

SECTOR PROGRAM FOR TRANSPARENCY IN AND REFORM OF FISCAL, SOCIAL AND JUDICIAL POLICY

(PE-0212)

EXECUTIVE SUMMARY

Borrower and guarantor:	Republic of Peru	
Executing agency:	Ministry of Economy and Finance (MEF)	
Amount and source:	IDB (OC):	US\$250 million
	Total:	US\$250 million
Terms and conditions:	Amortization period:	20 years
	Grace period:	5 1/2 years
	Disbursement period:	6 months
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency:	U.S. dollars from the Single Currency Facility
Objectives:	<p>In the short term, the objective of this operation is to develop a legal framework for introducing transparency and accountability in fiscal policy, and to protect spending on the social and justice sectors in the context of fiscal equilibrium. In the medium term, the objective is to develop public policies based on a process of participation by civil society to ensure transparency and accountability and improve governance in a democratic context.</p>	
Description:	<p>The design of this operation incorporates two factors. The first is the existence of a window of opportunity, a function of Peruvian conditions in 2001, marked by an electoral process that will result in a mid-year change in administration and the Congress, in which the present government will not participate. The present administration has made it clear that it intends to prepare the groundwork for an orderly transition of power and to introduce mechanisms that ensure transparency in the State's activities. The second factor is that the State reform needed to restore credibility and governance is a long-term goal that exceeds the scope of a single operation. This</p>	

single-tranche loan is the first operation in a US\$500 million program of sector loans for the year 2001, which may be supplemented by other operations still to be agreed on with the new authorities. This format has significant advantages, since it affords both the country and the Bank the ability to adapt to the change of government and allow the window of opportunity being presented in this political transition stage to be exploited. The conditions contained in the policy matrix were fully satisfied prior to submission of this operation to the Board of Executive Directors.

To promote the fulfillment of the objectives relating to the protection of spending on the social and justice sectors, mechanisms were created to contribute to civil society's ability to begin exercising control over these expenses. To ensure the sustainability of this operation's objectives in the medium term, plans have been made to carry out a number of studies and activities, and to create mechanisms for consultation with civil society. Such activities will be financed through a special fund established by supreme decree specifically for these purposes.

The conditions fulfilled by the government as described below are oriented toward increasing transparency and accountability in:

Fiscal policies and institutions. There is a legal basis for ensuring public access to government financial information in order to: i) eliminate the distortions in the information available to the authorities and the public; ii) reduce opportunities for arbitrariness, a situation that favors corruption; iii) improve civil society's ability to participate in government decision-making; and iv) strengthen governance in order to achieve effective democracy. The new legal basis is the result of an emergency decree containing regulations to allow public access to fiscal information and provide for the publication of detailed public finance data by budgetary and off-budget institutions, and an interactive system that affords access to additional information and greater transparency in the budget process by simplifying the submission of information such as tax expenditures and fiscal risk. Lastly, institutional coverage of the budget control exercised by the MEF has been expanded, and the Defense and Interior sectors have been included within the regular public financial administration cycle.

Anti-poverty and social protection policies and institutions. Actions have been carried out in order to: i) protect antipoverty and poverty relief programs from budget cuts and to introduce mechanisms to make the authorities accountable to civil society for completing this measure; ii) reduce breakdowns in coordination and

improve the State's ability to react to random shocks such as economic crises and natural disasters, including the creation of mechanisms for monitoring and for ensuring participation by civil society; and iii) set the stage for comprehensive reform of the country's social safety networks.

Justice policies and institutions. The groundwork has been laid for: i) formally establishing an anticorruption and public ethics building program; ii) reinitiating reform of the administration of justice system by ensuring its independence and participation by civil society; and iii) protecting spending on justice from budgetary cutbacks.

The Government has also fulfilled two special conditions relating to macroeconomic equilibrium and the implementation of subsequent actions to ensure the sustainability of this operation's medium-term objectives:

- a. **Macroeconomic stability.** The Executive Board of the International Monetary Fund has approved the agreement with that institution.
- b. **Special fund for subsequent actions.** A Supreme Decree has been issued authorizing the allocation of resources to prepare the foundation for facilitating the design of future reforms in the three areas of the sector program.

**The Bank's
country and
sector strategy:**

The Bank strategy as described in the country paper (GN-1992-1) emphasizes the need for a second generation of reforms, with a focus on efforts to reduce poverty and modernize the State. Both remain as crucial topics on the political agenda. This project reflects the Bank's response to these special circumstances affecting the country. This operation hinges on projects now under way to assist Peru with the first generation of reforms, paving the way to comprehensive reform of the public sector and the social safety net system.

**Environmental
review:**

As to its environmental impact, the operation focuses on policy actions that require no measures involving civil works or other actions that might have any direct environmental impact. It was also reviewed by CESI on 9 February 2001.

Benefits:

In the short term, the program's primary benefit will be to initiate the creation and implementation of participative processes at different points of the public decision-making chain, in three of the areas considered as being most important for ensuring sustainability of the conditions required for development. To that extent, introducing participative mechanisms and the means of ensuring the fulfillment of government plans strengthens the country's democratic institutions,

improving governance and consequently enhancing the conditions for development.

At the same time, subsequent actions to be commenced after the Board's approval of the operation will also yield considerable benefits in the medium term. The new administration that assumes power on 28 July will have a unique opportunity to deepen the process of structural reform, having at its disposal an array of diagnostic assessments and proposals for strengthening the fiscal, social and justice sectors.

Risks:

Since this sector loan involves a single tranche only and all the conditions stipulated in the policy matrix have been fulfilled, there are no risks that jeopardize the operation's objectives or disbursement in full of the resources.

However, the operation's design incorporates factors that go beyond loan disbursement and the government's term of office. Subsequent actions in the fiscal, social and justice sectors as described in chapter three must be executed after disbursement in full of the loan. There is therefore a risk that, since they are not disbursement conditions, and are financed, at least in part, through budgetary allocations, some of these activities will not be fulfilled. This risk is minimized through the creation, by supreme decree, of a special fund to finance these actions, with specific objectives and sufficient funds, as described in chapter three, as well as by a program fulfillment and impact evaluation. The policy letter submitted by the government and published also make clear the commitment to execute the actions proposed.

Legislation regulating access by the public to government information by means of an instrument not requiring prior discussion or consensus, such as the Emergency Decree, could adversely affect how deeply its provisions are accepted by the public, thus leading to subsequent amendments. Many of the provisions contained in the standards will have practical effect and force of law when the new Congress sits owing to the fact that since March 2001 information has been posted on the MEF website and the main presidential candidates and most political parties in the Legislature promoted this initiative during the election campaign.

Although this operation is self-contained and self-justifying, it also falls within the framework of medium-term reforms. Transparency in public finance, protection of the most vulnerable social sectors, and strengthening the process of reforming the administration of justice are only the first steps; they must be accompanied by a deeper reform of the State. If these subsequent reforms are not carried out, the consistency and integrity of the country's long-term reforms could be

jeopardized. Despite the fact that the political situation makes it difficult to mitigate this risk, the technical studies forming part of this operation will provide subsequent information to assist the next administration in becoming familiar with the State's areas of greatest weakness, as well as specific proposals for strengthening them.

**Special
contractual
clauses:**

The loan agreement will include the conditions set forth in the Policy Matrix (Annex I-1) and will state that the Policy Letter (Appendix I) is an integral part of the loan.

**Poverty-
targeting and
social sector
classification:**

This operation is classified as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). Programs for combating and alleviating poverty, which are to be protected under the program, play a fundamental role in sustaining the living conditions of the marginalized population, including women and indigenous peoples in extreme poverty.

**Exceptions to
Bank policy:**

None

Procurement:

Not applicable

I. FRAME OF REFERENCE

A. Background information

- 1.1 Bank assistance to Peru is indispensable at this time given the confluence of economic and political circumstances. The peaceful and orderly transition to a new Congress and a new administration may be affected by the short-term economic problems the country is facing. The multilateral community has responded with a coordinated effort to support the transition Government. In addition to this operation, this support includes a 12-month IMF standby program, and a structural adjustment program in the World Bank's social sector.¹
- 1.2 The proposed operation adopts measures that significantly improve governance by taking advantage of the window of opportunity that has arisen because both the Congress and the interim government have indicated they are committed to carrying out a peaceful and orderly political transition, maintaining macroeconomic stability, and have specifically committed to improving the transparency and openness of the country's institutions. The proposed operation includes measures that will send a clear and meaningful signal to the international community and domestic players as to the country's commitment to strengthening its democratic institutions.
- 1.3 This sector loan is the first in a program that includes two operations, each of US\$250 million, for 2001. This operation will support the interim government in fulfilling its fiscal obligations and will simultaneously improve the transparency and openness of State activities, increasing governance and protecting spending on critical social and justice programs. It will also create instruments that contribute to laying the groundwork for future reforms. These reforms will be supported by the second operation proposed for the second half of 2001.

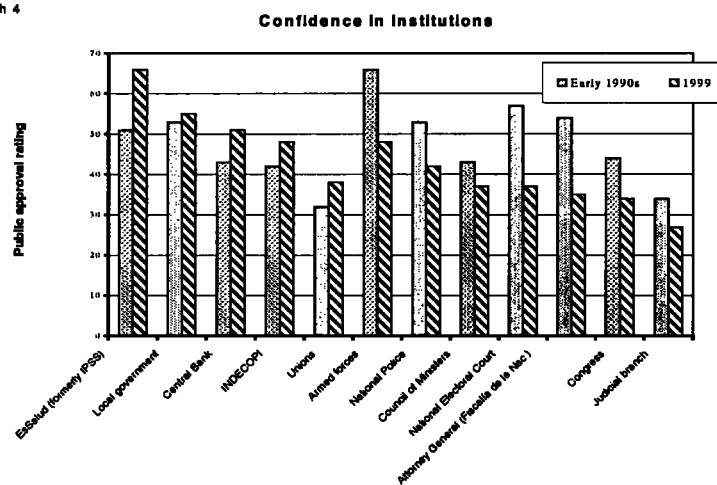
B. Socioeconomic context

- 1.4 In the early nineties, Peru succeeded in eliminating the hyperinflation and terrorism that had been wreaking havoc in the country since the latter part of the previous decade, and engaged in a strong stabilization program, accompanied by comprehensive structural reforms, within a context of fiscal adjustment. The Constitution, which was approved by referendum in 1993, consolidated the new rules of the game in the country. The Peruvian economy, which had been in a state of collapse since the mid-seventies, recovered. Both economic growth, which reached an average of 4.2% per year, and the doubling of real social spending, contributed to reducing the proportion of the extremely poor in the nineties.

¹ The World Bank initially prepared a sector loan of two tranches for US\$300 million, which is being reformulated.

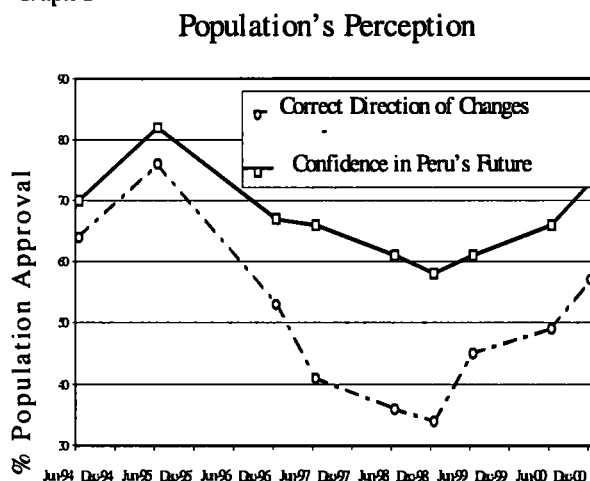
- 1.5 The depth, intensity and speed of the structural reforms was impressive. They covered liberalization of the balance of trade and the balance of capital in the financial system, the labor market, and included an ambitious privatization and concession program. This was accompanied by changes in the institutional framework to strengthen the State's regulatory role, including the creation of specialized agencies. Within one decade Peru went from being one of the countries with a legal and institutional structure least favorable to market development, to having one of the most favorable structures in Latin America (see Graph 1).

Graph 4



- 1.6 The economy responded positively to the new institutional structure. In general, the reforms were successful in their intermediate objectives: (i) the economy became more open, although without significant export diversification; (ii) direct foreign investment grew radically;

Graph 2

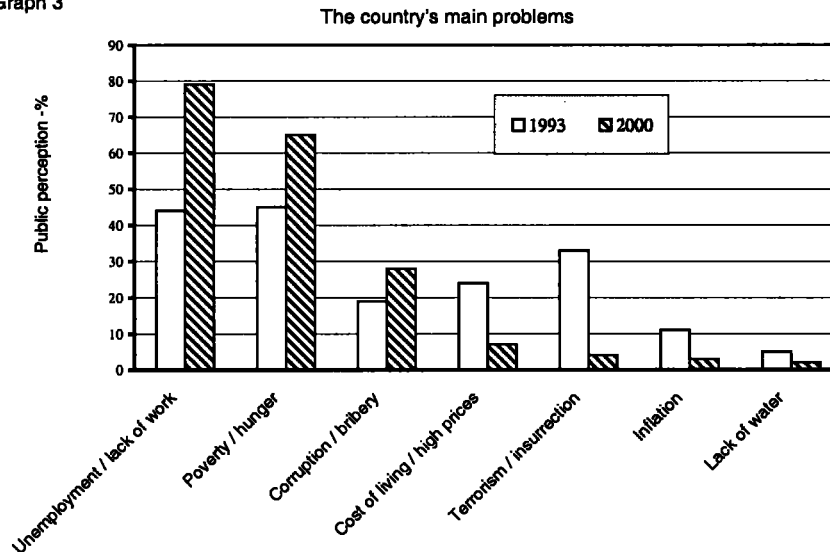


investment grew radically; (iii) financial intermediation increased significantly, but the dollarization of liabilities and assets in the financial system increased; and (iv) the labor market became more flexible, with a drop in job duration and an increase in temporary contracts. However, compared to the eighties, the unemployment rate grew, real wages declined and inequities in income distribution increased. The recovery of economic growth was also due both to an expansion in private investment, and to an increase in total factor productivity.² Opinion polls captured the success of the structural policy. The majority of the population

² Average growth rose from -0.8 between 1980 and 1990 to 4.7 between 1990 and 1998; 2% of the latter figure was due to an increase in capital and 2% to an increase in total productivity.

believes that the country is on the right track (see Graph 2). Many of the problems that Peruvians were facing in the early nineties, such as inflation, the cost of living and terrorism, had disappeared (see Graph 3).

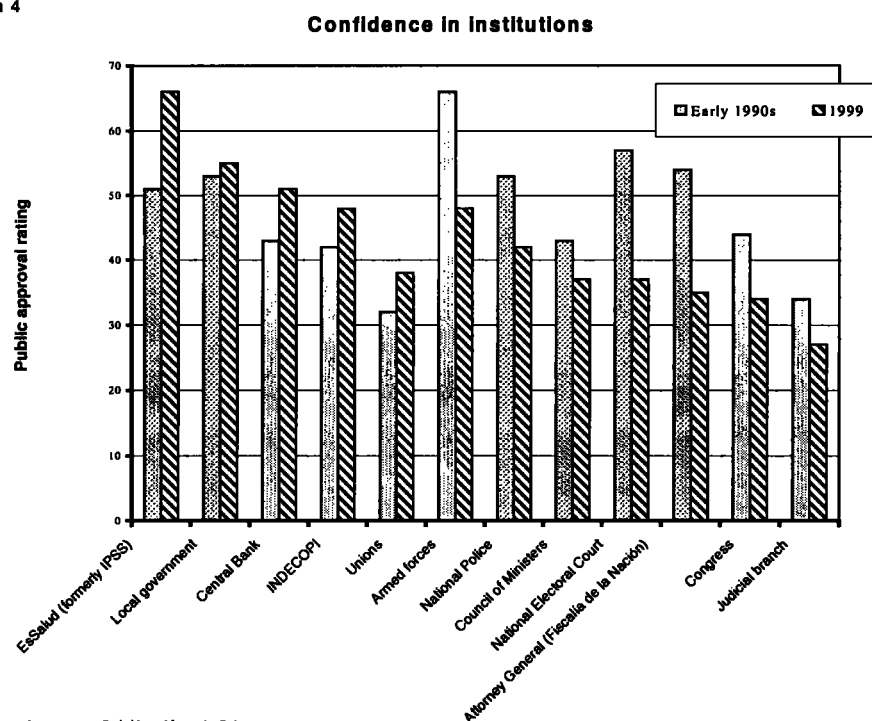
Graph 3



Source: Consultora Apoyo Opinión y Mercado S.A.

- 1.7 Despite the progress that has been achieved, the country still faces significant problems, as reflected in the population's concern for issues such as unemployment, poverty and corruption. Resolving them will involve implementing a set of actions to strengthen the country's institutionality, which go beyond continuing the first generation reforms. The population currently harbors a great deal of mistrust in the ability of critical public institutions, such as the judicial branch or the oversight agencies, to manage the system (see Graph 4).

Graph 4



- 1.8 This is partially explained by the need to deepen reforms related to the building of consensus around policies. In fact, within the current electoral context, issues such as transparency and openness, particularly with regard to the allocation of State funding, have become a significant part of the platforms of the most representative candidates.

C. Macroeconomic context

- 1.9 Although economic growth has recovered since 1993 within a context of macroeconomic stability, since 1997 it has declined and the fiscal situation has worsened. This is due to the influence of exogenous shocks such as El Niño, the Asian crisis and its impact in terms of trade, and the Russian crisis. The situation has worsened recently because of political uncertainty and the removal of the previous government.

Table N° 1
Macroeconomic Situation 1999–2001 *

		1999	2000	2001
<i>GDP Growth</i>	%	1.4	3.6	2.0–3.0
<i>Growth in gross private domestic investment</i>	%	–16.3	–1.1	2.7
<i>Inflation</i>	%	3.7	3.7	2.5–3.5
<i>Fiscal deficit</i>	% of GDP	–3.0	–3.0	–1.5
<i>Primary spending</i>	% of GDP	15.7	15.2	13.9
<i>Gross debt requirements</i>	Millions of dollars	2,409	2,294	1,800
<i>Current account</i>	% of GDP	–3.5	–3.0	–2.4
<i>Change in net international reserves</i>	Millions of dollars	–780	–223	265
<i>Exchange rate</i>	Soles per dollar	3.38	3.49	3.58
Memorandum				
<i>Primary spending</i>	Millions of dollars	8,194	8,240	7,786
<i>Social spending</i>	Millions of dollars	4,475	4,345	4,777
<i>Spending on programs focused on combating and alleviating poverty</i>	Millions of dollars	882	718	670
<i>Justice spending</i>	Millions of dollars	201	201	187
<i>Protected spending</i>	Millions of dollars			802
<i>Social programs</i>	Millions of dollars			483
<i>Justice sector</i>	Millions of dollars			51
<i>Other</i>	Millions of dollars			267
<i>Defense spending</i>	Millions of dollars	2,946	1,542	1,299
<i>GDP</i>	Millions of dollars	52,028	54,074	55,935

* 2001, scheduled.

- 1.10 Short-term macroeconomic challenges include sustaining fiscal discipline during the election period, complying with debt obligations and keeping external accounts manageable. In the medium term, the strategy includes recovering economic growth within a context of macroeconomic stability. For the year 2001, macroeconomic policy is based on three pillars. The first is to reduce the fiscal deficit to 1.5% of GDP by returning to the margins stipulated in the Fiscal Prudence and Transparency Law. To achieve this objective, the government has already significantly reduced spending, with an estimated real decline of 5% (1.4% of GDP). The government has also committed to keeping strict control over new taxes and other fiscal measures that might reduce tax revenue. The second pillar is to sustain a monetary policy consistent with the goal of reducing inflation to the international level, by imposing limits on growth in the monetary base within a context of a floating exchange rate. The third is the fulfillment of obligations relating to debt that has been engaged. The total financial requirements of the non-financial public sector (fiscal deficit of US\$900 million plus debt amortization)

are estimated at US\$1,800 [million], which will be financed by project disbursements estimated at some US\$500 million, external debt of US\$975 million and revenue from privatization and other sources of US\$325 million.

- 1.11 It is expected that these macroeconomic policy actions will contribute to achieving growth of between 2% and 3% this year while reducing inflation to 3% to 4%. Production growth this year is led by increasing exports which, together with a still depressed domestic demand, will cause the current account deficit of the balance of payments to decline even more in 2001. It is therefore expected that the Central Bank's net international reserves will increase.

D. Recent measures

- 1.12 On the political front, under the auspices of the Organization of American States (OAS), the country has achieved a consensus on the number of key areas, to facilitate an orderly transition of power. Recent measures—legal and constitutional changes approved and implemented—result in both an improved electoral process, and the recovery of the judicial system's independence. The presence of an interim government in power, which will not participate in the elections, represents an important change in Peruvian pre-electoral conditions over the past fifteen years. The new elections for president, vice presidents and members of Congress were held on April 8, 2001 and the second round of voting will take place in the first half of June. The new administration will take office on July 28, 2001. Steps have been taken in the economic plan to mitigate the crisis, with the issuance of a Fiscal 2001 Public Spending Efficiency and Ceilings Act, in February 2001.

E. Transparency and openness

- 1.13 Recent political events in Peru have led to discussions which up to now had not taken place, such as the effect of the lack of institutionality on economic development, and the lack of democracy, which appear in surveys on the country's major problems. The population is also seeing significant social advances, in that issues such as education, health and sanitation have declined significantly in the order of the people's priorities, despite the fact that concern for unemployment and poverty have increased significantly.

1. Fiscal policies and institutions

- 1.14 In the early nineties, Peru implemented a number of reforms aimed at establishing fiscal equilibrium. These reforms included reform of the tax system, modernization of the tax and customs administrations, and privatization. Relations with international creditors were also normalized. All of this led to an improvement in public finances. However, the fiscal balance has been deteriorating since 1998, to a global deficit of some 3% of GDP in 1999 and 2000.

- 1.15 In the summer of 1999 the Prudence and Transparency Law was promulgated, offering regulations for monitoring fiscal aggregates. This set quantitative limits on the fiscal deficit, annual spending increases and medium-term public debt, in addition to creating a fiscal stabilization fund and a two-phase budget approval system within a multi-year financial framework. However, in its first year of application it failed to meet the deficit limit, due to the fact that the law's compliance control mechanism was based on the principle of reputation, rather than on explicit sanctions. In order for this principle to be effective, there must be a culture of information, and for this to occur, mechanisms must be created for the public dissemination of fiscal information. Despite the fact that in 2000 the Ministry of Economy and Finance (MEF) began publishing certain information on its web site, a permanent system must be created to disseminate minimum information for citizens to be able to monitor fiscal aggregates.
- 1.16 The difficulty of addressing fiscal disequilibrium on a sustained basis is also due to structural defects in the public administration and the absence of appropriate debt and public spending administration policies, as well as the absence of mechanisms to promote transparency and accountability to civil society. Financial administration regulations originate almost exclusively from annual budget laws. The absence of a stable and comprehensive body of regulations is an obstacle to effective and efficient implementation of government spending programs and their enforcement by citizens. The demand for transparency originating from civil society is reflected in the existence of three bills on transparency in the National Congress; however, the scope of coverage of these bills, which apply to the entire public sector, plus the lack of information to allow the design of mechanisms appropriate for the complexity and diversity of State tasks, make them complex and controversial.
- 1.17 Although the country has taken great strides in terms of financial administration systems, there still remains much to do for the public finance regulations and formal mechanisms for the dissemination of information on budget execution to be appropriate for encouraging a policy of openness. Publishing detailed data on budget execution as well as information on the entire purchasing and contracting cycle would afford citizens the opportunity to evaluate the fulfillment of government policies as reflected in the annual budget law. Although the country has a State contracting and acquisitions law that requires the publication of certain data in the process, this must be supplemented by budget execution data.
- 1.18 Another weakness that must be addressed is the availability of information on public debt flows and aggregates, to allow for independent analysis of the sustainability of fiscal policies. A prudent and sustained debt policy would send appropriate signals to the capital markets, to maintain the lowest possible cost and risk in the liabilities portfolio. Despite the fact that the current public sector loan portfolio consists primarily of multilateral and bilateral loans, a transparency policy

in terms of public debt would facilitate the country's access to international capital markets under favorable conditions.

- 1.19 One of the reasons why it is feasible to attack the problem of transparency and openness in the fiscal environment at this time is because, with the Bank's support, the country has made great strides towards attaining such information. They are currently in the process of consolidating implementation of the Integrated Financial Administration System (SIAF), through which public entities will perform budget, treasury and accounting transactions in an integrated fashion. The SIAF will soon have acquisitions and contracting information as well as spreadsheets. This will then be the primary basis for extracting most of the data needed for a public fiscal information dissemination system. Within the scope of State companies and funds, the MEF, through the National Fund for the Financing of State Business (FONAFE), has made great strides in only three years, and now has similar detailed information and management indicators on these entities. In early 2001, the challenge was to bring the Defense and Interior sectors into this system. Once the public sector accounting system is functioning in each government entity, it will be possible to extend transparency from fiscal macroeconomic aggregates to coverage of disaggregated data.
- 1.20 The Prudence and Transparency Act which was one of the conditions of operation 1235/OC-PE was intended to provide a legal framework marked by quantitative rules in a multiyear budgetary context with transparency in the performance of fiscal aggregates. These regulations provided a legal structure for macrofiscal prudence and accountability. Discrepancies continued to exist however between the government and society and this information is needed for society to participate fully in discussions on efficiency, effectiveness, and equity of public finances.
- 1.21 The Public Access to Information Act which is one of the conditions of the present operation will help eliminate such discrepancies and is intended to produce fiscal transparency of disaggregated data. This requirement is set out in the quarter report on revenue, spending (by program and project), financing (by source and instrument), and debt (by source and instrument) at a budgetary and nonbudgetary institutional level. In addition, a report on tax expenditure and fiscal risk will need to be published annually as well as regular reports on central government procurement. A system will be created whereby the public is entitled to unpublished fiscal information. These two laws will give Peru a legal structure that includes most of the recommendations contained in the IMF Fiscal Transparency Code, thus complying with the four general principles of fiscal transparency: (i) clearly defined functions and responsibilities, (ii) public access to information, (iii) transparency in preparing, implementing, and publishing the budget, and (iv) independent evaluation of guarantees of integrity.³ In this way, Peru will be able to position itself

³ This code proposes best practices for each of the four general principles. See IMF Fiscal Transparency Manual www.imf.org. An assessment of compliance with the Code using the IMF questionnaire in the project technical files.

as a leader in the region in complying with the IMF Fiscal Transparency Act and similar standards in effect in developed countries.

- 1.22 Along the same lines, another important factor for tax policy to be acceptable is that the control mechanisms be effective and neutral, i.e., that they not be used arbitrarily. This arbitrariness is apparent on two fronts. First, the members of the Tax Court, the administrative appeals body for issues relating to national and municipal local taxes and customs duties, are designated at the discretion of the executive branch and in practice by a decision of the Minister of Economy and Finance, a practice that does not guarantee that they are competent or politically neutral. Second, the significant advances made by the tax administration in recent years have been tarnished by the arbitrary targeting of tax audits. The high level of tax evasion, particularly in the nonsalary income tax component, must be halted through a policy of supervision that incorporates technical and objective criteria of directed audits to reduce the level of noncompliance.

2. Antipoverty and social protection policies and institutions

- 1.23 In the nineties, Peru made significant progress in the fight against extreme poverty, although achievements relating to moderate poverty⁴ were reversed with the crisis of 1999. While the former declined from 24% to 15% in one decade, moderate poverty fell from 55% to 51% in 1997, but rose again to 54% in 2000. Progress in reducing the incidence of extreme poverty is attributed primarily to increased real social spending and the introduction of programs focused on its alleviation and elimination. Despite these efforts, persistent high rates of extreme poverty in the country and the recent increase in moderate poverty are signs that the programs implemented during the 1990s have had little impact on the vicious cycle of “extreme poverty—marginalization—extreme poverty,” and have not effectively protected the population from economic crises.
- 1.24 Social spending in Peru, despite the fact that it almost doubled in the nineties, is still below the Latin American average and continues to be highly pro-cyclical, with a variation coefficient greater than the product growth rate. The interim government has taken a series of measures to increase transparency and the impact of social spending: (i) it has reallocated 0.3% of GDP, intended originally for defense and interior expenses, toward the social sector; (ii) it has made public the social spending efficiency analysis and in the case of the health sector, information relating to effectiveness; and (iii) it is seeking to create a national and sub-national consensus on policies for alleviating and eliminating poverty through a recently established discussion panel, as well as consultations between the government and civil society, including marginalized groups.

⁴ The population counted as being in moderate poverty is considered to be that whose income is equivalent to up to twice the income received by those defined as being in extreme poverty.

- 1.25 The sustainability of these efforts needs to be supported through the creation of institutional mechanisms that reduce improvised decision-making, since these involve medium- and long-term investments. In 1998-99 the government developed a list of protected social programs with the intent of reducing the pro-cyclical nature of social spending. However, as occurred in the case of the mechanisms developed to promote fiscal prudence and transparency, this list was neither formally adopted nor do the mechanisms exist to demand it.
- 1.26 This is primarily explained by two factors: (i) the budget decision-making, planning and scheduling process in the social sectors is highly centralized, there is no evaluation and there is a lack of coordination between independent programs and executing agencies, which results in an overlapping of beneficiaries, with the consequent waste of resources that could be redirected toward unserved groups in extreme poverty;⁵ and (ii) information on the budget, its execution and the effectiveness of social programs is not public nor easily accessible. The combination of both factors has resulted in an excessive level of discretionary action in budget management, which causes priority social programs to be cut without stricter technical criteria, as occurred during the 1998-1999 slowdown. Given this, neither the entities nor even less the citizens are capable of objecting to a decision, since there is no mechanism which, first, makes it explicit, and second, allows social control over this spending. As a result, citizen trust in the effectiveness of social public spending has deteriorated.
- 1.27 The need to strengthen institutional foundations in the primary social programs, combined with limited access to basic information on them, in addition to making them more vulnerable to manipulation, fails to generate incentives to improving quality. A detailed analysis of who is spending, on what it is being spent, who benefits and what is the impact on the well-being of the beneficiaries, as well as the dissemination of this information, is crucial to executing social policy reform to ensure permanent improvement in the effectiveness of the country's social spending.
- 1.28 The Peruvian government, with the Bank's support, has prepared a schedule of the major social policy actions that must be taken to lay the groundwork for reform in the sector. These actions are presented in a work plan to support the CIAS Technical Secretariat, the office responsible for planning and coordinating national social policy, in 2001. The plan was prepared by the Deputy Minister of Economy and includes activities in the following areas: (i) coordination and rationalization of social programs; (ii) improvement in the system for monitoring and evaluating social spending through performance indicators; (iii) improvement in the process of focusing social programs; (iv) planning of impact and cost-effectiveness

⁵ The previous administration activated the Inter-Ministerial Commission on Social Affairs (CIAS) with a view to improving coordination mechanisms between ministries; unfortunately the commission has not met for over two years, since it has neither the initiative nor the technical support needed to fulfill its duties.

evaluations of social programs; and (v) improvement in the social protection system.

- 1.29 The country is also lacking in adequate social protection instruments to address co-variant shocks such as economic crises and natural disasters. As seen previously, the recent crisis of 1998-1999 had a considerable negative effect on extreme poverty, and since its effects are not merely short term, the absence of measures to protect against it may lead to severe reductions in the poor's investment in human, physical and financial capital. This will lead to a deterioration in their future ability to emerge from poverty and in the growth capacity of the economy as a whole. As a preventive measure to address economic crises, a social contingency plan was developed in 1998, which has been not implemented.⁶ Despite this fact, in the most recent crisis the government was able to satisfactorily protect the population living at the extreme poverty line,⁷ but the population living at the moderate poverty line is still very vulnerable.⁸
- 1.30 With a view to improving the social protection contingency network, the government has made some progress, including the development of a preliminary contingency plan to expand social protection under situations of economic contraction and/or natural disasters. This plan includes start and end criteria, as well as an operating and financial plan to ensure the timely availability of resources, aimed at stabilizing income levels and providing basic social services to vulnerable sectors. A work structure has also been prepared for improving the contingency plan that will incorporate the results of a vulnerability study to be carried out in coming months. The contingency plan includes such items as: (i) systems to identify the population affected by economic contractions and natural disasters; (ii) improved early warning indicators for plan activation; and (iii) identification of the plan's potential coverage shortfalls, as well as new instruments to better protect the affected population.

3. Justice policies and institutions

- 1.31 The weakness of the entities forming part of the country's institutional framework for resolving economic and social conflicts, as well as for protecting the rights of individuals, affects economic development, since it leads to a dangerous vacuum for individual solutions, as suggested by recent surveys carried out by the World Bank⁹ in over 58 countries. According to these surveys, the countries in which confidence in the justice system and in political and public institutions is lowest,

⁶ The serious effects of the recent crisis on moderate poverty and on nutrition indicators, which in the urban sierra show an increase in the rate of chronic malnutrition from 14.7% in 1997 to 24.3% in 2001, with a similar pattern for the rural coast, indicate that it is urgent to improve the country's social protection mechanisms.

⁷ The elasticity of extreme poverty to the rate of growth of per capita GDP between 1997 and 2000 was -2.43%.

⁸ The elasticity of moderate poverty to the growth rate of per capita GDP between 1997 and 2000 was -24.0%.

⁹ Business Environment and Enterprise Performance Survey, (BEEPS), 1999.

have limited growth capacity, the public apparatus tends to grow, the composition and productivity of public spending is distorted in favor of monumental investment projects, to the detriment of investment in basic services such as health and education, and it even affects the ability to capture and consequently redistribute taxes, deepening inequity and poverty.

- 1.32 Given this, not only is it important to have a clear regulatory and conflict resolution framework, but above all, there must be the ability to enforce such regulations and confidence in the institutions assigned that task. What is more, the degree of interaction between the various entities involved in providing justice makes it necessary for efforts to improve its quality and coverage to be based on coordination which currently does not exist in Peru. Without this, progress in reform will be less and the inter-institutional impact could even be negative.
- 1.33 The Peruvian justice administration system has been subject to successive reform efforts. The most recent began in the early nineties, when the lack of judicial legitimacy and incompetence provided the framework for the temporary suspension of the judiciary and the announcement of a massive dismissal of judges and auditors. The new constitution of 1993 proposed steps to reform the system which included provisions such as the following: (i) reintroduction of the Constitutional Court and expansion of the power of the National Council of Judges to select, promote and punish judges; (ii) the direct election of justices of the peace and district court judges; and (iii) the creation of the Human Rights Ombudsman Office. "Emergency regulations" were decreed in 1995 for the administrative modernization of the system and the resolution of specific problems such as the case backlog.
- 1.34 The institutional reform process was assigned to a group of non-jurists institutionalized in both the judicial branch executive commissions and the Public Ministry, and their authority to administer the judiciary was gradually increased, under the aegis of the need to undertake administrative reform. The reform programs that were adopted, by stipulating unrealistic time frames, also failed to provide for effective consultation and participation on the part of judicial and civil society, which was not established as a part of the process. To reduce the natural resistance of judges to the imposition of changes, their employment status was made more tenuous by increasing temporary assignments and replacements in the schedule.¹⁰
- 1.35 Regarding the political aspects of reform, the institutional weakness resulting from what was described above opened the way for political interference, which gradually compromised the sector's independence, through laws passed by the Congress primarily in the final two years of the last decade. By the end of the

¹⁰ To date, only about one-fourth of all judges and auditors are permanent, i.e., officials selected for their positions through a public selection process, subject to rules that guarantee transparency and access by merit.

nineties the reform process had stalled, financing had been reduced, special budgets for experimental programs had been cut and many of the measures that had been designed were left in suspense. After ten years of reform, the system's credibility had not improved and the citizens' perception of justice had barely changed.

- 1.36 The last quarter of 2000 saw the issuance of a set of regulations intended to dismantle the mechanisms for interference in the justice administration system¹¹ and the institutional groundwork began to be laid to allow for a new reform process, based on mechanisms to increase transparency and responsibility. There is a consensus that in order for the new reform of justice administration to have a visible and significant impact, and particularly in order for it to be sustainable, the process by which it is designed and implemented, include reporting and inter-institutional coordination mechanisms, must be transparent, and dialogue with civil society and the private sector must be reinitiated through the implementation of consulting mechanisms. The same applies to the reform of executive branch entities, for which it will be necessary to reestablish the structures and balances of power in order to make them responsible to the citizens for achieving results.

F. Bank strategy in the sector

- 1.37 The Bank strategy as described in the country document (GN-1992-1) emphasizes the need for a second generation of reforms, with specific emphasis on efforts to reduce poverty and modernize the State. Both remain critical topics on the political agenda. The existing loan portfolio reflects the Bank's support for the first generation of reforms to improve the allocation of the economy's resources and to increase private investment. This project reflects the Bank's response to the country's special circumstances and is based on projects in execution, laying the necessary groundwork for comprehensive reform of the public sector and the social protection system.

1. Bank programs in fiscal policy and institutions

- 1.38 With regard to the modernization of the fiscal public sector, the Bank's operations have been oriented toward strengthening specific institutions—the Ministry of Economy and Finance in its role of managing structural reform and public finance through the Integrated Financial Administration System (SIAF)—or specialized agencies—the National Tax Administration Superintendency (SUNAT) and the National Customs Superintendency (ADUANAS), the National Institute for the Protection of Competition and of Intellectual Property (INDECOPI). In general,

¹¹ The executive committees were deactivated, to be replaced by temporary councils consisting of members of the judiciary and civil society with functions extending to the issuance of regulations and establishment of government mechanisms for the judicial branch and the Public Ministry. The new institutional framework is expected to be approved before July. Authority was also restored to the National Council of Judges to select and audit judges and auditors. The approval of salaries and rights for temporary and permanent judges was eliminated. Finally, the preparation time for applying for a judicial career was reduced to two months in order to increase the supply of applicants.

operations provide clear pragmatic solutions to the specific objectives that have been identified. In 1996 the Bank also approved a sector investment loan (985/OC-PE), the policy matrix of which included conditions linked to the privatization and concession process. However, some of the conditions established for the most recent tranche of the matrix are still pending. During the same year there was an attempt to promote a second generation of reforms, this time through a government modernization program that would institutionalize advances in economic reform. This effort was stymied since the government decided not to make the commitment.

- 1.39 A new effort in this sense was the sector operation approved in 2000 (Public Finance Reform, 1235/OC-PE) which was an innovative return to the modernization agenda. The loan has already been disbursed and was centered on the use of budgetary and fiscal reform (including performance contracts) to achieve institutional change. This operation, which also avoided linking reform to fiscal adjustment policies, was limited to improving activities in the economic sector and doing so with other State agencies within the MEF's area of influence.

2. Bank programs in social policies and institutions

- 1.40 In the area of poverty and improving the efficiency of social spending, there are several operations that contribute to laying the groundwork for this program. FONCODES, which finances small social investment projects in poor marginalized communities in the rural sector, and Wawa Wasi, which finances community day-care centers and food programs for children of poor families, are essential components of a strategy for combating and alleviating poverty. With regard to reforms for increasing the efficiency and the effectiveness of social spending, there are two operations (1237/OC-PE and 1208/OC-PE) that have been recently approved in the education and health sectors, which are aimed at focusing subsidies on the poorest and most marginalized women and children and laying the groundwork for more meaningful future reforms. The proposed loan builds on the foundations of these operations and provides the additional diagnostics and proposals needed for a comprehensive and lasting reform of the social sector.

3. Bank programs in justice policies and institutions

- 1.41 In the justice sector, there is an operation aimed at improving access to basic justice through the creation of basic justice modules in poor and marginalized areas, which are characterized by high court backlogs and a very low proportion of judges per inhabitant. This project has been classified as non-satisfactory essentially because of the lack of coordination between the Public Ministry and the judicial branch, as well as the Justice Ministry's lack of resources for meeting its commitments, because they were not given priority in the budget. One of the objectives of the proposed program is to resolve coordination problems between the major participants in the judicial sector. An operation financed by the MIF (Multilateral

Investment Fund), executed between 1994 and 1996, supported the creation of arbitration and reconciliation systems and centers in the country's private and public sector entities.

G. Program strategy

- 1.42 To consolidate and expand the benefits of the aforementioned programs it is necessary to increase intra- and inter-sector coordination, introduce mechanisms to increase transparency and appropriate reporting instruments, and increase civil society's participation in the reform process. This operation seeks to lay the groundwork for second generation reforms, primarily in the area of governance, on the understanding that institutional transformation is a long-term social participation process.
- 1.43 The Bank's operating strategy recognizes that public sector reform is necessary to restore confidence and governance, a long-term goal that exceeds the scope of a single operation. This is particularly true within the Peruvian context of 2001, which is characterized by a mid-year change in administration and in the Congress. This operation, a single-tranche loan, is the first in a US\$500 million program of sector loans for the year 2001. This format has significant advantages. It provides both the country and the Bank with the ability to adapt to changes in administration and allows the window of opportunity presented in this political transition stage to be exploited.
- 1.44 The government's political strategy is dominated in the very short term by the objective of ensuring orderly general elections and an adequate transition of power to the new administration and Congress. Meeting this objective is based on three strategic actions: first, the promotion of governance; second, the need to avoid an unsustainable deterioration in the country's macroeconomic and fiscal performance; and third, the need to lay the groundwork for future reforms. In terms of administrative management, the transition government has proposed laying the groundwork for a more transparent and participative handling of public finance, ensuring protection for the least favored sectors and institutionally strengthening the administration of justice through technical instruments introduced by this sector strategy.
- 1.45 What is more, to lay the groundwork for future reforms, as part of this operation the government has agreed to allocate a budget sufficient to finance a number of studies and activities that will provide diagnostics and proposals in various areas for reforming the public sector. This plan reflects a commitment by the country to work in close association with the Bank in preparing the basis for reforms that it will support within the next sector loan, planned for the second half of 2001. The Bank and the World Bank are also supporting efforts originating from civil society to prepare a series of political documents as inputs for the next administration.

- 1.46 Therefore, to ensure the continuity of the work being initiated with this program, a Special Fund has been established as a condition, which will finance the activities and proposals constituting a bridge between the two program operations. It is expected that these results, plus a dialogue with the new government scheduled for the month of August, will be inputs for the design of the new operation.

II. THE PROGRAM

A. Objectives and description

- 2.1 In the short term, the objective of this operation is to develop the legal framework to introduce fiscal policy transparency and reporting mechanisms, as well as to protect social spending and justice within a context of fiscal equilibrium. In the medium term, the objective is to develop public policies based on processes involving participation by civil society to ensure transparency and openness, to improve governance within a democratic context.
- 2.2 The specific objectives are the following:
- a. **Fiscal policies and institutions**, to promote citizen participation in the monitoring and evaluation of government actions, by providing relevant fiscal information and eliminating distortions in fiscal administration.
 - b. **Anti-poverty policies and institutions**, to increase transparency and reporting in the social sector, through measures that simultaneously ensure the short-term protection of priority social programs and establish the basis for reform of the social sector.
 - c. **Justice policies and institutions**, to support modernization of the State by laying the groundwork for the institutionalization of sound practices (anticorruption) in future change processes and to reinitiate reform of the justice administration system through a transparent process, with short-term protection of priority programs.

B. Program structure

- 2.3 The loan is structured as a single disbursement activated by fulfillment of the conditions contained in the policy matrix. These have been agreed to with the government, and focus on areas that were considered critical to the country. They have been completely fulfilled and the proposed loan will therefore be disbursed in the first half of 2001.

1. Macroeconomic policy

- 2.4 This program is based on prudent macroeconomic management, a commitment reflected in the standby agreement signed by Peru with the International Monetary Fund.

2. Fiscal policies and institutions

- 2.5 The actions provided for in this component are oriented toward developing a new legal basis that guarantees: (i) the right to information and the ability to enforce it; (ii) the duty of all public budgetary and extra-budgetary institutions—including the Defense and Interior sectors—to publish information relating to budget, execution, human resources and acquisitions in a timely and comprehensive fashion; (iii) the introduction into the budget definition process of additional information, simplifying its presentation and clarifying budgetary and extra-budgetary spending, including tax spending and principal fiscal risks, among others; (iv) increased credibility of the conflict resolution system in tax matters by introducing selection by merit for members of the Tax Court and publishing its resolutions; and (v) increased horizontal equity of the tax system, by improving the taxpayer audit system.
- 2.6 To this end, the following actions were agreed to be taken: (i) issuance by the executive branch of a regulatory framework for citizen access to public finance data; and (ii) inclusion of the defense and interior sectors in the Integrated Financial Administration System (SIAF).
- a. **Regulatory framework for citizen access to public finance data.** Approval by the Executive Branch of an Emergency Decree¹² establishing the following was agreed to as a condition for disbursement of the sector program: (i) the minimum information to be published through the MEF web site and other media, including aggregate data on taxes, public spending, revenue, financing and the debt profile of the central government, financial statements of decentralized entities, an annual tax spending report, and complete information on State acquisitions and contracting; and (ii) a reporting structure for information contained within the macroeconomic framework. The creation of an interactive system in the MEF was also established by supreme decree, by which citizens may gain access to additional fiscal information, subject to the conditions of reasonableness and relevance.

¹² Article 118 of the Political Constitution of Peru states that “It falls to the President of the Republic: (19) to issue extraordinary measures, through legally binding emergency decrees, in economic and financial matters, when so required by the national interest, with the responsibility to so report to Congress. The Congress may amend or repeal the aforementioned emergency decrees.”

<i>Highlights of the emergency decree governing public access to fiscal information</i>	
<i>The legislation is based on the principle that the general public has the right to request information on public finances and that entities in the public sector are under the obligation to provide information that is truthful and to provide it promptly. To enforce this right, it is provided as follows:</i>	<ul style="list-style-type: none"> ✓ <i>Relevant information should include data relating to institutions and agencies of the central government and other decentralized authorities that have been, or are to be, established, including the funds, State-controlled enterprises, constitutionally established independent bodies, and local governments.</i> ✓ <i>An accountability mechanism has been established indicating the extent to which the macroeconomic framework has been fulfilled.</i> ✓ <i>A preelection report is to be published outlining what has been accomplished and setting out economic and financial projections and projected social data for the next five years, including the analysis of investment commitments already assumed and of all financial obligations.</i>
<ul style="list-style-type: none"> ✓ <i>A request procedure for the public and the obligation to publish on a systematic basis basic fiscal information that can be compared over time on budget, public spending, investment projects, staffing, hiring, management indicators, financial situation, balances, financing, etc.</i> 	

- b. **Extension of the SIAF to the Defense and Interior sectors.** As a condition for disbursement from the sector program, the spending of the Ministries of Defense and the Interior was included within the SIAF, under the same detail and monitoring standards as those applying to the other sectors included in the public budget.

3. Social and poverty alleviation policies and institutions

- 2.7 The actions provided for in this component are aimed at: (i) protecting poverty alleviation and combat programs from budget cuts and introducing mechanisms that allow civil society to demand fulfillment of this measure; (ii) reducing shortfalls in coordination and improving the State's capacity to react to covariant shocks; and (iii) laying the groundwork for comprehensive reform of the country's social protection network, including the creation of mechanisms for monitoring and evaluation, with the help of civil society.
- 2.8 To this end, it was agreed to improve the following in the social sector: (i) transparency and efficiency in spending; and (ii) the coordination, monitoring and evaluation of public spending. The key actions for achieving these improvements are the following:
- a. **Efficiency and transparency in social public spending.** This measure included: (i) approval by the MEF and posting of the minimum spending requirements for protected social programs on the MEF website; and (ii) preparation of a quarterly schedule for monitoring spending on protected social projects, including the quarterly posting of spending at that same level. The list of protected projects represents 10.3% of the 2001 national budget, equivalent to 1.4% of GDP. The technical criteria for selecting projects is aimed at ensuring the provision of basic social services and investment in human capital to the marginalized population in extreme poverty. Such information is

published on the MEF web site, as are the mechanisms for obtaining opinions from and consulting with civil society.¹³

<i>Criteria for selecting protected programs</i>	
<i>The protected programs were selected to ensure access to training in basic skills, minimum levels of health and nutrition to prevent physical and mental deterioration, and needs in terms of shelter and environmental safety by providing access to housing and basic sanitation. The protected programs are a slice of basic social spending on health and education and programs targeting extreme poverty.</i>	<i>Protected programs account for 10.3% of the country's primary spending. The government was consulted on the agreed programs and the government discussed them with each of the sectors involved. This represents a first step towards achieving a more dynamic process for review and selection of protected programs that will be accompanied by monitoring, impact assessments, and the results of the multiyear strategic plan.</i>
<i>The protected programs include nutrition and health for pregnant women and nursing mothers, basic education (preschool, primary school, and the first two years of secondary school), basic sanitation and housing, justices of the peace, lower courts and pretrial procedures, social assistance, support for rural communities, child care, adolescent care, and care for the elderly.</i>	

- b. **Coordination, monitoring and evaluation of social policy.** To improve its levels: (i) the ad hoc Technical Secretariat for the Intra-Ministerial Commission on Social Affairs (ST-CIAS) was appointed; and (ii) the social policy analysis, monitoring, and evaluation function was formally included in the Vice-Ministry of Economy's Regulations on Organization and Functions.

4. Justice policies and institutions

- 2.9 The actions provided for in this component are aimed at: (i) initiating the institutionalization of an anticorruption program and the building of public ethics; (ii) reinitiating reform of the justice administration system to ensure its autonomy and participation by civil society; and (iii) protecting justice spending from budget cuts.
- 2.10 To this end, the creation of mechanisms to facilitate reporting, introduce transparency policies in actions by the public authorities and encourage the participation by civil society in the reforms is being promoted as a measure to build consensus around them, and make them sustainable in order to increase access and the quality of justice. These are the following:

¹³ The list of protected programs and selection criteria may be found in the project technical files.

- a. **National Anti-Corruption Initiative Group (GINA).** Representatives of civil society as well as State institutions widely recognized for their moral quality were convoked to comprise a group to study the problem of corruption and prepare proposed policy guidelines to address it. The objective is to initiate a process of public-private consensus-building around combating this problem, as one of the elements that must be taken into consideration in State reform. To this end, based on a national corruption survey that was carried out, critical areas are being identified in which this occurs. This work will facilitate preparation of the diagnostic and guidelines for a policy to allow the establishment of programs for reforming and modernizing the country's critical institutions. Political participants will also be involved in this work. The GINCC and the specialized support team was put together between February and March.
- b. **Signing of an inter-institutional cooperation agreement among the principal participants in the justice administration system (GTAN).** Pursuant to this agreement, a high level work group and a technical secretariat were formed to serve as mechanisms of coordination between the judicial branch, the Public Ministry, the National Council of Judges, the Academy of Judges and the Ministry of Justice, which will also involve civil society, in order to: (i) develop a strategic plan for the justice administration system, to develop guidelines for its modernization based on inter-institutional consensus; and (ii) formulate consensus proposals for modernizing the justice administration system, with a view to ensuring that institutions operate in accordance with the criteria of efficiency, autonomy and independence, as validated through a process of consultation with civil society, including the corresponding legislation affecting the system, such as the basic laws of member institutions. This condition is fulfilled through the signing and publication of the inter-institutional cooperation agreement for reform of the justice administration system; and the appointment of its technical secretary and publication of the work plan for the following six months, which includes the issues for discussion and performance of the initial consultation with representative members of civil society associated with the System.
- c. **Efficiency and transparency of public spending on justice:** This measure included (i) the posting on MEF website of the list of protected projects; (ii) its inclusion in the quarterly program for monitoring spending execution, including the quarterly publication of spending at that level; and (iii) the same treatment being given to monitoring and consultation with civil society as are social programs.

5. Special fund

- 2.11 Finally, in order to ensure that actions initiated through this operation are continuous, a special fund¹⁴ of US\$700,000 was created by supreme decree, which will finance subsequent actions—studies and activities—which in addition to their inherent value, will allow preparation of a loan scheduled for the second half of the year within the framework of this program. The studies to be financed by the fund are described in Appendix I-3 and cover the three action areas of the sector program. Information on the fund's studies and activities will also be on the MEF web site.

¹⁴ For legal and budgetary reasons, the Special Fund established as a national budget project.

III. SUBSEQUENT ACTIONS

- 3.1 This operation falls within the framework of sector loans granted by the government for the year 2001, totaling US\$500 million. It is expected that both approval of the second sector program, and a US\$250 million disbursement, will take place in the second half of this year. Agreements reached with the authorities who will take office on July 28 will determine the features of the second operation, including the definition of the number of tranches, as well as the action areas in which it will be applied.
- 3.2 Within the context of this operation, the Bank is promoting action, diagnostics and reform proposals relating to various specific issues within the fiscal, social and justice areas, which will be financed by a special fund already created by the government and which are described in detail in the following sections. The issues covered are considered as being high priority for the Bank and will represent the framework of options within which the future Peruvian administration will be able to define the scope of the sector program, as well as other possible complementary operations with the Bank.

A. Fiscal policies and institutions

- 3.3 Implementation of the required measures within the context of this sector program lays the groundwork for more transparent fiscal management in order to provide for a more modern state apparatus, with sustainable fiscal stability, in the medium- and long-term framework. In order to identify future reform alternatives, financed using special fund resources, an agreement has been entered into to undertake studies in critical areas, such as the following: (i) distortions in the tax system; (ii) fiscal sustainability and efficiency; and (iii) the fiscal impact of the public sector employment system.
- 3.4 With regard to taxes, an agreement has been made to undertake studies on the following: (i) updating the Peruvian tax system, submitting a proposal to reduce distortions in the General Sales Tax (IGV), the Selective Consumption Tax (ISC), the Corporate Income Tax (IRPJ) and the Personal Income Tax (IRPN), including the corresponding legal and regulatory reforms; (ii) redesign of the Building Tax, to which end best practices in property tax management will be applied relating to the process of appraising properties and developing recommendations for their inclusion within the property registration system in coordination with Loan PE-0107 (Land Titling and Registration Project—Second Stage); and (iii) promotion of the country's regional trade integration and elimination of distortions in the labor market, to which end a study will be carried out to determine the economic impacts of tariff surcharges, special regimes and the Special Solidarity Tax (IES).

- 3.5 With respect to fiscal sustainability and efficiency, an agreement has been made to perform studies on the following: (i) debt instruments, with a view to expanding the set of options available to the public sector due to the fact that long-term public debt is currently practically limited to multilateral and bilateral debt, and therefore the study will cover the required legal and institutional reforms for the country to be able to gain access to international capital markets as well as to capture domestic savings with sovereign instruments. In the case of short-term financing, which is now reduced to the overdraft facility with Banco Nación, the possibility of introducing new financial debt instruments in the domestic market will be analyzed. There will also be (ii) a structural analysis of the public spending and a proposal to review its break down by sector and eliminate duplication resulting from the overlapping of functions among various state entities; and (iii) a study of financial management practices, emphasizing the design of budget policy, consolidation of the budget approval process into two phases, progress toward a public management system by results, and definition of a permanent legal framework of integrated financial management.
- 3.6 With regard to the fiscal impact of public employment, an analysis will be carried out of its structure, through a survey of data relating to the number, characteristics and remuneration of officials, employees, contractors and personnel under a services or outsourcing arrangement at approximately 540 executing units.
- 3.7 In addition, the government has launched major initiatives in two areas of tax administration that will serve as a basis for defining future operations of fiscal support. First, it introduced to Congress a bill to amend the section of the Tax Code pertaining to the membership of the Tax Court, which proposes a mechanism for selecting members based on merits and other qualifications to promote transparency in their opinions. Second, a development plan has been approved for SUNAT's supervisory function, in a move to promote the introduction of systems that permit the targeting of tax audits on the basis of technical and objective criteria. Amongst the targets of the SUNAT institutional plan for 2001¹⁵ are training for all auditors in integrated auditing system that permit the use of new external databases and new auditing methods. This will increase the quality of tax audits considerably.

B. Antipoverty and social protection policies and institutions

- 3.8 Reform of the social sectors includes three major objectives: First, reform of focused poverty combat and alleviation programs. Second, ensuring access by the entire population to good quality basic social services. Third, creating cost-effective

¹⁵ The Operational Plan for 2001 comes under the institution's Strategic Plan for 2001-2006 and covers four main areas: (i) taxpayer services, (ii) risk creation (supervision), (iii) organizational structure, and (iv) institutional image. Amongst the plan's major targets are increasing tax collection by 2% of real GDP growth, increasing the number of independent workers registered in the Health Insurance Plan (Essalud) by 7.1%, reducing the number of taxpayer claims by 6.9% and lowering SUNAT's current expenses by 10% of tax revenue.

mechanisms to provide a network of adequate social protection to the entire population. To achieve these objectives over the next few months, three groups of activities will be developed, which are intended to: (i) improve the design, coordination, monitoring and evaluation of social policy as a whole; (ii) rationalize and improve the cost-effectiveness of poverty combat and alleviation programs; and (iii) improve the country's social protection network.

- 3.9 Activities to improve the performance of the entire social policy include the following: (i) improving mechanisms for monitoring and evaluating social spending; (ii) applying a new poverty map that includes all information available in the country; (iii) developing a modified strategy for focusing on urban areas; (iv) preparing a strategy for rationalizing social programs; and (v) defining an effective mechanism for coordinating social policy and programs that include the promotion of dialogue and agreement between the public sector, the private sector, civil society and cooperation agencies.
- 3.10 Activities to improve the cost-effectiveness of programs focused on alleviating and combating poverty include the following: (i) diagnosing the principal causes of structural poverty and the basic needs of the country's extreme poor; (ii) diagnosing the effectiveness of the current network based on the diagnosis of the causes of poverty and the principal shortfalls affecting the marginalized and extremely poor population; and (iii) identifying and designing instruments that must be applied for an adequate strategy of combating and alleviating poverty, including the focus mechanisms to be used.
- 3.11 Activities to improve the social protection network include: (i) a vulnerability analysis of the country's various population groups, including both vulnerability to covariant shocks—such as economic crises or natural disasters—and vulnerability corresponding to idiosyncratic shocks—unemployment, catastrophic illness, etc.; (ii) diagnosing the effectiveness of the current social protection network based on the vulnerability analysis; and (iii) identifying and designing instruments to be implemented to protect the vulnerable population vis-à-vis the various types of shocks—income or food transfer programs, social insurance programs, unemployment insurance, health insurance, etc.—including the focus mechanisms to be used.

C. Justice policies and institutions

- 3.12 The measures included within this program will be complemented by actions that seek to lay the groundwork for a more transparent and equitable administration of justice. In order to identify the path to future reform, financed with resources from the special fund, an agreement has been entered into to engage in activities in the following areas:

- a. The development of guidelines to build public ethics. The structure of the contents that a national policy for combating corruption and building public ethics must have will be developed, as well as the conditions for applying it. The results of this work will be disseminated through the communications media, forums, and submission to the Congress, in order to generate a national dialogue and increase public awareness to promote citizen participation in eliminating this problem. Finally, a diagnosis of the institutions most vulnerable to this problem and the shortcomings of the institutional framework will be undertaken, in order to propose preventive and subsequent control systems.
- b. Design of a strategy to reform the justice administration system through mechanisms for consulting civil society. A set of studies and discussions will be undertaken on lessons learned in past reform processes, mechanisms to combat and eradicate corruption, and strategies for inter-institutional coordination and better use of institutional cooperation to modernize the justice administration system. The recommendations resulting from these studies will be submitted for consultation with civil society as considered in the work plan of the high level work group. This process must result in a strategic plan for strengthening the system, to be taken into consideration in the processes of modernizing each institution forming part of the group.
- c. The creation and implementation of coordination and focus mechanisms for basic protected justice programs. Efforts will be made to integrate the protective programs into the follow-up and monitoring system being designed for the social programs.

IV. PROGRAM EXECUTION

A. Borrower and executing agency

- 4.1 The borrower in this operation is the Republic of Peru through the Ministry of Economy and Finance. Because of the operation's multisector nature, the executing agency is the MEF Sector Loan Coordination Unit (UCPS). Other institutions also participated in the fulfillment of the conditions, insofar as it was a loan based on State policies, particularly in the execution of agreements relating to actions that will serve as a bridge for designing this program's second sector loan, as well as for defining other operations with the new authorities. Such institutions include the judicial branch, the Public Ministry, the National Council of Judges, the Academy of Judges and the Ministry of Justice.

B. Conditions for processing the disbursement

- 4.2 All conditions agreed to in this loan were fully completed and verified prior to their submission for consideration by the Bank Board of Directors; consequently, the disbursement would be processed into a single tranche immediately after approval of the operation. The means of verification for each of the conditions included within the policy matrix has been agreed to, using criteria that constitute sufficient evidence of completion. The means of verification are listed in appendix I-2.

C. Subsequent action fund

- 4.3 The fund to support subsequent actions under the program was created by supreme decree and includes the allocation of US\$700,000 to finance studies and activities in the fiscal, social and justice areas. The resources of the fund derive from the National Treasury (86%) and the Public Finance Sector Loan 1236/OC-PE (14%).

D. Audits

- 4.4 The Bank reserves the right to request that the Borrower submit financial reports on its use of the financing resources, evaluated by an independent auditing firm acceptable to the Bank.

E. Special contractual conditions

- 4.5 The loan agreement will include the conditions established within the policy matrix and will indicate that the policy letter is an integral part of the loan.
- 4.6 Another condition is that meetings be held periodically to evaluate the extent to which the subsequent actions referred to in chapter three have been fulfilled.

V. FEASIBILITY AND RISKS

A. Institutional feasibility

- 5.1 Although it is true that current political circumstances have significantly weakened the executive branch, particularly vis-à-vis the fragmented composition of the Congress, those same circumstances have acted as a window of opportunity, since all the political groups declared their commitment to introducing mechanisms of transparency and openness in State acts. Recent measures to re-institutionalize the justice administration system offer an opportunity to successfully establish a coordination capacity that will strengthen it vis-à-vis other State authorities, from the beginning of the conception of its reform.

B. Social and environmental impact

- 5.2 This operation qualifies as a project that promotes social equity, as described in the key objectives for Bank activity, contained in the Eighth General Funding Increase report (Document AB-1704). Programs for combating and alleviating poverty which are protected under the program play a basic role in sustaining the living conditions for the socially marginalized population, including women and indigenous peoples in extreme poverty.
- 5.3 Regarding the environmental impact, the program is concentrated on policy actions that require no measures involving civil works or other actions that might have any direct environmental impact.

C. Principal benefits

- 5.4 In the short term, the program's principal benefit is to have initiated the creation and implementation of participative processes, at different points of the public decision-making chain, in three of the areas considered as being the most important for ensuring sustainability of the conditions required for development. To this extent, the introduction of participative mechanisms and methods of requiring fulfillment of government plans strengthen the country's democratic institutions, improving its levels of governance and consequently increasing opportunities for development.
- 5.5 Later actions whose execution is subsequent to the loan approval will also derive considerable benefits in the medium term. The new administration to assume power on July 28 will be in a privileged position for addressing a process of structural reform of greater depth, by having diagnostics and proposals for strengthening the fiscal, social and justice sectors. The potential benefits of this component of the operation are high since they can lay the groundwork for complete modernization of three core areas of the public sector over the next few years.

1. Fiscal policy

- 5.6 The potential impact of achieving a system for monitoring fiscal information is high, since it makes explicit the policies that serve as the basis for State actions, making the authorities responsible for their decisions and placing the ability to demand their completion or modification in the hands of citizens. It improves social control over public policies by introducing mechanisms to promote transparency, and reduces opportunities for discretionary behavior that arise in the vacuum resulting from asymmetrical information between decision-makers and citizens. This will contribute to generating a demand for better results in public policies, which in turn will encourage the introduction of programs to improve management.

2. Social policy

- 5.7 By reversing the pattern of budget cuts in social programs, the loan contributes to reducing poverty levels in Peru. In addition to this effect, by emphasizing both the monitoring and analysis of social spending execution, as well as the protection of budgeted social spending, it contributes to better microeconomic analysis of the coverage and efficiency of each social program, which will allow better identification of problems affecting the operation of such programs.¹⁶
- 5.8 The program supports coordination and reporting actions in the social sector aimed at rationalizing redundant or ineffective programs and providing incentives to social program managers to improve their operations and impact.¹⁷ The operating plan for technical support to the CIAS will allow unification of the geographic focus instrument (the poverty map) and the application of this instrument to priority programs, and it will develop an individual focus mechanism for use in urban areas. All of these efforts are aimed at reducing the high levels of marginalization and filtration in current social programs and thereby improving the transparency, social control, efficiency and effectiveness of social spending. Such rationalization will result in significant savings of resources that should be used, first of all, to extend coverage to the unserved poor population, and second, on the possible implementation of new programs to create a comprehensive social protection system in Peru.

3. Justice policy

- 5.9 The recovery of confidence by civil society and economic agents in judicial institutions will contribute to better daily development by citizens. The

¹⁶ In 1999, for example, it was found that after budgeting 20% of public spending on basic social services, the executed figure came to only 16% (Source: Saavedra, October 1999).

¹⁷ Although US\$3,241 million is still needed to cover the moderate poverty gap, the amount required to do the same in the extreme poverty gap is only US\$318 million. Since spending on focused programs for alleviating and combating poverty greatly exceeds this amount (US\$1,046 million), a better focus would significantly increase the impact of social spending on the poverty rate.

strengthening of justice administration will yield benefits that will have a direct impact on the quality of life, governance and democratic stability. Governance in democracy is also weakened by ethical failures on the part of the political authorities when they are treated with impunity because of the absence of effective mechanisms for punishing the misuse of public resources.

- 5.10 Countries that face and resolve these problems with efficient systems for resolving conflicts—judicially and extra-judicially—have a greater likelihood of economic and social development. Countries where trust in the justice system and in political and public institutions is greater are better positioned to rationalize their oversized public sectors, make public spending more efficient and thereby generate economic growth and a more equitable distribution of income.

D. Principal risks

- 5.11 Since this sector loan is a single tranche and all the conditions stipulated in the policy matrix have already been fulfilled, there are no risks that might compromise achievement of its objectives or complete disbursement of its resources.
- 5.12 However, the operation's design includes factors that transcend disbursement of the loan and the government's term of office. The execution of subsequent actions in the fiscal, social and justice areas as described in chapter III must take place subsequent to complete disbursement of the funding. There is therefore the risk that by not being contingent upon a disbursement and by being financed, at least in part, by budget resources, some of these activities will not take place. This risk is mitigated through the creation, by supreme decree, of the special fund for financing support, with specific objectives and sufficient resources, as well as by the introduction of a program completion and impact evaluation. The policy letter submitted by the government, which has been published, also makes an explicit commitment to executing them.
- 5.13 Legislation regulating access by the public to fiscal information by means of an instrument not requiring prior discussion or consensus, such as the Emergency Decree, could adversely affect how deeply its provisions are accepted by the public, thus leading to subsequent amendments. Many of the provisions contained in the standards will have practical effect and force of law when the new Congress sits owing to the fact that since March 2001 information has been posted on the MEF website and the main presidential candidates and most political parties in the Legislature promoted this initiative during the election campaign.
- 5.14 This operation, despite being self-contained and self-justified, also falls within a framework of medium-term reform, the satisfactory development of which is necessary in order to make progress in achieving the program objectives. Transparency in public financing, protection of the least protected social sectors, and strengthening of the justice administration reform process are only a first step,

which must be accompanied by a deeper reform of the State. If this subsequent generation of reforms is not carried out, it could compromise the consistency and integrity of the country's long-term reform. Despite the fact that the political situation makes it difficult to mitigate this risk, the technical studies forming part of this operation will provide information to allow the next authorities to become familiar with the weakest areas in the State, in addition to specific proposals for strengthening them.

POLICY MATRIX

Prior Actions	Conditions prior to consideration by the Executive Board	Subsequent Recommended Actions
Macroeconomic stability	Approval of the 2001 IMF agreement by the Board	Fulfillment of the macroeconomic program
Fiscal policy and institutions actions: Approval in 1999 of the Fiscal Prudence and Transparency Law Approval in 2000 of changes to the State Acquisitions and Contracting Law Implementation of the Integrated Financial Administration System (SIAF) Approval of the 2001 Budget by Legislative Decree.	i) Issuance of an Emergency Decree containing regulations to facilitate citizen access to fiscal information, which provides for: (i) the publication of detailed public finance information by budget and off-budget institution; and (ii) affords greater transparency to the budget process by simplifying the submission of information, including tax spending and fiscal risk, etc. Issuance of a Supreme Decree creating an interactive system for access to information in addition to that provided for by the Emergency Decree. ii) Inclusion within the SIAF of the Defense and Interior sectors.	<ul style="list-style-type: none"> • Introduce more neutrality and fairness to administration and tax policy. To this end, proposals will be developed for complete reform of the tax customs system, eliminating current distortions. Tax Court will be strengthened by having membership determined through an open competition based on merits and the SUNAT audit function will be improved. • Streamlining of tax management mechanisms, including proposals for reforming public management, etc. • Initiate the process of public sector reform, including a review of employment policies and the progressive implementation of a management-by-results mechanism. To this end, studies and proposals will be prepared on the characteristics and number of public jobs, salaries, and a plan for extending management indicators and unemployment contracts, etc.

Prior Actions	Conditions prior to consideration by the Executive Board	Subsequent Recommended Actions
Antipoverty and social protection policy and institutions		
<p>actions:</p> <p>Presentation of a work plan for the first half of 2001 for the Vice Ministry of Economics to provide technical support to the CIAS and the definition of mechanisms for consultation with civil society.</p> <p>Submission of a preliminary social contingency plan for social protection against economic crises and natural disasters and an action plan for improving it.</p> <p>Creation of an antipoverty action committee with representatives of government and civil society on which the MEF would serve as technical secretary.</p>	<p>i) Approval by the MEF and posting on its website of minimum spending requirements for protected social programs and creation of a quarterly plan to control and monitor execution by program, subprogram and project.</p> <p>ii) Official appointment of the CIAS Technical Secretary and of the Vice Ministry of Economics as the entity responsible for providing analysis, monitoring and evaluation of social policy for purposes of supporting decision-making by the CIAS Technical Secretariat, and formal inclusion in the Regulations on Organization and Functions of the Vice Ministry of Economy functions of analysis, monitoring and evaluation of social policy.</p>	<p>Initiation of the process of improving the following areas:</p> <ul style="list-style-type: none"> • Programs focusing on combating poverty, including improving mechanisms for focusing, consolidating and improving assistance and social investment programs. • Basic social services such as education and health, including access to quality basic health and education for the entire population. • The creation of cost-effective <i>social protection</i> mechanisms, including a social contingency appropriate for addressing the population's vulnerability.

Prior Actions	Conditions prior to consideration by the Executive Board	Subsequent Recommended Actions
Justice policy and institutions		
<p>re actions:</p> <p>Elimination of the executive committees</p> <p>Restoration of the CNM authority</p> <p>Repeal of the law for approval of permanent and provisional judges</p> <p>Creation of temporary councils for the judicial branch and Public Ministry.</p>	<p>i) Creation of the National Anti-Corruption Initiative Group, hiring of the coordinator, and implementation of a national corruption survey.</p> <p>ii) Signing of an interagency cooperation agreement between the judicial branch, the Public Ministry, the CNM, the Academy of Judges and the Ministry of Justice, with the participation of the MEF for reform of the justice administration system, and publication of the work plan, appointment of the Technical Secretary and completion of the first consultation with civil society.</p> <p>iii) Approval by MEF and posting on its website of minimum spending requirement for protected programs selected in the justice administration system and creation of a quarterly plan to control and monitor budget execution by program, sub-program and project.</p>	<p>Reinitiating reform of the system through:</p> <ul style="list-style-type: none"> • The coordination of actions among the public and private sectors to adopt an anticorruption policy and public ethics building policy, based on coordinated action by the State/civil society • A planning process that results in a strategic plan for the system and guidelines for its modernization, based on an inter-institutional and social consensus that ensures transparency and openness in the process, and the independence and efficiency of justice institutions. • The formulation of consensus proposals to improve access to and the quality of basic justice.
Special Condition		
<p>With the support of the World Bank, United Nations and IDB, civil society institutions are preparing a priority policy agenda for 2001-2006 ("policy notes")</p>	<p>Creation of a special fund, by Supreme Decree, to prepare the basis for facilitating the design of future reforms in the three areas. Submission of the terms of reference. Allocation of fund resources.</p>	<ul style="list-style-type: none"> • Final actions and finished proposals for discussion with the authorities of the content of the sectoral operation in the second half of 2001.

DOCUMENTATION SUBMITTED BY THE MEF AS EVIDENCE OF COMPLETION OF THE CONDITIONS CONTAINED IN THE POLICY MATRIX

Macroeconomic Framework

Approval of the 2001 IMF agreement by the Board of Directors

OPINION: FULFILLED

Evidence: Copy of International Monetary Fund Public Information Notice (PIN) No. 01/26 dated 19 March 2001, approving Peru's Agreement with the IMF.

Fiscal Component

- a) Issuance of an emergency decree containing rules for public access to fiscal information, which provides at least for (i) the publication of detailed information on public finances by budgetary and off-budget institution; and (ii) greater transparency in the budgetary process by simplifying the way in which information is presented, including tax spending and fiscal risk, etc. Issuance of a supreme decree providing for an interactive system for access to information other than what has been provided for under the Emergency Decree.

OPINION: FULFILLED

Evidence: Copy of Emergency Decree No. 035-2001, published in the official daily newspaper *El Peruano* on Saturday 17 March, covering all the aforementioned issues. Copy of Supreme Decree 018-2001-PCM published in the Official Gazette (*El Peruano*) on Tuesday 27 February 2001 establishing the procedure to be followed by citizens to obtain access to information at public entities.

- b) *Defense and Interior sectors incorporated into SIAF.*

OPINION: FULFILLED

Evidence: Can be confirmed by accessing the Transparency Portal at the Ministry of Economy and Finance web page (www.mef.gob.pe). The Defense and Interior sectors have been reporting to the Integrated Public Sector Financial Administration System (SIAF-SP) since January 2001.

Social Component

- e) Approval and posting on the MEF website of minimum spending requirement for protected social programs and the establishment of a three-year plan for controlling and monitoring performance by program, subprogram, and project.

OPINION: FULFILLED

Evidence: Publication of the list of protected projects on the Ministry of Economy and Finance web page (www.mef.gob.pe) in the area of macroeconomic information, social sector, of the Economy and Transparency Portal. Presentation of the social program performance monitoring and evaluation plan. Presentation of a preliminary Social Contingency Plan for expanding social protection in adverse circumstances such as the periods of recession and natural disasters and a plan of action for improvement. Both plans are in the program technical files.

- f) *Official appointment of the CIAS Technical Secretary and the Vice Ministry of Economy as the entity responsible for the analysis, monitoring and evaluation of social policy with a view to supporting decision-making by the CIAS Technical Secretary.*

OPINION: FULFILLED

Evidence: Official letter No. 581-2001-PCM/SG-200 from the General Secretary of the Office of the President of the Council of Ministers, reporting that the CIAS, at its meeting of 21 February is in agreement as to the relevance and procedure for electing its Technical Secretary, and Official Letter No. 550-2001-EF/13 of the Ministry of Economy and Finance, naming Javier Abugattás Fatule, Vice Minister of Economy, as Ad Hoc Technical Secretary for the Interministerial Social Affairs Commission (CIAS), which was formally appointed pursuant to Supreme Decree 201-2001-PCM. Approval of the Regulations on Organization and Functions of the MEF incorporating analysis, monitoring and evaluation of social policy in the duties of the Vice Ministry of Economy.

Submission of a work plan for the first half of 2001 for technical support from the Vice Ministry of Economy to the CIAS and the establishment of mechanisms for consultation with civil society.

Official letter No. 581-2001-PCM/SG-200 from the General Secretariat of the Office of the President of the Council of Ministers, reporting that at the meeting of 21 February of the CIAS, the attached Work Plan was submitted and is available in the program technical files.

OPINION FULFILLED

Justice Component

- i) *Signing of an inter-institutional cooperation agreement between the Judicial Branch, the Public Ministry, the CNM, the Academy of Judges and the Ministry of Justice, with the participation of the MEF for reform of the system for the administration of justice. Publication of the GTAN work plan, appointment of its technical Secretary, and initial consultation with civil society.*

OPINION: FULFILLED

Evidence: Copy of the "Inter-Institutional Cooperation Agreement for Coordination of the Process of Modernizing the National Justice Administration System," duly signed on 23 March 2001 by the highest authorities of the judicial branch, the Public Ministry, the National Council of Judges, the Academy of Judges and the Ministry of Justice, with the participation of the MEF, sent to the Loan Coordination Unit by Official Letter No. 003-2001-P/CS-PJ by the Presiding Judge of the Supreme Court of Justice of the Republic.

Official Letter No. 015-2001-P/CS-PJ reporting the appointment of the Technical Secretariat of the High Level Work Group, and Office Letter 023-2001-P/CS-PJ whereby notification of the appointment of the new Technical Secretariat is given.

Also on 4 April 2001 a meeting was held with representative members of civil society associated with the justice administration system as provided for in the Work Plan, in the presence of representatives of the IDB and this unit.

On Wednesday 18 April 2001, the work plan of the High-Level Work Group work was published in *El Peruano*.

- j) *Approval by the MEF and posting on its website of the minimum spending level for protected programs selected in the justice administration system and creation of a quarterly plan to control or monitor budget execution by program, sub-program and project.*

OPINION: FULFILLED

Evidence: Publication of the list of protected projects, including those relating to justice administration, on the Ministry of Economy and Finance web page (www.mef.gob.pe) in the macroeconomic information area, social sector, on the Economic Transparency Portal. Submission of a plan for monitoring and assessment of the performance of social programs, that includes the justice plan, which are available in the program technical files.

OPINION: FULFILLED

- k) Creation of the National Anti-Corruption Initiative Group, hiring of the coordinator and taking of a national survey on corruption.*

Evidence: On Monday 16 April 2001, Supreme Decree 160-2001-JUS which appoints the National Anti-Corruption Initiative Group was published in the Official Gazette (*El Peruano*). Completion of the national anticorruption survey was verified with a copy to the World Bank indicating that the survey has been conducted. Also available in the program technical files is the document formally setting up the support team, in which Mr. Santiago Pedraglio is listed as support team coordinator.

- l) Creation of a special fund, by supreme decree, to prepare the basis for facilitating the design of future reforms in the three areas. Presentation of the terms of reference, allocation of resources to the fund.*

OPINION: FULFILLED

Evidence: The Supreme Decree 068-2001-EF was published in the Official Gazette (*El Peruano*) on 20 April 2001. This approves the establishment of the Subsequent Action Fund (FAS). On 30 April 2001 Ministerial Resolution 144-2001-EF/10 was approved corresponding to the FAS budget categories, the execution schedule and the operating regulations.

SUMMARY OF THE TERMS OF REFERENCE FOR SUBSEQUENT PROGRAM ACTIONS

WORK PLANNED FOR THE FISCAL COMPONENT

Study Topic

<i>Study Topic</i>	<i>Description</i>
1. Updating of the Tax System	
(1a) Application of taxes (emphasizing the financial sector): income tax and general sales tax	<ul style="list-style-type: none"> Determine the need to maintain incentives (emphasizing the financial sector) with a view to increasing the efficiency and fairness of the tax system and ensuring fiscal equilibrium. To this end: a) the impact of the current incentives and achievement of the economic policy objectives will be studied; b) it will be determined whether the current tax allows for new financial instruments to be developed; and c) comparable legislation will be reviewed Diagnose the tax administration situation and analyze and propose an action plan to strengthen the SUNAT within the context of the proposed tax policy reforms
(1b) Public Finance	<ul style="list-style-type: none"> Prepare the elements of the tax policy from the tax system update report. Define a methodology for calculating the tax yield and study of the economic effects of tax reform alternatives (tax analysis) from the measures proposed by the tax consultant (1a) in the IGV, the ISC, the IRPJ and the IRPN Define a methodology for calculating the fiscal cost of current and proposed tax spending Perform other necessary studies for an update report of the Peruvian tax system
(1c) Tax law	<ul style="list-style-type: none"> Review and propose changes to the Tax Code and the Code of Ethics for tax administration employees. Prepare the draft legal and regulatory standards required for implementing the tax reforms.
(1d) Natural resources taxation	<ul style="list-style-type: none"> Review and propose changes to current regulations on tax stability agreements, mining incentives and current tax incentive regimes for the exploitation of non-renewable natural resources Propose alternatives for implementing a tax system for non-renewable gas, mining and oil resource operations, given the various types of tax burdens (income, property, sales) as well as their impact on fiscal and business returns, and administration and compliance costs Define the scope of application, calculation and distribution of the tax. To this end: a) constitutional and legal regulations will be reviewed for achieving a specific definition adapted to the nature of the tax; b) the current distribution will be analyzed and an appropriate proposal made, in view of the effects and compensatory measures; c) revenue per tax and by share of income will be determined; and d) a multisectoral team will be created to coordinate recommendations and the study proposal at the level of the executive branch, regional and local governments, and the Congress.
(1e) International taxation	<ul style="list-style-type: none"> Analysis of current treaties to exchange information and avoid double taxation Define the major recommendations of treaties to exchange information and avoid double taxation Define the structure of a law and regulations covering transfer prices for Peru

<i>Study Topic</i>	<i>Description</i>
2. Implementation of the Property Tax	
(2a) Design and implementation of the property registration system	<ul style="list-style-type: none"> • Review of the set of existing documents (studies carried out on this issue in recent years by various institutions such as COFOPRI and INADUR) • Conceptual development of the Property Registration System. This involves identifying the requirements of various users (citizens, companies, institutions) as well as defining the scope of the system, participants, basic tables, and a technical glossary. All of this should lead to an initial design of the System. The idea is a database that includes specifications addressing the requirements of all users. Also, define the structure of a property registration code. • The country's property registration situation. Study and evaluation of the various efforts made by institutions such as: <ul style="list-style-type: none"> a) COFOPRI (Informal property registry), b) PETT (Rural registry), c) Public Mining Registry (registry of complaints and operations), d) National Superintendency of Public Records (property registry), e) National Cultural Institute (inventory of areas of archeological and cultural interest), f) National Assets Superintendency (SBN) (registry of State properties) and g) Municipalities (Lima and 2 districts, 2 provincial) <p>A comparative analysis will also be carried out of experiences from other countries (comparative study of Chile and Colombia)</p> • Feasibility study of a property registration system, taking into consideration current law and necessary external conditions. In principle, it is an attempt to evaluate a methodology and rational centralized design (uniform, simplified, efficient) and a decentralized administration. This study must also include a corrected design of the system. • Prepare an action plan to implement the property registration system. This plan must include both technical proposals of a formal-legal type, as well as system proposals.
3. Analysis of Foreign Trade and Labor Market distortions	
(3a) Tariff structure	<ul style="list-style-type: none"> • Analyze the Peruvian tariff structure within the context of its neutrality and equity vis-à-vis participants in the economy and trade policy in general • Propose changes to the current tariff structure and special regimes (e.g. CETICOS), proposing changes to reduce the average tariff level and variation and increase the fairness and transparency of the tariff system as a whole • Submit a document identifying the principal distorting factors of the tariff structure and proposed measures for eliminating them
(3b) Application of the general sales tax to exports of services	<p>Determine whether the structure that is currently applied allows for competition by services provided abroad. To this end,</p> <ul style="list-style-type: none"> • current laws and definitions and their economic effects will be reviewed. • The administration of the export services tax will be analyzed.
(3c) Study of the application of the selective consumption tax	<ul style="list-style-type: none"> • Establish the medium and long-term tax structure for both goods and services.
(3d) Study of labor charges	<ul style="list-style-type: none"> • Review and evaluation of legislation. Sectoral analysis of distortions resulting from labor charges
4. Public Sector Employment Survey	
(4a) Computer support for the employment survey	<ul style="list-style-type: none"> • Support the MEF Information Technology Office in the design, development and compilation of a public sector employment survey

Study Topic	Description
5. Analysis of the Public Spending Structure	
(5a) Public spending analysis	<ul style="list-style-type: none"> • Study public spending from the perspective of identifying possible duplication in the objectives of various budget programs, particularly in the social area; • Prepare a report identifying and proposing solutions to duplications that have been identified, and provide the statistical historic context for analyzing the evaluation of public spending by function.
6. Public Debt Analysis	
(6a) Sovereign debt administration	<p>Institutional Framework.</p> <ul style="list-style-type: none"> • A new structure has been established for the organization of the DGCP, which takes into consideration the functions of the front, middle and back office responsible for debt management policies. <p>Public Debt Management Models</p> <ul style="list-style-type: none"> • A Public Debt Management Model that includes the following aspects: <ol style="list-style-type: none"> a) Financing and/or restructuring strategies b) Analysis of the composition of the current medium- and long term debt portfolio c) Management of liquidity and market risks • Stochastic model portfolio management, which allows for the quantification of various public debt risks. • Analysis and studies underway: <ol style="list-style-type: none"> a) Draft medium-term public debt management program. b) Study of the possibilities of developing the sovereign debt market in the domestic capital market. c) Evaluation of the possibilities of developing the short-term debt market through the Treasury d) Analysis of Peru's opportunity to gain access to international capital markets based on consultations with investment banks and various proposals that have been received. <p>Financial/Legal Regulatory Structure</p> <ul style="list-style-type: none"> • General Public Debt Bill, which includes a series of processes relating to debt and will allow for the development of an appropriate legal framework to provide more active and dynamic management of the debt portfolio • Regulatory study necessary for the issuance of debt in the capital markets; the legislation will be reviewed and amended to incorporate new opportunities such as the issuance of short-term instruments (Treasury Bills) • Adaptation of the legal regulatory framework to engage in issuances on the foreign market. • Study of financing needs, based on assumptions contained in the Multi-Annual Macroeconomic Framework, which had been incorporated into the development of the debt management model (DGAEF)
7. Financial Management Study	
(7a) Modernization of public management	<ul style="list-style-type: none"> • Analyze the MEF strategy to promote the execution of results-based spending. • Analyze the implementation of management agreements in FONAFE and the strategic planning process led by the DGAEF.
(7b) Public finance and budget management	<ul style="list-style-type: none"> • Analyze the current process of formulating and executing the budget and its links to the government economic program; • Propose mechanisms to strengthen fiscal governability based on budget formulation and execution, taking into consideration such items as budget approval in 2 phases: at the macro/global level and at the micro/sectoral level.

WORK PLAN FOR THE SOCIAL COMPONENTS

<i>Topic of Study</i>	<i>Description</i>
1. Study of the implementation of social programs	
(1a) Monitoring and evaluation of social spending	<ul style="list-style-type: none"> Identify an evaluation agenda (both impact and cost-effectiveness) for the first year of operation of the DGAEF as support for the CIAS Technical Secretariat and a schematic plan for subsequent years (2-3 years), beginning with programs without evaluations that absorb a great deal of resources, and taking into consideration both technical and political aspects; Plan the beginning of evaluations for the first year; study the feasibility of assigning a percentage of each project's budget to an impact evaluation and the monitoring and evaluation process; Analyze actions carried out to date as well as training needs in the evaluation and preparation of performance agreements in the social sector and propose a training program.
(1b) Targeting processes	<ul style="list-style-type: none"> Design and finance an information system to support the application of a new poverty map that annually incorporates information available from the household surveys and administrative records of institutions active in the social sector; Provide advice for spending programs relating to assistance and additional social investment for the application of the new poverty map to the resource allocation process (<i>Vaso de Leche</i> [Glass of Milk], <i>Comedores</i> [Dining Rooms], etc.); Propose and consult a modified focus strategy in urban areas.
(1c) Design of a social program rationalization strategy	<ul style="list-style-type: none"> Taking into consideration studies made to date, propose a social program rationalization strategy to consolidate a new institutional structure for the various sectors of public administration and facilitate productivity in the use of resources. This task must be carried out in coordination with other consulting firms; Prepare an improved version of the current social protection contingency plan, coordinating consultations and the necessary policy decision processes Prepare terms of reference and lead the process of bidding, selecting the firms, evaluating proposals and supervising the firm selected for the activities described in heading 2 of this component.
(1d) Facilitate the processes of agreement and dissemination of social reform proposals	<ul style="list-style-type: none"> Propose and support the application of an effective policy and social program coordination mechanism (periodic meetings, etc.); Design mechanisms to promote dialogue and agreement between the public sector, the private sector, civil society and cooperation agencies, on the one hand, and poor citizens on the other, to increase the social control of social programs and strengthen existing coordination entities.
2. Social Protection Study	
(2a) Evaluation of social policy and improvement of the social protection contingency plan	<ul style="list-style-type: none"> Prepare an exhaustive evaluation of the guidelines and successes achieved by the Peruvian government's social policy in coordination with the social components consulting team. The terms of reference must include at least two sections: one dedicated to the strategy for combating and alleviating poverty, and one dedicated to social protection, including at least the following: <ol style="list-style-type: none"> Diagnostic of the effectiveness of the current network for combating and alleviating poverty based on a diagnostic of the causes of poverty and the principal shortages affecting the population in extreme poverty, as well as the intervention and focus mechanisms applied; this must be prepared based on a review of the state-of-the-art methodologies applied to this issue;

<i>Topic of Study</i>	<i>Description</i>
	<ul style="list-style-type: none"> b) Analysis of the vulnerability of the various population groups in the country, including vulnerability to both covariant shocks (such as economic crises or natural disasters, etc.), and idiosyncratic shocks (unemployment, catastrophic illness, etc.); c) Diagnostic of the effectiveness of the current social protection network based on an analysis of vulnerability and a diagnostic of the current network for combating and fighting poverty; • Identification and design of the instruments that must be in place to implement an effective social protection network with the participation of other social participants (in addition to the State), to ensure a minimum quality of life for the poorest population, protect vulnerable populations against various types of shocks (income or food transfer programs, social insurance programs, unemployment insurance, health insurance, etc.) and allow poverty to be efficiently addressed with a view to advancing in the design and implementation of a social policy integrated with a national development policy.

JUSTICE COMPONENTS WORK PLAN

<i>Topic of Study</i>	<i>Description</i>
1. National Anticorruption Initiative Group - GINA	
(1a) Establishment of the National Anticorruption Initiative Group (GINA)	Establish a National Anticorruption Initiative Group (GINA) consisting of representatives of civil society, which provides the meeting space and impact to achieve the project's objectives with respect to diagnosis, dissemination of research, and orientation profiles for combating corruption, together with the party or political movement that wins the general elections
2. Group of Experts and Consultants	
(2a) General coordination (2b) Experts (3) (2c) Specialists (3) (2d) Special consultants	Provide the methodological designs, the aforementioned diagnosis, the dissemination of results, the plan profile, and support for coordination with candidates in the second round of elections and/or the political group that wins the general elections, for the examination of factors that include a general policy for combating corruption and promoting public ethics, and presenting such alternatives as it deems appropriate.
3. Regional Events	
(3a) Preparation of the events (3b) Development of the events (3c) Support for the local press, etc.	Hold six Regional Forums, with the participation of institutions from civil society, the private sector and local state agencies. At these forums, the results of the survey on perceived corruption will be disseminated, an initial approximation of the characteristics of corruption in the regional and local environment will be made, and recommendations will be received from the corresponding institutions and the groundwork laid for establishing institutional agreement mechanisms linking individuals and organizations in civil society to each other and to the State.
4. Round Table and Analysis of the Corruption Situation	
(4a) Presidential meeting (4b) International forum (4c) Publication (4d) Contingencies and miscellaneous	<ul style="list-style-type: none"> • Convoke a round table and analysis with the team of the future government that wins the general elections, to explain to them directly the corruption situation in Peru • Coordinate the need to design guidelines for developing a future anti-corruption agenda • Hold an international forum at which the diagnosis of corruption in Peru and the possible guidelines for a future national anti-corruption policy will be explained.
5. High Level Work Group-Technical Secretariat	
(5a) Strategic planning and other specific consulting actions	Facilitate the design of a strategic plan to modernize the justice administration system. Contribute methodology tools and information for decision-making, and train an inter-institutional team in them.

<i>Topic of Study</i>	<i>Description</i>
(5b) Mechanisms for consulting with civil society	In coordination with the strategic plan design teams, propose mechanisms for the participation of civil society in reforming the justice administration system.
(5c) Preparation for consultation with civil society	Prepare the materials and methodology for the consultation, as well as the results reports.

MINISTRY OF ECONOMY AND FINANCE

OFFICIAL LETTER 026-2001-EF/10

**POLICY LETTER FOR SECTOR LOAN FOR TRANSPARENCY AND REFORM OF
FISCAL, SOCIAL AND JUDICIAL POLICY**

Lima, 23 February, 2001

Mr. Enrique Iglesias
President
Inter-American Development Bank
Washington, D.C.

Dear Mr. Iglesias:

1. Peru finds itself at an economic watershed, a situation presenting an unprecedented opportunity to restore public trust in the country's leaders, a trust that for a variety of reasons has been seriously eroded in recent years. The transition government headed by Dr. Valentín Paniagua Corazao has outlined some ambitious short-term objectives to prevent the political situation from deteriorating further and to open the door to an orderly transfer of power to the next administration.
2. To achieve these objectives, the transition government will concentrate its efforts on the main areas of interaction between the public sector and civil society. Another pivotal issue is the need to increase transparency in all areas of government activity, so that the public can understand public policy and evaluate it through democratic participation.

Social policy is the government's principal tool for protecting society's most vulnerable groups. To this end, the mechanisms available to the public sector for poverty relief must be consolidated, by incorporating them into a development strategy and transforming them into a government policy that transcends any given political period.

Lastly, leaving the country vulnerable to a public sector that is not transparent exacerbates the lack of trust in the judicial system, a situation that must be gradually reversed, in order to put in place a new system that safeguards over the rights of its people and husband's public resources.

3. The administration of fiscal resources, the contributions of all Peruvians, is an area in which transparency and public participation must be fostered. As you will note, Mr. President, the Government of Peru is preparing major initiatives to involve civil society actively as a custodian in monitoring government actions.

Elsewhere, every effort will be made to ensure that social policies are implemented in a framework of greater transparency with standards that guarantee the long-term sustainability of programs considered to be of priority.

The government will provide decisive support for judicial reforms, by seeking to build a consensus on strategies for reform and spurring actions to reduce corruption.

4. Our administration has accorded priority to pushing ahead with these reforms, as far as present conditions permit, so that the next administration has the wherewithal to take up the daunting and complex challenge of modernizing the public sector. To this end, we will initiate a series of studies on fiscal, social, and judicial policy, which are expected to be of considerable assistance to the authorities that assume the reins of government next 28 July in developing their government program.

5. In order to implement these reforms and any others subsequently adopted by the new administration, the government hereby requests that the Inter-American Development Bank provide a credit in the amount of US\$400 million for 2001.

The subject of the present letter, a sector loan in the amount of US\$200 million for transparency in and reform of fiscal, social, and judicial policy would be the first of two operations which, if approved, would be carried out in the first half of the year. The second operation in a similar amount will be implemented in the second half of 2001 and will continue with the reforms and modernization of the State, which are to be established with the members of the next administration.

6. In support of our request, the present letter describes:
 - a. The government's macroeconomic policy framework and the external financing plan, which has the backing of the International Monetary Fund (IMF). This framework covers fiscal, foreign, exchange, and monetary policies.
 - b. The government's commitment to fulfilling the objectives of ensuring greater transparency in fiscal information, optimizing the allocation of public resources in priority social programs, and supporting the reform of the administration of justice.
 - c. The actions that the government will undertake to give continuity to the process of fiscal, social, and judicial reform, which would serve as a basis for the second sector operation in 2001.

BACKGROUND

7. In 1998 and 1999, the Peruvian economy was buffeted by three exogenous events that had a negative impact on macroeconomic performance and fiscal equilibrium. First, the worsening of the Asian crisis kept down the prices of Peru's principal exports. Second, the El Niño phenomenon caused direct losses of approximately US\$1.2 billion (or about 2% of GDP) in public infrastructure, adversely affecting production, especially in agriculture and fishing. Lastly, the Russian crisis led to a contraction in credit worldwide.

As a result of these problems, a substantial volume of short-term capital flowed out of the country in the second half of 1998.

8. As you are aware, 2000 was a particularly difficult year in terms of our country's political stability. The controversy over the election results and the transition of power, and other well-known events that occurred subsequently caused the Congress to institute constitutional measures to restore political order. New general elections were called for 8 April 2001 and a government of transition was installed under an interim President, Dr. Valentín Paniagua Corazao.
9. The climate of political uncertainty was one of the reasons that the economic recovery begun in late 1999 stalled. Private investment remained depressed, causing economic activity to stagnate. In this scenario, according to preliminary estimates, GDP expanded by 3.6 percent in 2000, the fiscal deficit touched 3 percent of GDP, and the balance of payments current account deficit fell to 3 percent of GDP.

MACROECONOMIC POLICY FRAMEWORK AND EXTERNAL FINANCING

10. The priorities of the transition government include prudent fiscal and monetary management and dynamic structural reforms to improve economic competitiveness and restore public confidence in the management of state resources. In our view, these are a *sine qua non* for the next administration to be able to begin its mandate in a stable setting.

The government's economic program for 2001 is backed by a standby agreement with the IMF in an amount equivalent to 128 million SDRs, funding which is considered as an interim measure by the Peruvian government. As to structural reforms, a work program has been formulated in close consultation with multilateral financial institutions.

11. Despite the uncertainty over macroeconomic management in an election year, the government is committed during its mandate to a policy of strict fiscal discipline that would reduce the fiscal deficit in 2001 from the 3 percent estimated for 2000 to 1.5 percent of GDP. This improvement would make it possible to meet the targets set in

the Fiscal Prudence and Transparency Act, which was formulated with the support of the Inter-American Development Bank under a public finance reform program.

To fulfill this fiscal target, public spending will be strictly controlled and all further measures that might reduce tax revenues will be avoided. The aggregate nonfinancial public sector financing requirement is put at US\$1.758 billion (fiscal deficit of US\$866 million plus amortization of debt), which will be covered through project disbursements (US\$500 million), external borrowings (US\$975 million), revenue from privatizations and other sources.

12. In 2001, GDP is expected to grow between 2 percent and 3 percent, based on an inflationary target of 2.5 percent to 3.5 percent and current account deficit of less than 3.5 percent of GDP. According to its monetary program for 2001, the Central Reserve Bank of Peru will continue using the money supply as its interim target in order to bring inflation down to world levels. It will also continue with a flexible exchange-rate policy, with Central Bank intervention in the currency market being limited to controlling temporary fluctuations in the exchange rate.
13. The government will redouble its efforts at structural reform, given the importance of this initiative for attracting private investment, creating jobs, raising economic efficiency, and increasing net international reserves. As to investment, the government expects revenues from privatizations and concessions to exceed US\$500 million in 2001.

FISCAL SECTOR

14. Transparency in public finances and effective mechanisms to ensure accountability are essential for raising the confidence of national and foreign private agents in government actions and for securing efficiency, effectiveness, and equity in the administration of public resources. Access by the public to information on fiscal management will result in better designed public policies, thus making it possible to address society's real needs satisfactorily.
15. A first step in that direction was the passage of major legislation such as the Fiscal Prudence and Transparency Act and the amendments to the State Procurement Act. However, we have not gone far enough.

To reinforce transparency and introduce mechanisms for accountability, regulations having the force of law will be approved to permit access by the public to fiscal information. These regulations will establish minimum requirements for public disclosure of information on revenue (including tax expenditure), spending, the deficit and deficit financing, and the consolidated public sector debt profile. An information disclosure system will also be set up, whereby the public will have access to additional information within parameters of what is reasonable and relevant.

16. The integrated financial administration system (SIAF-SP) is a public finance management instrument that incorporates the information of the budgetary, financial, and accounting process, guaranteeing that information is internally consistent and revenue and public spending are monitored and controlled. As a sign of the government's commitment to absolute transparency in finance management, the SIAF-SP register will extend to all executing units within the central government by incorporating those in the Defense and Interior sectors.
17. On the fiscal front, the government will take further steps to increase tax collection and improve customer relations. To this end, the National Superintendency of Tax Administration (SUNAT) will enhance information and consulting services and modernize audit procedures in order to identify and fight tax evasion, using objective technology-based criteria. The SUNAT will devote its efforts exclusively to reducing arrears rates from 3 percent to 1 percent in the case of large taxpayers and from 25 percent to 10 percent in the case of medium-sized taxpayers by the end of 2001. Payment arrears will be monitored closely to prevent tax debt from increasing in real terms. In addition, the government will review the regulatory framework with a view to consolidating SUNAT's regulatory and operational powers, and to streamline its tax collection and audit procedures.
18. To optimize the operations of the Tax Court, the highest administrative authority for taxation and customs, and to ensure a high degree of objectivity and professionalism among its members, a bill will be introduced to Congress to make the system for electing and appointing its members more transparent and to permit objective evaluation of candidates based on their merits with input from civil society, thus giving the Court's decisions more authority.

SOCIAL SECTORS

19. The country has been making great strides to eradicate poverty and better the quality of life. As a result of these efforts, extreme poverty has declined and the quality of life indicators have improved. However, there are still institutional shortcomings and weaknesses in policy design that minimize the impact that social spending has on raising the living standards of low-income groups.

Amongst the institutional factors that circumscribe the effectiveness and efficiency of social spending are poor intersector coordination, duplication of efforts in different agencies, the absence of capacity to regulate and monitor the quality of management in the social sectors, operational weaknesses in the Interministerial Social Affairs Commission (CIAS), and the absence of a coherent policy built on consensus. As to policy design, problems include regressiveness, lack of transparency, ineffective targeting of social spending, and limited capacity to respond to economic crises and natural disasters.

20. In order to resolve these institutional problems and boost the efficiency and effectiveness of social programs, permanent systems will be implemented to supplement existing ones, to ensure coordination, monitoring, and evaluation of social policy as part of the process of modernization of the State. At the same time, the CIAS will be strengthened through the appointment of a Technical Secretary and the Deputy Minister of Economy will be given the task of providing technical advisory assistance.
21. The aim is to make social programs more efficient through regular follow up on and evaluation of priority areas, using the performance indicators developed last year. The budgets of institutions that develop social programs will be gradually allocated, based on these indicators. As an adjunct, public participation in the process of controlling and evaluating the use of public resources in these sectors will be fostered. Such participation is impossible without timely, quality information. Therefore, the transparency of social spending will be enhanced by making information on government activities and projects in the war on poverty available to the public.
22. The government is planning to formally establish a social safety contingency net as a standing institutional body to provide a comprehensive social policy response in times of recession or natural disasters, thus making it possible to protect the income of the most vulnerable population groups. This strategy will include mechanisms authorizing the use of funds from the Fiscal Stabilization Fund (FEF) to expand suitable social programs in response to certain economic conditions. Also, this network will be based on an efficient information system to monitor and evaluate the impact of a crisis and the effectiveness of the response mechanisms.
23. With a view to alleviating the adverse effects of economic performance, the government is committed to identifying essential projects as part of critical programs for social development for 2001. The public funding earmarked for these programs will not be subject to budgetary retrenchment.

JUSTICE SECTOR

24. The government considers it vitally important to counter the uncertainty and lack of predictability caused by weaknesses in the present system for the administration of justice and the corruption that has disrupted the public and private sectors because they undermine the perception of country risk, our capacity to attract investment, and growth and development. To this end, this program will seek to set the stage for ensuring that subsequent efforts at State reform are based on the pillars of a recovery of the public's trust in its institutions and the capacity of Peruvians to demand better performance from their officials. Hence, guaranteeing the independence and autonomy of the judicial branch is considered essential.
25. In the wake of the major advances to reestablish institutions in the justice sector with measures such as the elimination of the executive commissions, restoration of the powers of the National Council of the Magistrature, the repeal of the Regular and

Alternate Magistrates Ratification Act, and the establishment of the Temporary Councils of the judicial branch and the Attorney General's Office (Ministerio Público), mechanisms must be created to coordinate the efforts of all institutions involved in the administration of justice, while preserving and reinforcing their independence, so that a strategic plan can be designed for the system and the guidelines for their modernization, based on interagency and social consensus that guarantees transparency and accountability. In this regard, an interagency agreement between the judicial branch, the Attorney General's Office, the National Council of the Magistrature, the Ministry of Justice, and the Academy of the Magistrature will be encouraged in order to draw up a plan of action to meet the challenges posed by the reform process.

26. The means of designing the guidelines of an anticorruption policy within civil society will be facilitated. To do so, a national survey on corruption will be conducted to identify critical areas in which it is prevalent, and support will be given for the establishment of a group of national anticorruption representatives from civil society, and a specialized team will be formed to provide them with the technical support in the belief that by working together agreement can be reached on specific actions to extirpate this evil in the near term.
27. Lastly, the government will identify essential projects to guarantee the reform of the system for administration of justice, but primarily to ensure that there are no set backs in the progress made to expand the coverage of basic judicial services to the country's very poor. The public funding earmarked for these projects will not be subject to budgetary cutbacks.

INDICATIVE ACTIONS FOR 2001-2002

28. The medium term is the timeframe for these reforms. The government is making a concerted effort to fit its annual activities into a multiyear strategy, building a consensus on major initiatives to generate State policies that endure beyond the present administration. This approach is particularly valid in the current political context.

In fully keeping with its responsibility to provide leadership in a period of transition, the government's main objective is to smooth the way to an orderly and democratic transfer of power. The acceptance by society and economic conditions in general provide a unique opportunity for deepening the economic reforms and coordinating them with others of a social and political nature.

29. To make this first operation the precursor of a second loan under the same annual program, the country must establish mechanisms and actions that ensure the continuity of the reform process on which it is embarking. The government is committed to conducting studies that permit significant progress to be made in the three areas mentioned (fiscal, social, and judicial reform) in order to attain the major objectives established for 2001 and set the stage for major reforms in the future.

30. As to fiscal reform, in the context of modernization of the State, the government will prepare studies and proposals for reform in (i) tax and tariff policy that maintain the criteria of neutrality and equity while seeking to eliminate existing distortions, (ii) treatment of external debt, (iii) human resources administration, and (iv) coverage of management and performance indicators and incorporating them into the budgetary process. Once they have been prepared, these proposals will be posted on the Ministry of Economy and Finance's website.
31. On the social front, the foundations will be laid for future reform by strengthening poverty-targeted programs and consolidating social assistance and investment programs and making them more efficient. Work will begin on evaluating the mechanisms for financing basic health services and on improving the quality of public services. Cost-effective social safety mechanisms will be established, including a social contingency plan designed to meet the needs of vulnerable groups.
32. The government is providing decisive support for reform of the system for the administration of justice. Among the actions to which we are committed under the sector program is support for the design of a strategic plan for the system and the guidelines for its modernization, based on interagency and social consensus that guarantees transparency and accountability. Also, support will be provided for shaping proposals for consensus on increasing access to basic justice and its quality, on strengthening institutions by guaranteeing their efficiency, autonomy, and independence, and on adopting specific actions to eradicate corruption.

CONCLUSIONS

33. Peru has gone a long way in modernizing the public sector and, as noted in the present letter, the transition government is committed to moving forward in this area, charting an ambitious course for the short term. The accomplishment of its targets will open the way for the next administration to initiate its mandate in the best possible conditions in a setting of macroeconomic stability with invaluable technical support for the design of future initiatives for State reform. We consider it vitally important that the next administration begin its mandate in a framework of greater transparency, permitting more effective monitoring and evaluation of public policies by civil society. Thus, we trust that public confidence in the workings of government will be restored, a critical element for a democratically elected administration.
34. The present challenge is therefore to assure macroeconomic stability and strengthen the underpinnings of a process of sustained economic expansion while setting guidelines for raising efficiency in social spending and strengthening the democratic system. The Peruvian government hopes that its request for a loan to finance a sector program for transparency in and reform of fiscal, social, and judicial policy will be approved.

[signature]

Minister of Economy and Finance

PROPOSED RESOLUTION

PERU. LOAN ____/OC-PE TO THE REPUBLICA DEL PERU

**Sector Program for Transparency, and Reform in Fiscal, Social, and
Judicial Policies**

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the República del Perú, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Sector Program for Transparency, and Reform in the Fiscal, Social, and Justice Policies. Such financing will be for the amount of up to two hundred fifty million dollars of the United States of America (US\$250,000,000) from the Single Currency Facility resources of the Ordinary Capital of the Bank, and will be subject to the "Financial Terms and Conditions" and the "Special Contractual Conditions" of the Executive Summary of the Loan Proposal.