DEBT AND DEBT SERVICE REDUCTION PROGRAM

(PE-0103)

SUMMARY

BORROWER:	**The Republic of Peru**	
EXECUTING AGENCY:	**The Ministry of Economic Affairs and Finance**	
AMOUNT AND SOURCE: IDB:	**up to US$235.5 million (OC)** **Single Currency Facility** **(100% in U.S. dollars)**	
FINANCIAL TERMS AND CONDITIONS:		
	Amortization period:	**20 years**
	Grace period:	**5 years**
	Disbursement period:	**9 months**
	Interest rate:	**Variable**
	Inspection and supervision:	**1%**
	Credit fee:	**0.75%**

OBJECTIVES:

This operation is designed to help improve Peru's external viability and foster economic development through support for the debt and debt service reduction program and financing for the purchase of collateral and a debt buyback in the context of an agreement with commercial banks (the "Agreement").

DESCRIPTION:

The program would enable approximately US$10.8 billion in external debt to be restructured. As part of a concerted effort, the Bank's financing would be joined by support from the World Bank, the International Monetary Fund, and Export-Import Bank of Japan. Financing from these sources (totaling an estimated US$800 million), in conjunction with the use of the country's reserves (for an estimated US$635 million) would enable Peru to finance the purchase of collateral and debt buyback under the Agreement, for a sum of about US$1.435 billion. The final amount of IDB funding will be determined once more accurate figures are available on the cost of collateral and the country's financing needs. Based on available information, IDB support is expected to cover about US$233 million of the Agreement financing requirements.

ENVIRONMENTAL CLASSIFICATION:

The Environment Committee has classified this as a Category II operation.
BENEFITS: The program would make a contribution toward normalizing Peru's relations with foreign creditors and, eventually, with world capital markets. Furthermore, in making it possible to decrease and restructure the stock of debt, the program would be an important factor in reducing the risk associated with Peru as perceived outside the country and in lowering the financing costs which Peru's public sector and private sector will face on world markets. In addition, the program would help improve the financial management of international reserves, and would also contribute to implementation of the government's

stabilization and structural reform program now under way, much of which would be backed by the Bank under other operations.

RISKS:

The main risk associated with the operation is the possibility that insufficient resources would be available to punctually service the external commitments involved. This risk is associated with the possibility that serious balance-of-payments difficulties might arise (e.g., as a result of shifts in the terms of trade, sizable fluctuations in capital flows, or a retreat from the reforms implemented). Factors that diminish the likelihood of this happening, however, are the volume of Peru's accumulated international reserves, the authorities' determined action to improve fiscal discipline in order to narrow the trade deficit, and favorable prospects for an even more robust export sector once investment projects of recent years in the tradable sectors mature. Also, the debt and debt service reduction operation itself, by acting on one of the causes of Peru's balance-of-payments vulnerability (high indebtedness), will help minimize the aforesaid risk. It is hoped that this risk will also be mitigated by the Peruvian authorities' willingness to continue taking appropriate and timely steps in response to circumstances. The government has launched major macroeconomic adjustment and structural reform initiatives with support from the IMF, the IBRD, and the IDB. Moreover, the Peruvian authorities stand ready to take timely corrective action in the event of any slippages resulting from failure to adhere to the general guidelines of the current program of national modernization and poverty reduction.

EXCEPTIONS TO BANK POLICY:

Waiver: In order for the program to take place, the multilateral agencies will need to grant the borrower waivers of negative pledge covenants. A recommendation has been made to the effect that the Board of Executive Directors should approve the Bank waiver.

SPECIAL ISSUES:

Facility: The IDB loan would be made pursuant to the operational guidelines of the debt and debt service reduction facility approved by the Board on March 13, 1991. The allocation period would need to be extended for this operation.

THE BANK'S COUNTRY AND SECTOR STRATEGY:

The Bank's strategic objectives are as follows: (a) to contribute to successful completion of the structural reform process; (b) to support the government's efforts to bring down poverty indicators significantly by the end of the decade and improve delivery of social services; (c) to foster modernization of the State; and (d) to provide technical and financial assistance for rehabilitation and expansion of the country's physical infrastructure. The debt and debt service reduction program is compatible with the Bank's strategy for Peru, since it will help place the country on a stronger international footing and thereby put in place more favorable conditions for economic growth.

SPECIAL CONTRACTUAL CONDITIONS:

The program will be formalized in a loan agreement. Special contractual conditions to be met before disbursements begin include: confirmation by the borrower that resources are available for collateral purchases and the debt buyback; that the borrower has made substantial progress on arrangements to sign agreements with the institution or institutions to manage the security accounts for the discount bonds, par bonds, and front-loaded interest reduction bonds that are to be issued; and maintenance of a macroeconomic context consistent with the program objectives. Also, the borrower will be required to prepay all or part of the loan in the event of: (a) failure to use the loan proceeds for the authorized purposes or (b) release of portions of collateral. In the event of a release of collateral, prepayments will be made to the IDB, the IBRD and the IMF pro rata to each institution's specific contributions.

POVERTY TARGETING:

Not applicable