long-term institution-building has not been fully studied. The rules of public works are not applied to the procurement procedures of FONCODES, because of the urgent necessity of social assistance. It can be said the question of building a coordinated system remains unsolved.

The second problem is delayed qualitative reforms in administration itself in providing public services of top priority, such as health services and education, and formulating a policy

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<sup>23</sup> With reference to Izumi Ono (1996)

in each area. Successful structural adjustment results from downsizing of the Government, which will be freed from financial burdens and ensure the people basic, substantial services. The Pandolfi Cabinet, deciding to promote drastic reform, organized the Administrative Modernization Committee in July 1996. Currently its 15 working groups evaluate the functions and objectives of the ministries, with assistance of the Inter-American Development Bank (IDB) and other institutions. In 1997, specific reform plans were presented, based on the evaluation results. They are to be incorporated in and implemented by the 1998 budget. The establishment of an administrative organization relied on by the people, efficient and effective, not affected by the government in power, and capable of representing true public interest, and improved capacity of the government to maintain an administrative organization highly independent without being affected by the current government -- these are of critical importance for Peru toward the future.

The third problem is the comprehensive role played by the Ministry of the Presidency. It sometimes overlaps with functions of other ministries and local governments. In fact, the concentration of appropriations in social development could be pointed out in the 1996 budget, as the appropriations to the Ministry were the second largest in the central Government, next to those of the Ministry of Economy and Finance. A challenge is to promote the decentralization of power and functions, to develop undertakings that can appropriately answer the regional needs.

The fourth issue is judicial reform. Peru has experienced few such reforms thus far. In 1996, the administrative-organ-led Judicial Coordination Conference (CCJ) was organized for full-scale reform, with assistance of the World Bank and other institutions. The aim is an efficient judicial and administrative structure; corruption-free, prompt, efficient, and fair judicatory power, and the provision of judicial services. If this provides easy and fair access to the judicial system for low-income people and provincial people, the judicature will increase people's reliance and contribute to improved living conditions of the poor. Such reform will make the market economy rules observed and disseminated. It will provide a foundation indispensable for people-centered, sustainable development.

### **3.4 Environmental conservation**

#### **3.4.1 Measures by the Government**

Since the creation of the National Council on the Environment (El Consejo Nacional del Medio Ambiente: CONAM) in December 1994, in accordance with Law No. 26410, the Government of Peru has been devoted to environmental conservation. The environment-related ministries have thus far dealt with environmental problems independently. CONAM, which is newly born and not yet strong enough, will coordinate measures by these ministries, with multilateral and bilateral assistance for strengthened environmental administration.

The Ministry of Energy and Mines, and the Ministry of Industry, Tourism, Integration, and International Trade Negotiations, require existing enterprises to formulate independent long-term plans to control environmental pollution, with the existing facilities, in 10 years. The ministries are monitoring the implementation of these plans. The Government is positively addressing environmental problems, with special assistance from the IDB and the U.S. Agency for International Development (USAID), in environmental pollution control.

Coordination between development assistance projects and activities of environmental-

conservation-related NGOs is often effective in promoting environmental conservation. As environmental administration agencies generally have few expert personnel, because of low salaries, it is necessary to obtain the cooperation of these NGOs, which have excellent, motivated human resources for environmental conservation.

### **3.4.2 Present environmental conditions by region**

#### **(1) Costa**

The coastal region of Peru, covered with a desert, is an advanced region in the country, having cities, including Lima, the capital. In the city of Lima, the air is polluted by emissions from automobiles and factories, producing an increasing number of people suffering from respiratory diseases. Lima has, in its peripheries, extensive, unlawfully occupied quarters called "pueblo joven," whose sanitary condition is very bad in many areas because of the lack of waterworks, sewerage systems, and waste treatment. The coastal sea is increasingly polluted by effluents from fish meal processing mills and from mining in the upper reaches of rivers, domestic waste water from cities, and industrial effluents from factories.

#### **(2) Sierra**

Sierra, situated in the Andean mountains and highlands, has many steep slopes and sparse vegetation. Soil erosion is worsening there. Forests are becoming smaller due to extended farmland and cutting for firewood. There are quite a few areas that need urgent afforestation for erosion control. Rivers and some 1,500 lakes have been polluted by strong-acid effluents from mines and waste liquids from ore dressing plants in mining areas of copper, zinc, tin, etc.

#### **(3) Selva**

Selva, abutting on the Amazon on the eastern side of Peru, makes up about 60% of the country's territory. This region, possessing most of the country's forest resources, is thought to have great potential for agricultural and forestry development. Blessed with biodiversity, it is also a vast treasury of species. Its development, however, has not been advanced, due to underdeveloped traffic networks, as the region is far from costa and sierra. Expansion of farmland and reckless cutting of trees have accelerated deforestation, resulting in a loss of one-fourth of the cultivated lands and forests on the eastern slopes of the Andes. Deforestation has aggravated soil erosion, causing damage to farmlands and roads. The cultivation of cocas in this region poses a social problem.

### **3.4.3 Present conditions and challenges of industrial pollution, urban environments, and the natural environment**

Industrial pollution in Peru includes water contamination caused by wastewater from ore dressing (copper, lead, zinc, and so forth), air pollution caused by sulfur dioxide and arsenic from smelters, and water contamination and air pollution caused by marine product processing and emissions from automobiles. Insufficient or no treatment of industrial waste poses another problem. In the Lima metropolitan area, environmental pollution includes air

pollution by emissions from automobiles, and water contamination caused by household wastewater. Provincial cities have insufficient treatment facilities for general waste.

It is urgently necessary, first, to strengthen the environmental administration system, establish environment-related laws and regulations (environmental standards, emission and waste standards, etc.), and develop human resources in the environmental area. Second, it is necessary to address individual pollution cases more vigorously. Measures for controlling industrial pollution include the building of an air pollution monitoring network in the Lima metropolitan area, in addition to measures for mine pollution and industrial wastes. Measures for treatment of general waste are needed in major provincial cities, and improvement of the living environment by providing safe drinking water, household wastewater treatment, and treatment of general waste is required in pueblo joven in the Lima metropolitan area, which is mainly inhabited by the poor. It is also important to raise people's awareness of the significance of environmental problems.

A reduction in forest resources, a reduction in indigenous plants and animals, a reduction in marine resources, soil erosion in farmlands, and desertification have been proceeding. It is necessary to address forest conservation, biodiversity conservation, and the establishment of sustainable agriculture, from a long-term viewpoint.

Natural conditions have distributed water resources unevenly over Peru. An important issue is their sustainable utilization, as demand for water is expected to increase in the Lima metropolitan area, whose population is increasing. A current challenge is to make good use of water sources in sierra and selva, with due consideration given to the ecosystem in these regions. Water contamination has reached the coastal region and is increasingly polluting lakes, including Lake Titicaca. Water quality conservation is needed for tourist resources conservation and the sustainable utilization of water resources.

Frequent earthquakes and floods, in addition to the El Niño Current, often bring disasters to Peruvian people. Buildings' lack of earthquake-proof structures, and the lack of safe evacuation routes and refuges in densely populated areas, can aggravate earthquake disasters. A challenge would be to introduce the concept of aseismic structures in the building standards and revise them. It is also important to implement housing policies in high-risk areas, such as pueblo joven, to protect low-income people. Much rain in the summer causes rivers flowing from sierra into costa to flood at their lower reaches. As floods are thought to be caused by reduced water-holding capacities resulting from deforestation, as well as by topographic conditions in the mountainous regions, river control is needed in frequently flooded areas. It can also be said that fundamental flood control needs forest conservation and afforestation. Floods are apt to seriously damage low-income people living in these dangerous areas. Again, it is necessary to promote poverty alleviation and housing policies from a medium- and long-term viewpoint.