



USAID | **PERU**
FROM THE AMERICAN PEOPLE

PERU PRA PROJECT
Poverty Reduction and Alleviation
Contract No. 527-C-00-99-00271-00

ANNUAL REPORT
FY20052005

Volume 1

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February 7, 2006
CHP-1673-06

Mr. John Irons
CTO/Team Leader
Economic Growth
USAID/Peru

Ref: PRA FY2005 Annual Report
Contract No. 527-C-00-99-00271-00

Dear Mr. Irons:

It is my pleasure to submit herewith the FY2005 Annual Report for the Poverty Reduction and Alleviation Project (PRA).

We are pleased to report that during FY2005 the PRA Project, against its major performance indicators, has continued to meet or exceed performance targets as specified in our contract. This performance is noteworthy as it has been achieved under tight budgetary constraints, as a result of USAID/Peru's Mission-wide resource limitations. We appreciate the Mission's open dialogue and flexibility this year as we have worked to reduce operating costs while at the same time delivering result as specified under PRA contract amendment #15.

In FY2005, under PRA's Business Component, PRA supported enterprises generated incremental sales of almost \$34.0 million, representing 121% of the annual target and a 15.8% increase over FY2004 results. Exports accounted for \$12.8 million of this total representing 38% of annual project sales. Of PRA's 219 active client enterprises, 108 (41%) exported all or a portion of their production during FY2005 and 64 (29%) were classified as micro-enterprises and contributed \$5.7 million (17%) to PRA's annual sales results. Perhaps more importantly 734 micro-enterprises were linked to PRA client businesses through subcontracting or outsourcing arrangements. Also note worthy this year was the significant progress made toward international certification of several forest concessions in Ucayali Department. This work, a result of close collaboration between PDA and PRA, is expected to result in early FY2006 in the first-ever international sustainable forest management certification in Peru.

During FY2005 PRA-supported enterprises generated the equivalent of almost 13,000 permanent jobs thereby exceeding the lower cumulative results threshold for employment generation under PRA contract amendment #15. Women accounted for more than 4,600 (36%) of total incremental employment generated during the year.

PRA generated investment results of over \$3.00 million exceeded the established annual target by eight per cent (8%). Two new artichoke processing facilities in Huancayo and significant investment by OLAMSA in Ucayali Department, in conjunction with the PDA project, to increase African palm oil production by 1,000 hectares, accounted for the lion's share of PRA's FY2005 investment performance. Despite this performance, private sector investment in the *sierra* and *selva* remains very low reflecting the historically acute under investment in infrastructure in the *sierra* and *selva* and continued security problems which have deteriorated over the past year.

Under the PRA Alternative Development component PRA's four ESC's serving the coca valleys and associated departments worked closely the PDA ESC and its four sub-ESCs to more intensively serve the 30 USAID-designated priority Alternative Development (AD) districts. During FY2005 US\$18.6 million in new sales were generated in the seven Alternative Development departments representing 55 percent of total PRA annual sales results. Of this amount \$3.3 million were generated in the 30 priority AD districts up 57%, from \$2.1 million during FY2004.

Due to Mission-wide budget constraints, we were instructed by USAID/Peru in September, 2005 to wrap up PRA's Public-Private Partnership (PPP) component by the end of March 2006, once the Amazon Central highway concession transaction and the design phase of the Port of Callao PPP transaction are complete. Notwithstanding the fact that PRA's PPP component is being closed 17 months ahead of schedule, it will have achieved major results under challenging circumstances. In addition to the design of four rural electrification projects, three critically important highway concessions, traversing the coca producing regions of central Peru either will have been contractually closed or in the advanced design and transaction stage. This is a major accomplishment particularly given the size and scope of these PPP infrastructure transactions. Moreover, PRA will only have spent roughly 50 percent of its original CLIN 2 budget.

Finally, with less than two years remaining under the current PRA contract amendment and with the anticipated inauguration of a new Government in July, 2006, we share with the Mission in this annual report some ideas on how the PRA Project might be transformed from a successful USAID initiative into a broader national program. A subsequent phase might well receive USAID or other donor support, but in the main, it could and should continue on as a largely Peruvian effort. Developing and implementing successful exit strategies for donor financed projects is always a challenge regardless of country and the specific donor. It is to this end that we lay out some preliminary ideas.

On behalf of the entire PRA Project team and Chemonics International we wish to express our appreciation for the excellent support we have received from the Mission over the past several years. Similarly, we would like to express our appreciation for the strong support and excellent professional working relationships we have enjoyed with our colleagues from PROINVERSION, the Ministry of Transport and Communication (MTC), the Ministry of Economy and Finance (MEF) and DEVIDA.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'DT', with a long horizontal stroke extending to the right.

Douglas L. Tinsler
Chief of Party
Peru PRA Project

Cc: Hilda Arellano - Mission Director
Susan Brems - Deputy Mission Director
Juan Robles - PRA Coordinator
Eduardo Albareda - Economic Growth Team
James Dunlap - Regional Contracting Officer
Michael Greene – Director, Alternative Development Program
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Victor Merino – Team Leader, Peru-Ecuador Border Program
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(PERSUAP)**

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SECTION I

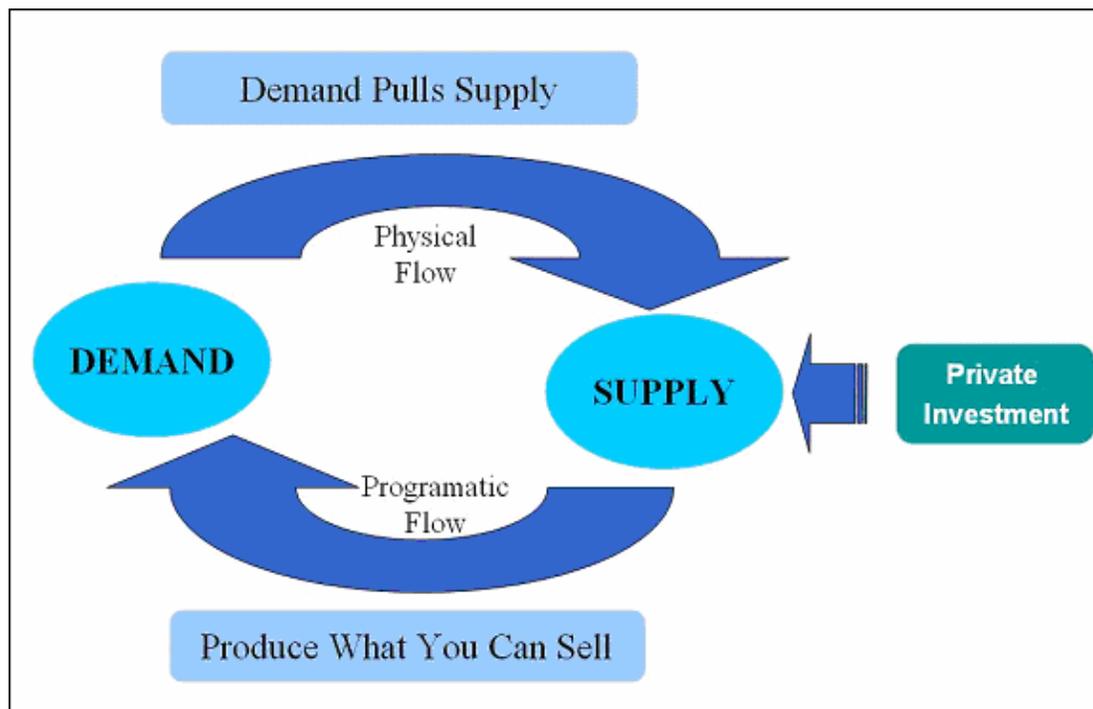
Introduction: PRA FY2005 Annual Report

A. PRA Principles and Looking Toward the Future: As with our FY2004 Annual Report we believe there is value in summarizing the operating principles which underlie the PRA Project and which make it unique. It is particularly fitting this year to discuss these principles for two reasons. First, under the current contract Amendment (No. 527-C-OO-99-00271-00) the PRA Project has less than two years remaining until contract closure. For this reason it would be useful to discuss the PRA principles and suggest how they might be transitioned by USAID or by the Government into a useful follow-on activity, should that be desired by either or both parties. Second, the FY2005 PRA annual report will be published at the onset of national elections for a new President and Congress. As such, with the prospects of a new Administration assuming office, a review of PRA principles and how they might be usefully applied by a new Administration to alleviate and reduce poverty in Peru over the next five-year presidential term seems appropriate. Accordingly, we review here the PRA objective, underlying PRA principles and subsequently layout a framework as to how these principles might be transitioned from the current USAID financed PRA Project to a broader Government of Peru (GOP) program financed entirely by the Government or in conjunction with one or more donors.

B. The PRA Objective: The objective of the PRA Project is to contribute to the reduction of poverty through the mobilization of private enterprise activity and investment in key economic corridors, defined as poor areas exhibiting economic growth potential. Several principles underpin PRA's approach to poverty reduction through each of its three component activities: the PRA Business Component; the PRA Alternative Development Component; and the PRA PPP Infrastructure Finance Component.

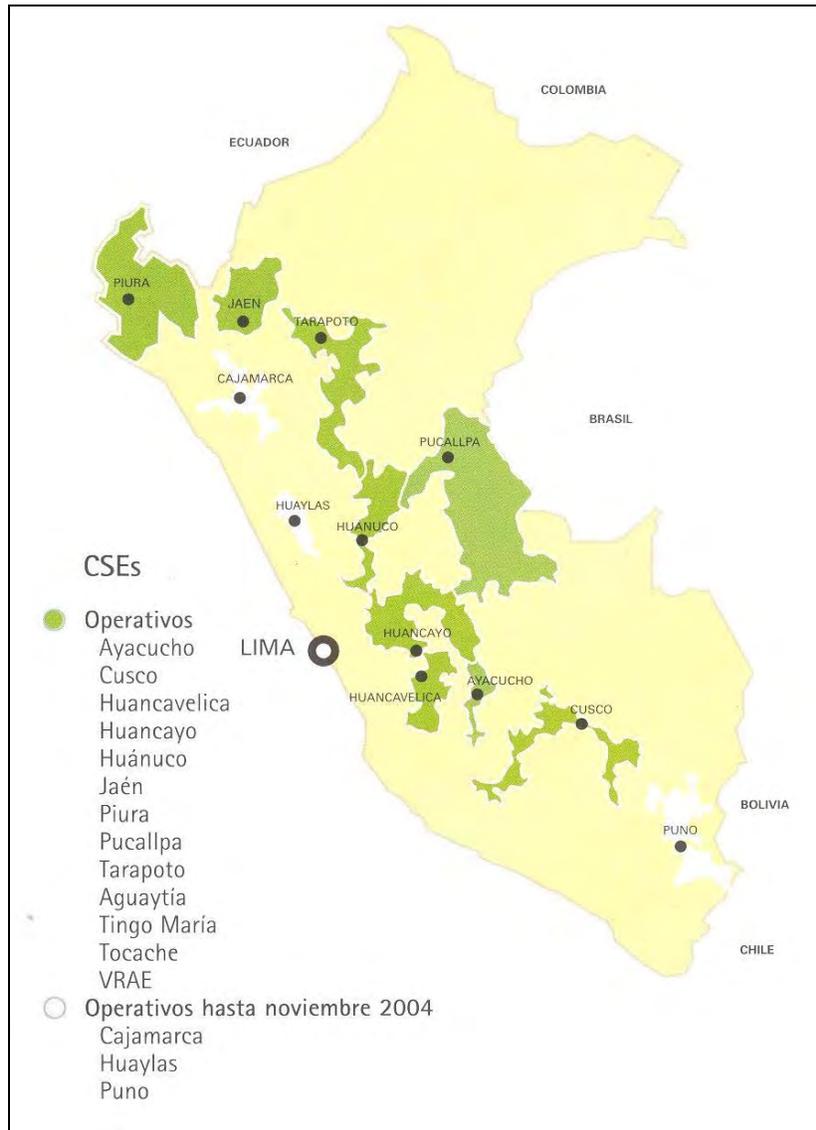
B1. PRA Business Component Principles: Five operating principles drive the business component of the PRA Project:

- **Demand-Driven:** As depicted in Figure I-1, PRA attacks poverty through a demand-driven approach to economic growth. Understanding demand and recognizing that demand pulls supply is the project's central operating principle. Production is focused on what can be sold, not on selling what has been produced. Equally important to the acceptance of demand as the point of departure for defining PRA interventions is the principle that PRA defines and articulates demand not in the abstract or based on econometric models, but rather in very practical terms; i.e, the identification of demand as defined by specific, private enterprises and entrepreneurs. In short, demand is seen and articulated through the optic of specific private enterprises. This specific focus on identifying demand at the enterprise level flows directly to the second principle underlying the PRA conceptual model.

Figure I-1: PRA's Point y Departure – Demand

- Private-Sector Led:** PRA clients are enterprises and entrepreneurs with a specific name, address, telephone number and email. Put another way the focus of PRA is not on sectors, products or on groups of producers, but specific business enterprises. PRA interventions are geared to enhance the ability of each supported enterprise to fully exploit its identified market potential. In our judgment a crucial missing ingredient in the development of the *sierra* and *selva* of Peru is the paucity of entrepreneurs and associated business enterprises. Hence PRA's client focus is to support and nurture the growth of business enterprises throughout the nine economic corridors and seven Alternative Development Departments where PRA activities are centered.
- Decentralized Implementation through Regional Economic Corridors:** PRA interventions are implemented in economic corridors characterized by a high incidence of poverty but with identified economic growth potential. This decentralized "corridor" approach is carried out through nine Economic Service Centers (ESCs) located in Peru's *sierra* and *selva* and in the northern departments of the country, with ESCs located in Piura and Jaen, associated with Ecuador-Peru Bi-national Commission (see Figure I-2). These Economics Service Centers provide technical assistance to enterprises with identified markets to eliminate specific bottlenecks and to improve their competitiveness through: (i) further strengthening both domestic and export market linkages and value chains; and, (ii) the elimination of specific bottlenecks which constrain enterprise growth.

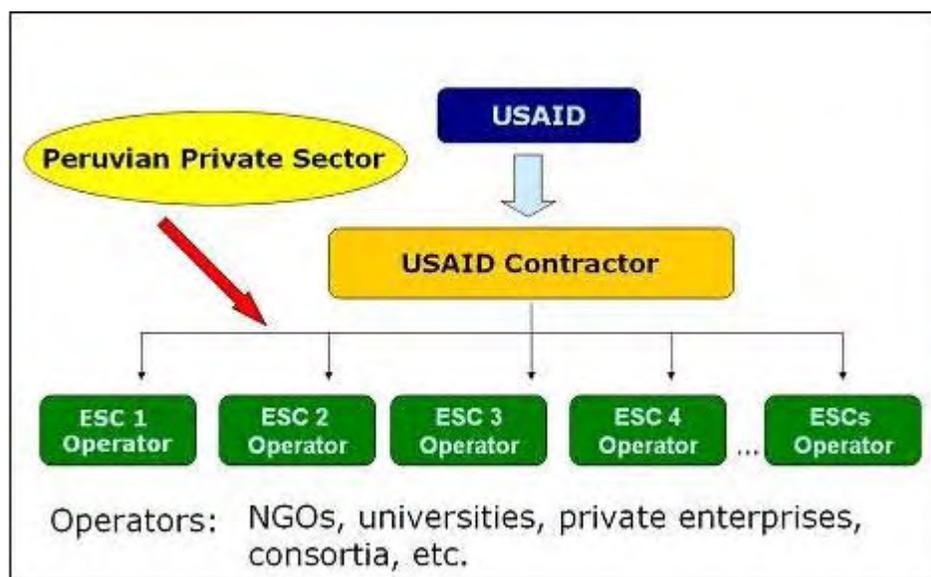
Figure I-2: PRA Economic Corridors



In Peru, based on PRA's more than five years of field activity, the principle constraint faced by Peruvian enterprises and entrepreneurs operating in the *sierra* and *selva* has been the organization of supply and the linking of that supply with specific enterprises. This value chain bottleneck is largely a consequence of the acute fragmentation of land holdings among hundreds of thousands of small holders who operate at subsistence levels, generally without titles, and who live and work in a highly politicized agrarian environment characterized by the absence or weakness of government institutions, frequent terrorist activity and illicit drug production and trafficking. Building confidence and effective working linkages between business enterprises and agrarian producers in this volatile environment has been PRA's single most important contribution over the initial years of the project activity. PRA's Economic Service Centers (ESC's) have been the key institutional facilitator linking enterprises with producers across numerous value chains.

- Outsourcing PRA Implementation to Private Sector Institutions:** In contrast to many Government and donor programs, management of the PRA project has been "outsourced" at both the national level and at the ESC level to private institutions (Figure I-3). USAID, as the managing and funding donor, has retained a private contractor, presently Chemonics International, to organize and supervise program implementation. The USAID financed contractor has, in turn, managed and run the PRA project at the ESC level through competitively selected, regional consortia of private sector enterprises, NGOs and regional universities. Each selected ESC operator is responsible for its overall budget and the attainment of key program results defined in terms of incremental enterprise sales, employment and investment. This "outsourced" arrangement has allowed for the expeditious and efficient implementation of the project, including the ability to replace both the prime and ESC subcontractors if performance targets are not achieved.

Figure I-3: PRA Outsourcing in Execution



In Peru today this form of "outsourced", top to bottom implementation of a Government sponsored program by private contractors stands almost alone. Peru has a long history of highly centralized, bureaucratically managed programs in virtually every sector. The Government is conscious that the prevailing centralized design and public sector implementation of development programs is not working and performing as they should. Discussion of "Reform of the State" is the subject of much current debate but, as yet, without real focus, let alone results.

Legislation to decentralize power to regional and municipal governments has recently been implemented and is presently supported by USAID and other donors. This excellent Government reform initiative needs to be further complemented with fresh thinking on how to implement public sponsored programs at all levels of government through new organizational and financing models. The "outsourcing" model as presently practiced by

the PRA project, stands as a worthy example, with tested Peruvian based results, and should be considered for replication both at the national and at the regional government level.

At present the USAID-supported PRA project is scheduled to close in September, 2007. The new Government, scheduled to take office in July of 2006, has the opportunity to continue the PRA project on its own account, upon termination of USAID support, if it moves expeditiously to articulate the necessary policy and possibly legal changes that may be required to allow the Government, whether national or regional, to finance programs using the "outsourcing" model as presently practiced under PRA project with USAID financing.

- **Continuous Performance Monitoring:** As documented in this Annual Report, PRA results are subject to continuous performance monitoring of incremental enterprise sales, employment generation as well as investment. At the on-set of each working relationship with a new PRA enterprise client a formal agreement is reached with the client that it will allow PRA access to its books overtime, on a confidential bases, to determine the net incremental sales, employment and investment that have been generated as a result of specific PRA support. The presence and rigorous management of the PRA monitoring system has been a key factor affecting program continuity and performance. Without the constant feedback of performance results provided by the PRA monitoring unit, the project would not have a systematic way to judge performance of individual ESCs and, in turn, make management adjustment to improve project performance.

These five operating principles have guided and governed PRA design and implementation since the inception of the project in 1999. With the advent of PRA Contract modification #15 in 2003 two additional components were added to the project. Each of these components, like the PRA Business Component, is guided by a set of operating principles.

B2. PRA Alternative Development Principles:

- **Intensified Focus On and Linkage with the DEVIDA/USAID Alternative Development (AD) Program in Seven Priority AD Departments:** Since May 2003 PRA has taken several concerted actions to further strengthen and concentrate its focus on and work in the seven Alternative Development Departments (Figure I-4) as called for in PRA contract modification #15.

As we have learned over the years working in the *sierra* and *selva*, and particularly in the coca valleys, an important missing variable in the economic development equation, perhaps the key missing variable, is the paucity of private enterprise activity in these regions. This is evident to even the causal observer visiting Aguaytia, Tingo Maria, Tocache, Juanjui and San Alejandro in San Martin and Ucayali Departments and San Francisco in the VRAE. Equally obvious is the lack of supporting institutions in these regions which are essential for businesses to function and flourish. Of particular note is the limited presence of commercial banking services.

Figure I-4: Alternative Development Departments

The reason why there is relatively little business activity in the *sierra* and *selva* is not due to the absence of opportunity. This perspective was reinforced once again to the PRA team during a four-day visit this year to the *selva* with potential investors from Malaysia. Upon the conclusion of their visit the Malaysian team marveled at the potential of the Peruvian *selva* comparing it with their own tropical environment. From palm oil to pepper and forest products they asked why there was not more business activity and investment even partially comparable to that in Malaysia? To the Malaysians the reasons were obviously not the productive potential of the Peruvian *selva*. The answer lies, we believe, in the pervasive risk aversion the Peruvian business sector holds toward investing and working in both the *sierra* and the *selva*, the combined consequence of years of poorly designed and implemented agrarian reform, terrorism, and illicit coca production and associated trafficking.

To counter this pervasive risk aversion, PRA has intensified its efforts since 2003 to bring businesses and entrepreneurs to the region, holding their hands, if you will, in an effort to

build confidence that working and investing in the *sierra* and *selva* makes sense. Each limited PRA success has served as fuel for future success. Frito Lay's long standing risk aversion to sourcing potatoes from Peru led them to import potatoes from Colombia. This practice was changed through PRA's steady work over three years. Frito Lay now sources its potatoes for domestic potato chip production entirely from small-scale producers in Huanuco. This success gave Frito Lay the confidence to work with PRA in Aguaytia to source bananas from *ex-cocaleros*, rather than Colombia, for their popular "Caribas" brand of banana chips. As with Lay's potato chips, each package of "Caribas" *chifles* now proclaims: "Made in Peru with Pride". This confidence building work with the business sector, coupled with PRA's ability to organize producers to meet the quantity and quality standards of a formal and demanding business partner is what PRA's work is all about. We start with the enterprise and work backwards to bring in the producers, thus connecting demand with supply. We subsequently work to build lasting "business bonds" between the private and subsistence sectors, with particular emphasis on working with and integrating *ex-cocaleros* into sustainable, business-based markets.

An important contributing factor to the risk aversion of the business sector to invest and create jobs in the *sierra* and *selva* is the poor state of highway infrastructure in the region. USAID recognized this long standing structural weakness early on in the PRA Project and encouraged PRA to search for solutions to the infrastructure bottleneck through the project's policy component. To this end, PRA commissioned a study in 2001 to identify the most important highway bottlenecks constraining growth in the 10 PRA economic corridors¹. Of the 24 highway segments studied, the Fernando Belaunde Terry (FBT) highway between Tarapoto and Tingo María stood out as the single most important highway infrastructure investment the Government could undertake with an internal rate of returned (IRR) conservatively estimated at 26% and where losses alone from forgone agriculture production in the Department of San Martin, in the absence of the project, are estimated at \$36.0 million annually.

With the P.yV highway study in hand in 2002 the Association of Municipalities of San Martin (AMRESAM) formed an FBT working group, chaired by the Vice Minister of MTC and composed of representatives from both the national and local governments, AMRESAM, San Martin's congressional representatives, the private sector, PRA, DEVIDA and USAID. PRA was requested by the Working Group in early 2003 to carry out a study focused on the possibility of eliminating San Martin's exoneration from the national valued added tax (VAT) provided that the VAT taxes subsequently collected were dedicated to the construction of infrastructure, particularly the FBT in the Department of San Martin.

In April 2005 Congress passed a law², as formulated by the FBT Working Group with PRA support, eliminating San Martin's exoneration from the VAT tax, establishing in the process the requirement that San Martin VAT proceeds (estimated at \$14 million annually) be dedicated to financing infrastructure, particularly the FBT. After almost four

¹ P.y V. Ingenieros S.A.; "Estudio Sobre la Inversión en Infraestructura Vial Prioritaria"; September, 2001; Lima, Peru.

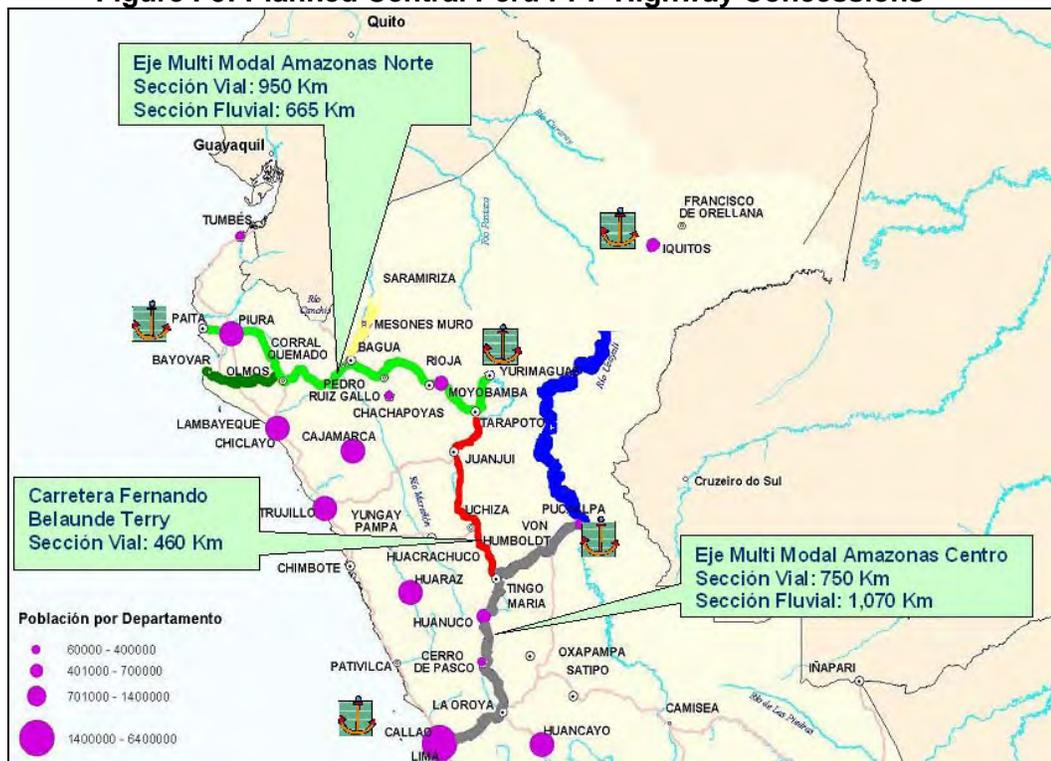
² Ley No: 2875; Ley de Inversión y Desarrollo de la Region San Martin y Eliminación de Exoneraciones e Incentivos Tributarios; El Peruano; 6 July 2005; p.296122.

years of work the FBT Working Group has established the essential Government financial support required to successfully develop the FBT through a PPP concession.

In July 2005 PRA was requested by USAID and AMRESAM to consider the FBT for inclusion as one of the four to six PPP projects to be developed and closed under the PRA PPP Infrastructure component established by Contract Amendment No.15. PRA presented a preliminary design for an FBT PPP transaction to USAID and DEVIDA on August 24, 2005. The FBT preliminary design is attached as Annex E

In the two plus years since PRA Contract Amendment No. 15 was signed the PRA PPP team has focused almost exclusively on solving the acute highway infrastructure problems confronting the *sierra* and *selva* of Peru, in particular in those areas in San Martin and Ucayali Departments with acute problems of coca production and drug trafficking. In this regard the \$228 million, 950km Amazon North highway concession has been successfully closed. The \$100 million, 847km Lima to Pucallpa highway concession is in the final design and bidding stage and is expected to close during the first semester of 2006. Finally, with the passage of the VAT Exoneration Law for San Martin and the preliminary design of the FBT now complete, the stage is set to definitively resolve the transport problems that have constrained the development of central Peru for centuries. When completed the market access and associated transport savings from each of these three PPP highway concessions (Figure I-5) will put money into the pockets of small holders, including *ex-cocaleros*, season after season, far in excess of short-term subsidies that have historically been offered by Government and donors in return for the eradication of coca.

Figure I-5: Planned Central Peru PPP Highway Concessions



B3. PRA Public-Private Partnerships (PPP) in Infrastructure Finance Principles: The PRA PPP infrastructure finance component has been guided by three important operating principles:

- **Alpha to Omega Technical Assistance:** To ensure comprehensive, professional and transparent structuring of PPP projects, the PRA team has since the inception of the PPP component advocated the importance of the transaction advisor, in this case the PRA PPP team, advising the client from the onset of each PPP Project design to final contract award. This "turn-key" approach has been used in the case of both major highway concessions handled by PRA to date. However, in the case of on-going PPP work for Callao USAID has limited the funding and involvement the PRA team to making contributions only to the transaction design phase. While we appreciate and understand USAID's funding constraints this resource limitation will clearly limit and circumscribe the ability of the PRA PPP team to bring to closure this PPP transaction. Chemonics experience in Indonesia, Colombia, the Philippines, South Africa and now Peru provides the empirical base demonstrating the importance of "turn-key", Alpha-to-Omega transaction advice to successful closure of PPP infrastructure projects.
- **Encourage Vigorous Competition:** To foster transparency and generate the lowest cost service provision to end-users and Government, all PRA PPP infrastructure interventions are designed to encourage vigorous competition among PPP infrastructure providers, both domestic and international. Even after a vigorous domestic and international promotion effort with respect to the Amazon North highway concession we were only able to mobilize a handful of qualified investors/operators. We have redoubled our efforts with respect to the on-going Amazon Central highway concession and expect a more robust turn out for this second major highway concessions.
- **Tap Local Capital Markets:** To reduce risk as well as tap Peru's substantial (i.e., over \$9.0 billion in assets) and dynamic capital market all PRA PPP project interventions are designed to specifically tap the financial resources potentially available from domestic sources.

C. The PRA Model: Looking to the Future: With less than two years remaining under the current USAID PRA contract and with the advent of national elections and the inauguration of a new Administration in July 2006, it is timely to lay out a few ideas on how the PRA Project might be transformed from a successful donor sponsored activity into a broader national program, which still might receive support from USAID as well as other donors, but which would continue on, in the main, as a largely Peruvian initiative whether or not additional donor support is forthcoming. Developing and implementing successful exit strategies for donor-financed projects is always a challenge regardless of the country and the specific donor. It is to this end, implementation of a successful exit strategy for the PRA Project and USAID, to which the following paragraphs are addressed.

The value of this review is further reinforced given the current Administration's clear articulation and commitment to several policy themes which are likely to be continued and deepened by the next Administration. We maintain that if the PRA operating principles and management model

were concretely and specifically linked with these policy directions, overall enterprise-driven economic growth in the country, particularly the *sierra* and *selva*, could be accelerated.

Two policy themes are of central relevance to this discussion; i.e., export led growth and local government decentralization. Each of these policy themes, while not explicit aspects of the PRA model *per se*, are highly compatible with PRA's approach to enterprise driven economic growth. Accordingly, we discuss below how a closer link between these policy directions and PRA's operating principles and organizational approach could substantially strengthen the Government's ability to translate sound policy direction into greater on the ground results:

Export Led Growth: For some years now the Government has adopted an export-led growth model and has consciously promoted export growth through MINCETUR, PROMPEX, FUNCODES and a number of other state institutions. The PRA Project, while not explicitly aimed at promoting export growth, has in fact been a powerful force in the Government's overall export drive. For example, in FY2005 fully 38 percent of PRA's \$34.0 million in sales, or \$13.0 million, were destined for export markets. In FY2005 108 of PRA's 219 active enterprise clients found all or part of their markets outside Peru. These export results were achieved through the individual and collective action of 10 Economics Service Centers (ECSs) financed by USAID and managed under the overall PRA USAID contract.

Due to budget constraints USAID was forced to close three PRA Economic Service Centers at the end of FY2004. Unfortunately, two of these ESCs, Puno and Cajamarca were the leading ESCs in promoting and generating export oriented sales. Eighty percent of the Cajamarca ESC's sales and seventy-nine percent of the Puno ESC's sales, totaling \$5.4 million, were destined for export markets in the U.S. and Europe. The Huaylas ESC's export sales of \$200,000, while much lower than either Puno or Cajamarca, were due to increase dramatically in the years ahead given PRA's support over several years to the emergence of a number of export oriented cut flower enterprises supported by the Huaylas ESC.

The concern here is not with the cut in USAID resources, as donor support from any source is always of a temporary nature and serves to jumpstart development activities. What is of concern, is that notwithstanding a highly supportive Government policy in favor of export-led growth, three strong export-oriented Economic Growth Centers (ESCs) which, with each passing year, were generating greater and greater export results, had to be shut down as the Government was not in a position to follow through with financing where USAID left off. As a consequence from FY 2005 onward three high performing ESCs have left the scene and have not been replaced with a comparable Peruvian institution capable of supporting new enterprises as they look to enter export markets in three important economic corridors with substantial export potential. We believe it is important for both Peru and USAID to find solutions to ensure the sustainability of the PRA Program once USAID assistance comes to closure in September 2007. We believe there are a number of ways to ensure PRA's sustained presence if USAID and the new Administration take appropriate action over the remaining months of the current PRA contract.

To try to bridge this gap between positive, on-going government policy and short term project activity, PRA provided, at USAID's request, a Trade Capacity Building (TCB) proposal which was presented and endorsed by both sides during the *Tratado de Libre Comercio* (TLC)

negotiations in November 2004 (see Annex B). While accepted in principle by both Governments, the PRA Trade Capacity Building proposal remains unfunded.

The key to the sustainability of the PRA activity rests with folding the PRA concept and operating principles into national policy implemented through a decentralized program framework carried out by regional governments. If interested donors, such as USAID, desire to support a national PRA program in a subsequent phase they could do so by concentrating on a subset of regional departments, such as the seven AD Departments, while other donors focus on their preferred subset of regional governments. The point here is for the GOP and their donor partners to expand the coverage of the successful USAID financed PRA experience across all 25 regional departments. A national, but decentralized approach to PRA would avoid the problem faced by USAID where budget shortfalls forced the closing of three highly successful, export-oriented Economic Service Centers in the absence of alternative financing from government or other interested donors.

Local Government Decentralization: The potential linkage as well as policy and program synergies between the Government's policy and program of decentralization and PRA's program of enterprise-led growth carried out originally through ten (10) Economic Service Centers strategically located throughout the *sierra* and *selva*, suggests an important opportunity to link the PRA program into the Peruvian Government's broader policy of local government decentralization.

PRA receives numerous requests from regional governments for support, most recently the Department of La Libertad. However, given PRA's concentration in the seven Alternative Development Departments and the Peru-Ecuador Border region, the project is not in a position to respond to these requests due to the focus and priority of USAID to concentrate its limited resources in the aforementioned Departments and their associated economic corridors.

Accordingly, PRA's response to these requests from regional governments, which now have their own independent sources of finance, is that they do not have to wait another day to have their own PRA organization and operation, as long as they commit and adhere to the five operating principles that have collectively defined PRA's success over the past five years. These principles, which we have called in our dialogue with regional governments the "Secrets of PRA" are summarized in Figure I-6 below.

The acceptance by regional governments of the first two strategic PRA principles, demand focus and private enterprise driven, constitutes the *sine qua non* for future success of any regional government to effectively support enterprise and export-led growth in their respective regions. The first principle, "demand pulls supply" or "produce what you can sell, not sell what you produce" is the point of departure for everything else. If decision-makers remain wedded to traditional production, supply-driven models so typical of most government and donor supported programs, there is little chance for success. Second, PRA works through specific private enterprises each with a "name, address, telephone and email". In short, the PRA client is a specific business or entrepreneur who understands his or her demand equation in specific terms. With full commitment to these two strategic principles the chances are great that new sponsors of

the PRA model, such as regional governments, can replicate the success PRA has achieved under the auspices of USAID.

Figure I-6: The Secrets of PRA



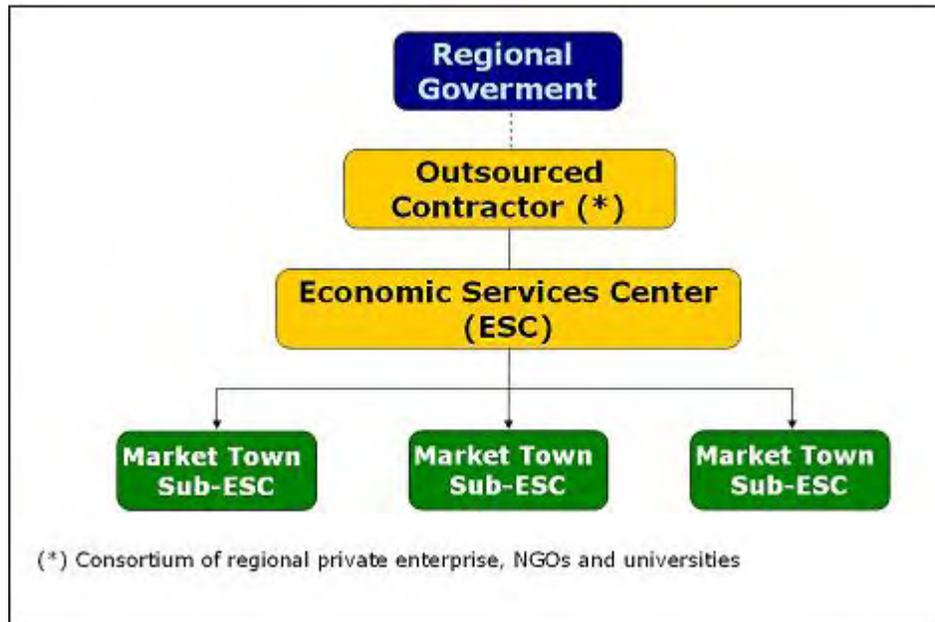
The three remaining "PRA secrets" to success deal with principles of organization and management. The first, decentralization of Economics Service Centers (ECs), should be easily assumed by newly participating regional governments. Simply put, each ECS should be located in a secondary or tertiary market town within the department, close to where business happens. For any given PRA regional development model it is easy to envision a regional government creating a central ECS located in the department's principal market town with sub-ECS located in secondary or tertiary market centers all close to "where the business is" in specific economic growth corridors.

The second key management principle, "outsourcing", may be more problematic for local governments to achieve, but is central to the success of the PRA model (see Figure I-7 below).³ Simply put, the PRA technical assistance model needs to be implemented by private agents, defined as private enterprises, NGOs, universities or a combination of these private concerns, and not, repeat not, through the bureaucracy of any given regional or local government. Each ECS operator would be selected by open competition by the supervising regional government and would receive its annual budget as defined by the contract and be accountable for results at the end of the operating year to the regional authorities. Each ECS would be accountable to its regional government sponsor but it would operate, as at present, as an independent, private contractor with the liberty and flexibility to work with its enterprise clients, independent of the regional or local government bureaucracy.

The final tool to complete the PRA regional model would be the PRA enterprise-based monitoring system where by mutual agreement the PRA ESCs would agree with each prospective client to have access to the books of the participating enterprise to record ESC-related annual sales, employment and investment results for a specified number of years.

³ For a discussion of "outsourcing" possibilities and issues in Latin America and Peru see: Schneider, Ben; *Outsourcing: La herramienta de gestion que revoluciona el mundo de los negocios*; Grupo Editorial, Norma; 2004.

**Figure I-7: Region/Department PRA Economic Service Center (ESC)
ORGANIZATIONAL MODEL**



By generalizing the PRA model from a specific donor financed and managed instrument into a general program of the Peruvian Government, managed and implemented through local government, the GOP could greatly expand the pace of private sector driven enterprise growth, particularly export led growth, while at the same time strengthening incipient regional governments by making available to them an outsourced organizational and management model for enterprise and export led growth that could be managed and financed under each respective regional administration.

The existing PRA administrative, financial management, contractual and information systems and processes which have been fully developed and tested under the existing USAID PRA contract for the past five years could be relatively easily transferred to participating regional governments should the new Administration wish to embark upon a program to transform the USAID PRA model into a Government of Peru program implemented through participating regional governments.

The fact, however, that the PRA model has not been independently replicated outside the framework of the USAID supported PRA project suggests that notwithstanding the logic of "copy cat" replication of the PRA program to new areas under local government auspices, the fact of doing so remains easier said than done. Given this reality, we have outlined below a proposed pilot project, within the context of the on-going PRA project, which would attempt to transition the on-going PRA Economic Service Center activity in the Department of San Martin from the responsibility of the USAID contractor to the Regional Government of San Martin before the close of the PRA project in September, 2007. We submit that if this transition can be successfully accomplished in San Martin the basis will exist for transitioning PRA activities in other respective economic corridors supported by USAID to the responsible local governments. It follows that if this transition could be successfully accomplished then the program could be

expanded and replicated in other, non-USAID supported Departments with the consequent impact on enterprise development and export led growth.

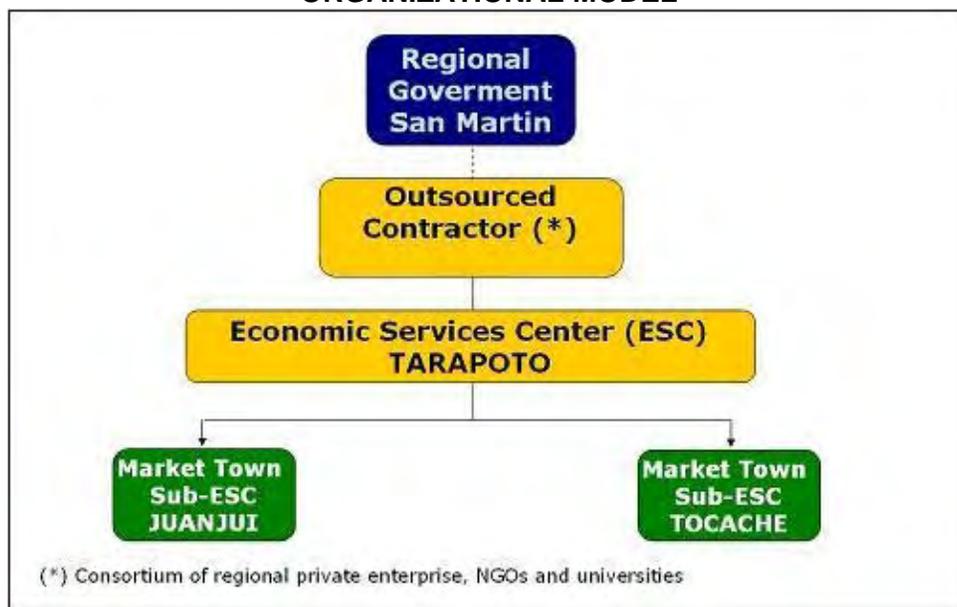
C1. Test Case - PRA San Martin: With less than two years remaining under the current PRA contract, it would be possible, if USAID and the appropriate national and regional authorities were interested, to establish a pilot PRA Economic Service Center operation under the management auspices of the Regional Government of San Martin. For the sake of illustration we present here a conceptual model where the Department of San Martin would assume responsibility for the PRA ESC in Tarapoto with technical assistance and transitional support provided by the current PRA contractor to guide the San Martin Department management team through the process of establishing and managing a PRA program according to the five operating principles that have governed PRA since its inception in 1999.

Program Objective: The objective of the PRA San Martin Program would be the same as that established for the overall PRA program; i.e. to contribute to the reduction of poverty in San Martin through the implementation of a demand-driven, enterprise led economic growth strategy for the Department of San Martin.

Applicable Operating Principles: The PRA San Martin ESC would operate under the same five operating principles that govern the overall PRA Project:

- Demand Driven
- Enterprise Led
- Outsourced Management of ESC
- Decentralized ESCs
- Continuous M&E

Figure I-8: PRA San Martin Economic Services Center (ESC) ORGANIZATIONAL MODEL



PRA Organization and Management: The PRA San Martin ESC would operate under the overall direction of the Regional Government of San Martin. The President of San Martin Department would appoint a senior staff member as the Account Officer for the PRA San Martin operation. The PRA Account Officer would be supported by a two person professional and administrative staff who would oversee the PRA San Martin ESC, advise the San Martin Regional President on the overall status and performance of the ESC operation as well as serve as the liaison officer between the Regional Government and the PRA coordinating contractor (i.e., Chemonics) based in Lima. The PRA San Martin ESC contractor would report to the PRA Account Officer and through him to the PRA Lima Office. Consideration would be given to establishing ESC sub-centers in Juanjui and Tocache as shown in Figure I-8. The Economic Corridor of the San Martin ESC would be defined as at present with Moyabamba, Tarapoto, Juanjui and Tocache serving as the key market towns.

PRA San Martin Budget and Cost Sharing Arrangements: The calendar year 2006 budget for the PRA San Martin operation is shown in Figure I-9. This budget reflects the full cost of operating the proposed San Martin ESC Office.

Figure I-9: Model PRA ESC Budget

(US\$)						
ITEM		First Quarter	Second Quarter	Third Quarter	Fourth Quarter	TOTAL
1	Salaries LT	35,650	30,852	41,598	41,598	149,698
2	Consultancies	16,647	18,324	18,324	18,324	71,619
3	ODCs	6,177	6,177	6,177	6,177	24,708
4	Equipment	0	0	0	0	0
5	Travel	4,413	4,413	4,413	4,413	17,652
7	Mgt. Fee	6,288	5,974	7,049	7,049	26,360
SUB TOTAL COST		69,175	65,740	77,561	77,561	290,037
IGV		13,143	12,491	14,737	14,737	55,107
TOTAL COST		82,318	78,231	92,298	92,298	345,144

The annual budget for the San Martin ESC is approximately US\$ 345,000 for calendar year 2006. Under the proposed pilot scheme, the Department of San Martin would be requested by USAID to pick up a mutually agreed portion, perhaps 50 percent, of the of the San Martin ESC costs currently financed by USAID. For the nine months of calendar year 2007, USAID financing would decrease to perhaps 25 percent, and the regional government would finance a larger proportion of the San Martin ESC costs.

National Support for PRA San Martin Pilot Program: During the pilot phase of the PRA San Martin ESC program, PRA's Lima headquarters office would continue to provide overall program guidance to the San Martin ESC as well as assume responsibility for identifying foreign markets and investors as well as manage the PRA monitoring and evaluation system. If the program were to move into a post-USAID phase it would be necessary for the GOP to retain a national or international contractor to fulfill these roles currently managed by the USAID PRA contractor.

Conclusion: The transition proposal outlined above is obviously a very preliminary outline of what might be more fully developed into a PRA "exit strategy" should the Mission desire to develop such a strategy and supporting program in the first instance. We believe the development and implementation of an exit strategy is important because the PRA methodology works and can be replicated relatively easily given appropriate technical and financial support. To not develop such a strategy would be a loss for both Peru and USAID.

SECTION II

PRA Business Component

The purpose of the Peru Poverty Reduction and Alleviation (PRA) Project's business component is to contribute to poverty reduction by generating sustainable income and employment and mobilizing private sector investment in poor "economic corridors" through regional Economic Service Centers (ESCs). The ESCs work with established as well as new business clients in each corridor, identifying market opportunities and contacts inside and outside the country. PRA's nine Economic Service Centers, eight financed by USAID and one financed by *Minas Buenaventura* through a GDA arrangement with USAID, provide technical assistance to improve client competitiveness, through the organization of supply at the local level, introducing improved technologies and non-financial assistance in managing the expansion of client businesses.

PRA results in each economic corridor are measured and reported quarterly as well as annually through three business related performance indicators: (i) net incremental sales generated by PRA-supported businesses; (ii) net incremental employment generated; and (iii) incremental fixed asset investment induced by PRA. Modification 15 to the PRA contract established the following performance targets for the PRA Business Component:

- 45,000 – 52,000 additional jobs
- \$140,000,000 to \$160,000,000 in incremental sales
- \$12 million to \$14 million in new investments

PRA business results are on target to meet or exceed these contractual targets. To date, PRA has generated \$97.9 million in sales, 9.2 million days of labor (the equivalent of 45,934 permanent jobs)¹, and \$8.8 million in new investment. During the current review period, PRA exceeded the minimum contractual target for employment results. We believe that PRA's achievements to date are due, in large part, to the trust and confidence the project has established over the years with the Peruvian private sector. The next two years however, bring a certain degree of uncertainty because of the upcoming presidential 2006 elections and the change in government that will take place as a result. We expect social unrest to increase during this period around the issue of coca eradication and alternative development, making it more difficult to link to markets communities who have signed voluntary eradication agreements, and complicating PRA's business promotion efforts in the seven alternative development departments where it operates. Difficult challenges lie ahead. PRA must refocus and reinforce the management of the ESCs to prepare for and respond to these challenges in order to ensure successful achievement of contract targets.

¹ One permanent job is considered to be the equivalent of 200 days of labor.

Figure II-1: PRA Cumulative Results through September 2005

ESC	Net Sales	Days of Labor	Investment
	US \$		US \$
AYACUCHO	4.651.332	759.977	153.993
CUSCO	11.921.826	1.183.036	16.116
HUANCAYO	15.544.407	1.018.431	2.651.035
HUANUCO	4.321.623	419.360	38.304
JAEN	14.053.341	993.629	528.321
PIURA	413.426	20.159	20.556
PUCALLPA	10.615.740	1.430.554	1.730.405
TARAPOTO	7.331.821	1.072.869	1.015.947
AGUAYTIA	1.268.582	332.081	79.219
TINGO MARIA	426.494	18.102	0
TOCACHE	138.250	25.256	0
VRAE	712.310	47.201	17.000
CAJAMARCA	10.930.059	799.978	379.210
HUAYLAS	7.884.949	415.972	1.990.412
PUNO	7.671.864	650.098	169.868
Total	97.886.026	9.186.704	8.790.385
HUANCAVELICA	1.600.073	62.499	177.387

A. PRA FY2005 Sales Performance.

PRA-supported businesses generated incremental sales of \$33.99 million during FY2005, representing 121% of the annual target, and a 15.8% increase over results from the previous fiscal year.

Figure II-2: PRA FY2005 Sales Results vs. Targets

ESC	Sales US\$	Target US\$	% achieved
JAEN	5,900,796	3,861,410	152.81%
CUSCO	4,516,428	4,158,442	108.61%
HUANCAYO	5,803,132	5,346,568	108.54%
PUCALLPA	3,755,982	3,564,379	105.38%
AYACUCHO	1,537,175	1,485,158	103.50%
TARAPOTO	2,144,559	2,970,315	72.20%
PIURA	413,426	766,533	53.93%
HUANUCO	737,226	1,782,189	41.37%
PDAP AGUAYTIA	1,268,582	1,100,857	115.24%
PDAP VRAE	712,310	929,332	76.65%
PDAP TINGO M	426,494	594,063	71.79%
PDAP TOCACHE	138,250	1,534,189	9.01%
CAJAMARCA	1,863,071	—	—
HUAYLAS	3,168,736	—	—
PUNO	1,603,835	—	—
Total	33,990,004	28,093,435	121%
HUANCAVELICA	1,074,481	1,156,000	93%

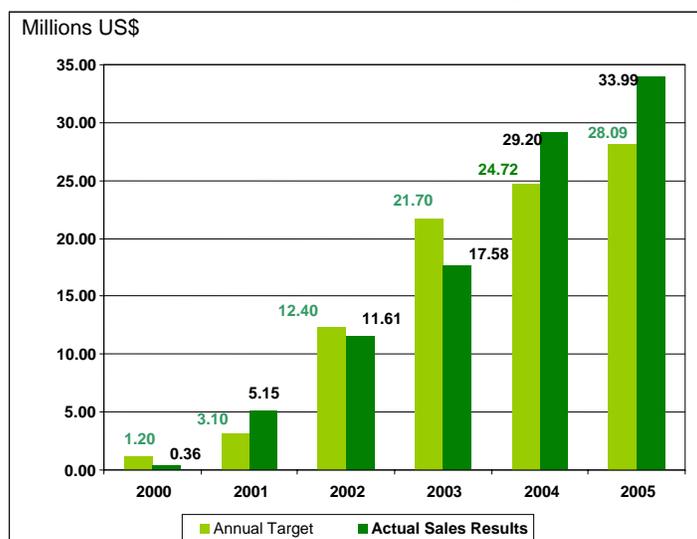
The ESCs that made the greatest contribution to FY2005 project sales results were: Jaen, Huancayo, Cusco, Pucallpa, Tarapoto, and Huaylas (closed in December 2004). The combined

sales from these six ESCs account for 74% of PRA’s total FY2005 sales results. The ESCs with the greatest progress toward their annual sales targets were Jaén (152%), PDA Aguaytía sub-ESC (115%), Cusco (108%), Huancayo (108%), Pucallpa (105%), and Ayacucho (103%). The Huancavelica ESC, funded by *Minas Buenaventura*, made notable progress during FY2005, reaching 93% of its annual sales target.

The PDA sub-ESC in Tocache and the PRA ESC in Huánuco made the least progress toward their annual sales targets, with nine percent and forty-one percent, respectively. A variety of factors contributed to these results, including a difficult business environment and unrealistic targets. The Piura ESC opened in April 2005 and achieved \$413,426 in sales, or 54% of its annual target for FY2005, in just six months of operation.

Cumulative sales since PRA’s inception in 1999 reached \$97.9 million during FY2005.

Figure II-3: PRA Annual Sales vs. Targets 2000-2005



A1. Exports. Exports by PRA-supported businesses reached \$12.8 million during FY2005, representing 38% of overall project sales for the period. The ESCs with the greatest percentage of export sales were Huancayo and Cusco. The Huaylas, Puno, and Cajamarca ESCS, which closed between November and December 2004, also contributed significantly to PRA’s exports. The ESCs with the least exports during FY2005 were Huánuco, Tocache, Aguaytía, and Jaén.

The principal export products during the period were trout (18% of total exports), coffee (15%), jewelry (8%), and flowers and plants (6%). The United States was the largest single recipient of PRA-supported exports (43%), followed by France, Spain, Germany, Canada, Norway and the United Kingdom.

Figure II-4: PRA FY2005 Exports (% of Sales)

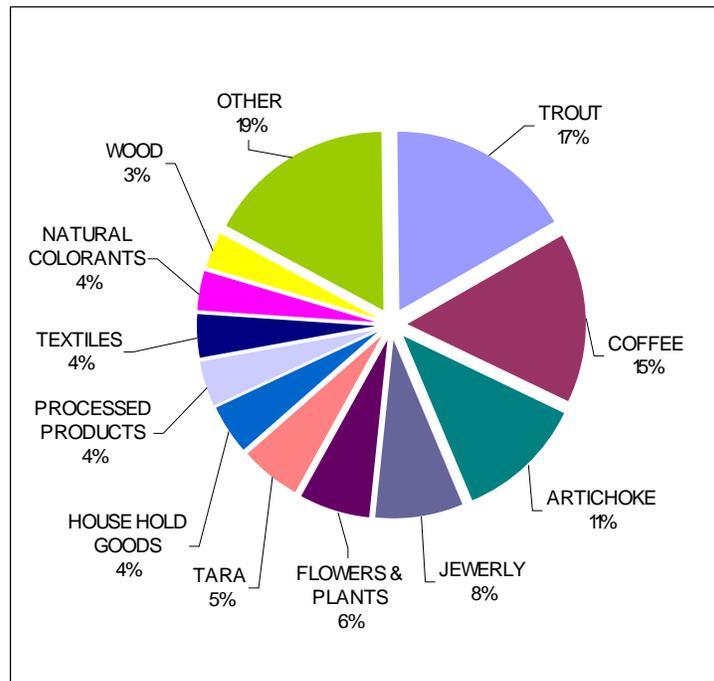
ESC	Total PRA Sales US\$	Value of Exports US\$	% Exports / Total Sales
HUANCAYO	5,803,132	3,849,029	66%
CUSCO	4,516,428	2,604,533	58%
AYACUCHO	1,537,175	743,685	48%
PUCALLPA	3,755,982	426,618	11%
PIURA	413,426	183,044	44%
TARAPOTO	2,144,559	119,116	6%
JAEN	5,900,796	66,110	1%
HUANUCO	737,226	0	0%
VRAE	712,310	406,101	57%
TINGO MARIA	426,494	150,262	35%
AGUAYTIA	1,268,582	25,768	2%
TOCACHE	138,250	6,261	5%
HUAYLAS	3,168,736	1,656,959	52%
CAJAMARCA	1,863,071	1,617,799	87%
PUNO	1,603,835	939,283	59%
TOTAL	33,990,004	12,794,567	38%
HUANCAVELICA	1,075,352	100,798	9%

Figure II-5: Principal Export Markets, FY2005

Country	Amount US\$	% of Total Exports
USA	5,447,179	43%
France	993,435	8%
Spain	911,205	7%
Germany	896,783	7%
Canada	757,275	6%
Norway	670,251	5%
United Kingdom	546,934	4%
Other	2,571,504	20%
Total	12,794,567	100%

Since PRA's inception, 41% of its client businesses have been involved in exporting. During FY2005, 108 of its 219 active clients (49%) exported.

Figure II-6: Principal Export Products, FY2005



PRA ESCs have supported and participated in the formation of the *Planes Estratégicos Regionales de Exportaciones (PERX)*, an initiative of Peru’s Ministry of foreign Trade and Tourism (MINCETUR) supported by USAID, in their respective regions. ESC staff have provided key input, participated in PERX workshops, and in some cases served as members of regional export commissions. In addition, ESC staff in various corridors have organized and participated in events to increase regional export capacity and promote the Peru-U.S. Free Trade Agreement. At USAID’s request, PRA prepared a Trade Capacity Building (TCB) proposal that was accepted by both the Government of Peru and the United States at the Puerto Rico round of the current TLC negotiations (see Annex B).

B. PRA Employment Performance.

During FY2005, PRA-supported businesses generated nearly 2.6 million days of labor, or the equivalent to 12,891 permanent jobs, thereby exceeding the minimum contractual target for employment results with a cumulative total of 45,934 jobs created to date. Nevertheless, PRA’s FY2005 employment results reached only 82% of the project’s internal annual target, which was set aggressively based on an assessment of the potential in each corridor.

The ESCs that made the most progress toward their annual employment targets were Aguaytía (271%), Ayacucho (109%), Cusco (85%), Jaén (71%), Tarapoto (69%), and Pucallpa (65%). The ESCs in Cusco, Aguaytía, Huancayo, Jaén, and Pucallpa generated the most employment during the period, accounting for 62% of PRA’s total FY2005 employment results.

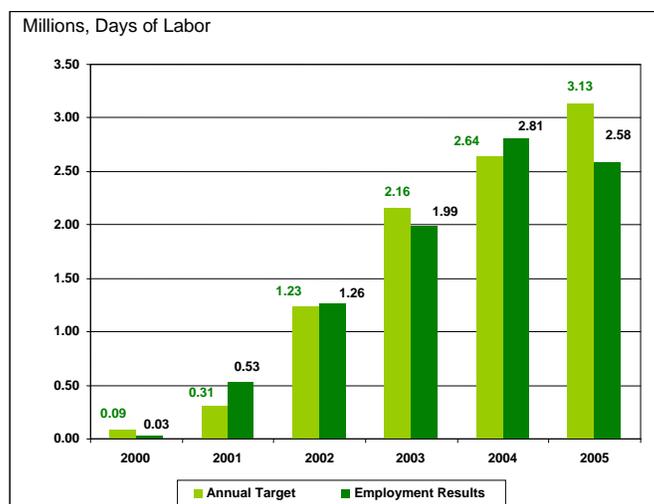
Figure II-7: PRA FY2005 Employment Results

ESC	Days of Labor	Target	% Achieved
AYACUCHO	180,368	165,535	108.96%
CUSCO	394,601	463,498	85.14%
JAEN	306,205	430,391	71.15%
TARAPOTO	228,930	331,070	69.15%
PUCALLPA	260,025	397,284	65.45%
HUANCAYO	311,170	595,926	52.22%
HUANUCO	71,324	198,642	35.91%
PIURA	20,159	85,437	23.60%
PDAP AGUAYTIA	332,081	122,701	270.64%
PDAP VRAE	47,201	103,583	45.57%
PDAP TINGO M	18,102	66,214	27.34%
PDAP TOCACHE	25,256	171,000	14.77%
CAJAMARCA	122,501	-	-
HUAYLAS	141,636	-	-
PUNO	118,590	-	-
Total	2,578,151	3,131,282	82%
HUANCAVELICA	39,903	113,870	35%

The ESCs in Pucallpa, Jaén, and Huancayo achieved the highest growth in employment over the previous year, due to the palm oil business with OLAMSA (Pucallpa), rice with AGROSINOR (Jaén), and artichokes and trout with TALSA, AGROMANTARO, and PISIFACTORIA de los ANDES (Huancayo).

Despite positive employment results for FY2005, PRA fell short of its internal annual target. The closing of ESCs in Cajamarca, Huaylas, and Puno in December 2004 affected PRA's employment results, as did the fact that the new Piura ESC was only in operation for half of the year. Another factor affecting employment results was that client businesses such as PISIFACTORIA de los ANDES that are not highly labor intensive were able to expand their sales during FY2005 with existing capacity, without a corresponding increase in employment.

Figure II-8: PRA Annual Employment Results vs. Targets, 2000-2005



C. PRA Investment Performance.

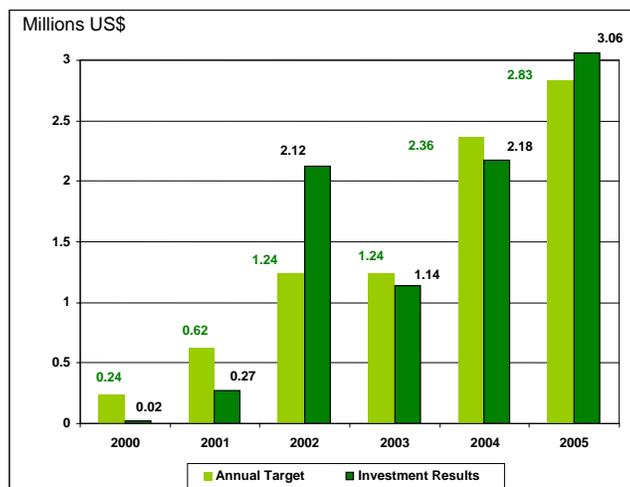
During FY2005, PRA generated \$3.06 million in new fixed asset investments, representing 108% of the project's annual target. The most significant investments were generated in Huancayo and Pucallpa. The Huancayo ESC accounted for 58% of PRA's total investment results for the period, due in large part to investments by TALSA and AGROMANTARO totaling \$1.5 million for new artichoke processing facilities. The Pucallpa ESC also contributed significantly to PRA's investment results, with important investments by palm oil producer OLAMSA and by SEM PERU in processing and drying facilities for hard yellow corn. Also noteworthy was an investment by ROMERO TRADING for coffee processing in Jaén.

Figure II-9: PRA FY2005 Investment Results

ESC	Investment US\$	Target	% Achieved
HUANCAYO	1,765,442	539,024	327.53%
PUCALLPA	533,497	359,349	148.46%
JAEN	469,335	389,295	120.56%
AYACUCHO	128,519	149,729	85.83%
PIURA	20,556	77,279	26.60%
CUSCO	0	419,241	0.00%
HUANUCO	0	179,675	0.00%
TARAPOTO	0	299,458	0.00%
PDAP AGUAYTIA	79,219	110,985	71.38%
PDAP VRAE	17,000	93,692	18.14%
PDAP TINGO M	0	59,892	0.00%
PDAP TOCACHE	0	154,672	0.00%
CAJAMARCA	0	—	—
HUAYLAS	2,599	—	—
PUNO	46,129	—	—
Total	3,062,295	2,832,289	108%
HUANCAVELICA	177,273	100,000	177%

While the Cusco ESC did not report any new investments before the close of FY2005, its client PISIFACTORIA de los ANDES is currently completing an investment of more than \$400,000 and is contemplating the construction of a new processing plant. The remaining ESCs did not report investments of significance during the period.

It is important to note that the investments reported by PRA's ESCs do not give a complete picture of private sector investment in the corridors. PRA reports as attributable results only those new investments in fixed assets, with an expected useful life of at least one year, that are directly induced by the project. This results indicator does not take into account working capital investments or other investments by client businesses that are not directly induced by the project. Thus, the total investments by PRA client businesses in the economic corridors is much greater than the amount reported as results attributable to the project.

Figure II-10: PRA Annual Investment Results vs. Target, 2000-2005

In many ways, PRA is a response to both the real obstacles to investment in Peru's *sierra* and *selva* and the risk aversion of the Peruvian private sector. By working with and accompanying businesses in these areas, PRA has performed well toward its contractual targets, which were intended to establish value chains and provide a critical mass to ensure the sustainability of businesses, jobs, and incomes. The investment target specifically was intended to serve as an indicator of sustainability. PRA has achieved important results, despite the difficult context in which it works. Nonetheless, the level of private investment is very low in the *sierra* and *selva* of Peru, where obstacles to investment, such as the lack of infrastructure and security, are greatest.

We firmly believe that private sector investment is key to ensuring sustainable development in the *sierra* and *selva*. Attracting the necessary private capital to these regions is a challenge that requires greater attention, incentive, and resources (infrastructure, handholding, and risk mitigation) above and beyond the resource availability of PRA, to encourage productive investment in these historically neglected regions of Peru.

D. Principal products and clients. The principal products or businesses supported by PRA in FY2005, according to sales volume, were rice, trout, African palm oil, flowers and plants, coffee, and artichokes.

Rice. The most significant rice sales come from Jaén, and to a lesser extent Tarapoto. The Jaén ESC is working with AGROSINOR and MOLINOS SELVA. The Tarapoto ESC is working mainly with AGRIVOLA EL BIAVO and AGROFORESTAL. PRA's assistance has included improving market penetration (AGROSINOR), promoting productive chains to supply mills located in the producing regions (MOLINOS), and the installation of new areas of rice cultivation (AGRICOLA EL BIAVO).

Figure II-11: Principal Products, by Sales (FY2005)

Product	Net Sales (US\$)	% Total Sales
RICE	6,435,985	19%
TROUT	3,301,397	10%
AFRICAN PALM OIL	2,853,157	8%
FLOWERS AND PLANTS	2,349,696	7%
COFFEE	2,005,631	6%
ARTICHOKES	1,649,829	5%
HOMEGOODS	1,384,302	4%
COTTON	1,369,905	4%
FRUIT	1,350,850	4%
POTATO	1,219,161	4%
JEWELRY	1,022,974	3%
POULTRY	890,489	3%
TARA	717,688	2%
PROCESSED FOOD PRODUCTS	624,496	2%
OTHERS	6,814,444	20%
TOTAL	33,990,004	100%

Trout. The most significant sales come from the Huancayo and Cusco ESCs. The principal client is PISIFACTORIA de los ANDES, which is based in Huancayo but in the last year has begun to invest in Puno on Lake Titicaca, now under the purview of the Cusco ESC. Other firms with important investments in the Puno region are RIVER FISH and the *Asociación de Pequeños Truchicultores de Puno* (APT). Important investments have also been made in Huancavelica by the municipal enterprise PISIGRANJA MUNICIPAL de ACORIA and SUMAC CHALLWA, S.A. in conjunction with PISIFACTORIA de los ANDES.

PRA's assistance has included helping to forge strategic alliances by linking PISIFACTORIA de los ANDES to firms such as CALIFORNIA'S GARDEN in Oxapampa and APT in Puno, both of which supply trout to PISIFACTORIA. PRA has also assisted RIVER FISH and PISIFACTORIA in setting up and securing their investments in Puno.

It is important to note the role that PISIFACTORIA de los ANDES has played in generating new investments and its linkages with small enterprises in Huancayo, Huancavelica, and Puno. This is an excellent example of how a business with a sustained market can generate backward linkages in the value chain in areas of the country where development of this magnitude had previously been impossible.

African palm oil. Nearly all sales come from the Pucallpa ESC and its client business OLAMSA, with which PRA has worked for five years. The PDA sub-ESC in Aguaytía also supports this product through its assistance to the ASOCIACIÓN de PALMICULTORES de SHAMBILLO and through the financing of a seedling and nursery operation, managed by OLAMSA, that will shortly result in the cultivation of an additional 1,000 hectares of African palm plantations.

Flowers and Plants. Eighty-five percent of the flower and plant sales for the period came from graduated clients of the Huaylas ESC which continue to report results as an effect of PRA's earlier intervention. The Huancayo and Huánuco ESCs also contribute to flower and plant sales.

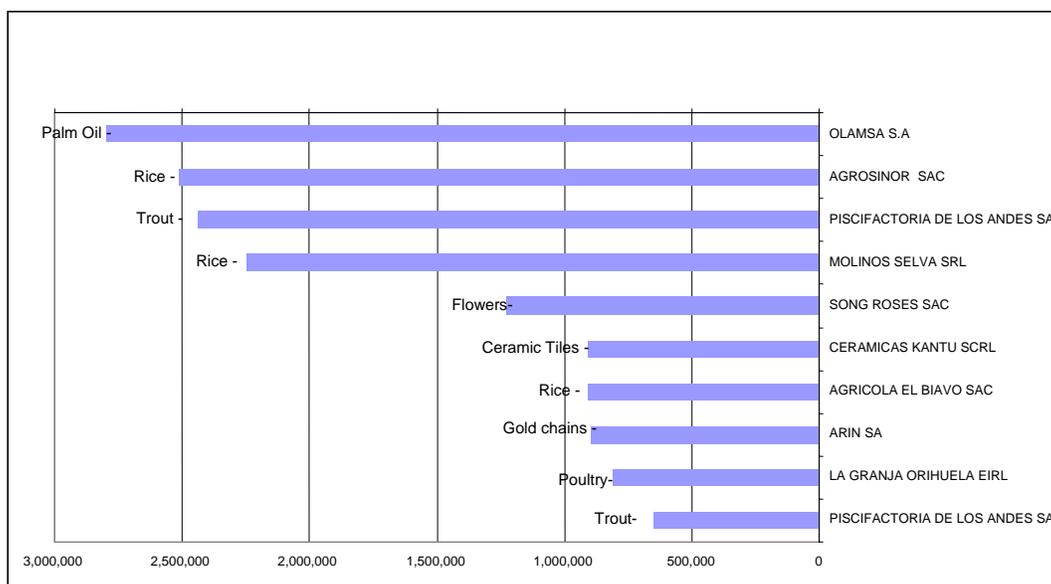
The principal clients in Huaylas are SONGROSES and ZULX INTERNATIONAL. In Huancayo, PRA works with VIVERO LOS INCAS, which is based in *La Merced*. The companies that stand out in Huánuco are BELLA FLOR and RODIL RUIZ.

Developing this kind of business in the *sierra* has been important because it generates greater value and employment than other, more traditional products in these regions. However, expanding this business will require considerable investment, especially for export markets that demand high quality and stable volume.

Coffee. Coffee is one of PRA’s most widely supported product in various corridors. The ESCs with the most coffee sales for the period were Cusco, Puno, and Huancayo. The PDA sub-ESCs in Tingo María, VRAE, and Aguaytía also contributed. Historically, the Jaén ESC has been strong in coffee sales. PRA’s intervention has included assisting businesses in achieving certification for organic and specialty coffee, as well as providing harvest and post-harvest technical assistance to improve the yield suitable for export markets.

Artichokes. PRA supports the artichoke business in several economic corridors. Huaylas and Huancayo have registered the highest artichoke sales, but this product is gaining importance in Huancavelica and Ayaucho as well. An important achievement has been the significant investment (US\$1.5 million) by the companies TALSA and AGROMANTARO for new artichoke processing facilities in the Mantaro valley. This investment will have an important impact and will generate new opportunities for agricultural production in the area.

Figure II-12: Principal PRA-Supported Businesses, by Sales FY2005 (US\$)



During FY2005, a total of 211 client firms reported results, making up PRA’s portfolio of active clients. The clients with the most sales for the period were: OLAMSA (African Palm oil, Pucallpa) with US\$2.8 million; AGROSINOR (rice, Jaén) with US\$2.5 million; PISIFACTORIA

de los ANDES (trout, Huancayo) with US\$2.4 million; MOLINOS SELVA (rice, Jaén) with US\$2.2 million; and SONG ROSES (flowers, Huaylas) with US\$1.2 million.

Two of the top ten selling firms listed in the table above, SONG ROSES (flowers, Huaylas) and ARIN (gold chains, Cajamarca), are clients of ESCs that closed in December 2004. These graduated businesses continue to report results attributable to PRA's earlier intervention, demonstrating both the impact of the project's assistance and the sustainability of the businesses themselves without an ongoing need for further assistance.

E. Micro-enterprises. The participation of micro-enterprises has been very important to PRA's business promotion activities. Of the project's 219 active clients during FY2005, 64 (29%) were micro-enterprises. More importantly, a total of 734 micro-enterprises were linked to PRA client businesses during FY2005 through subcontracting and outsourcing.

Micro-enterprises contributed significantly to PRA's FY2005 results, generating \$5.7 million in sales (17% of total sales) and 2,755 permanent jobs (21% of total employment generated).

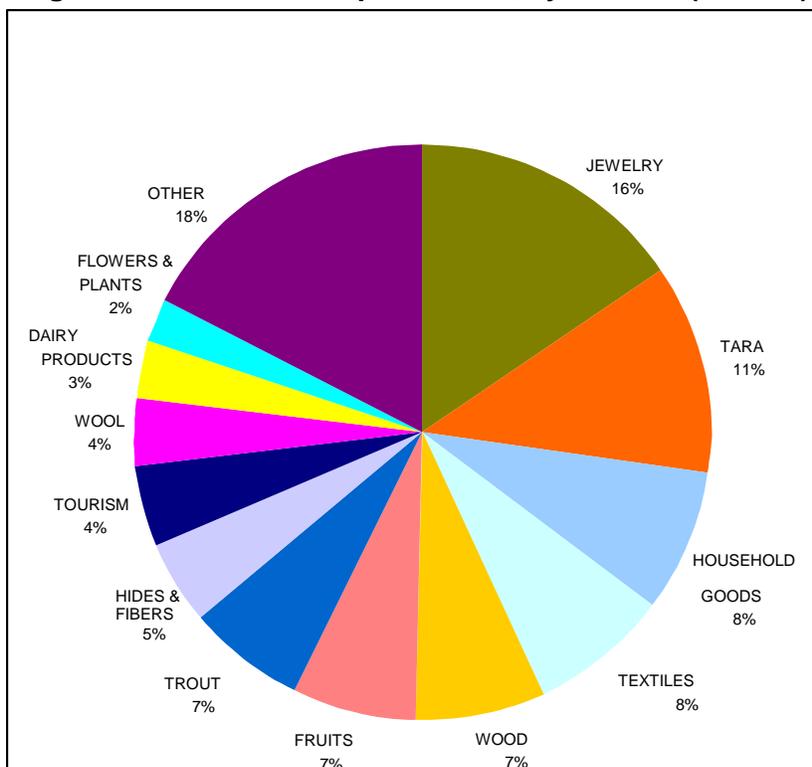
Figure II-13: Participation of Micro-Enterprises in PRA Results, FY2005

ESC	Total PRA Clients	# Micro-enterprises that are PRA Clients	# Micro-enterprises linked to PRA Clients	Sales US\$	Employment (Permanent Jobs)
AYACUCHO	29	16	204	590,163	661
CUSCO	30	5	119	1,146,358	151
HUANCAYO	31	6	148	184,546	436
HUANUCO	5	3	—	158,019	72
JAEN	18	9	6	359,962	107
PIURA	3	—	—	0	0
PUCALLPA	10	3	66	423,541	135
TARAPOTO	9	—	—	0	0
AGUAYTIA	14	7	—	152,891	53
TINGO MARIA	5	1	—	0	0
TOCACHE	5	4	1	133,407	125
VRAE	14	3	—	98,318	90
CAJAMARCA	11	2	32	1,775,470	584
HUAYLAS	17	4	66	43,983	3
PUNO	18	1	92	658,683	339
TOTAL MICRO-ENTERPRISE	219	64	734	5,725,342	2,755
% Micro-Enterprise / Total				17%	21%
TOTAL PRA				33,990,004	12,891
HUANCAVELICA	21	7	39	191,299	45

The participation of micro-enterprises has traditionally been greatest in the production of gold chains and *tara*, businesses that were supported by the Cajamarca ESC which closed at the end

of 2004. Micro-enterprises also play a large role in household goods and handicrafts, especially in Ayacucho, Cusco, and Puno.

Figure II-14: Micro-Enterprise Sales, by Product (FY2005)



The relationship between micro-enterprises and larger businesses is symbiotic. The involvement of micro-enterprises allows larger companies to respond more quickly and efficiently to the market with the required quality and volume. Relationships with larger businesses offer micro-enterprises greater economies of scale and access to larger, more sustainable markets.

F. Small Producers. PRA-supported businesses are linked to a large number of small producers that supply primary and intermediary products to larger companies. During the FY2005, more than 41,705 small producers were linked to PRA client businesses in this way. Seventy-seven percent of those small producers are from the agricultural sector, which reflects the predominance of agro- and agroindustrial businesses in the *sierra* and *selva* of Peru. Other important sectors for small producers are livestock, handicrafts, jewelry and tourism.

It is important to note that the small producers linked to PRA client businesses are from rural areas in the *sierra* and *selva* of Peru where poverty rates are extremely high. The development of businesses in those areas provides a direct improvement in their income and quality of life.

Figure II-15: Small Producers Benefited by PRA, FY2005

Small Producers	Nº Beneficiaries	%
AGRICULTURE	31,998	76.7%
LIVESTOCK	3,700	8.9%
GATHERERS	2,142	5.1%
ARTISANS	1,563	3.7%
TOURISM & OTHER SERVICES	1,481	3.6%
TROUT	565	1.4%
MINING	150	0.4%
WOOD	66	0.2%
AQUICULTURE	40	0.1%
TOTAL	41,705	100%

G. Gender. Eleven percent of PRA's active clients during FY2005 were led by women. Of the 734 micro-enterprises linked to PRA client businesses during the period, 329 (45%) were women-led.

Figure II-16: Participation of Women in PRA-Supported Businesses, FY2005

ESC	Total PRA Clients	No. Women-led	Micro-Enterprises linked to PRA Clients	No. Women-led
AGUAYTIA	14	1	-	-
AYACUCHO	29	3	204	17
CAJAMARCA	11	1	32	11
CUSCO	30	3	119	9
HUANCAYO	31	3	148	146
HUANUCO	5	1	-	-
HUAYLAS	17	1	66	42
JAEN	18	3	6	0
PIURA	3	-	-	-
PUCALLPA	10	2	66	40
PUNO	18	1	92	64
TARAPOTO	9	-	-	-
TINGO MARIA	5	1	-	-
TOCACHE	5	-	1	-
VRAE	14	5	-	-
TOTAL	219	25	734	329
%	100%	11%	100%	45%

During FY2005, PRA-supported businesses generated 12,891 permanent jobs. Of those, 4,622 jobs (36%) went to women. The ESCs with the greatest employment generation for women were Huancayo, Aguaytía, Cajamarca, and Ayacucho.

Figure II-17: Permanent Jobs Created by PRA, by Gender (FY2005)

ESC	Women	Men	Total
CUSCO	898	1,075	1,973
HUANCAYO	563	993	1,556
AGUAYTIA	493	1,168	1,660
CAJAMARCA	466	146	613
AYACUCHO	424	478	902
PUNO	399	194	593
JAEN	307	1,224	1,531
HUAYLAS	283	425	708
TARAPOTO	261	884	1,145
PUCALLPA	201	1,099	1,300
HUANUCO	172	184	357
VRAE	44	192	236
PIURA	42	59	101
TOCACHE	36	91	126
TINGO MARIA	33	58	91
TOTAL	4,622	8,269	12,891

The businesses that generated the greatest amount of employment for women during the period were cotton, textiles, natural colorants (*bixina*), household goods, and flowers and plants.

Figure II-18: Permanent Jobs by Gender and Product, FY2005

Product	Women	Men	Total
COTTON	567	1,384	1,952
TEXTILES	478	74	552
NATURAL COLORANT	436	294	730
HOUSEHOLD GOODS	419	519	938
FLOWERS & PLANTS	402	697	1,098
COFFEE	376	874	1,250
JEWELRY	343	18	361
RICE	310	1,596	1,906
POTATO	244	254	498
FRUITS	190	387	576
OTHER	857	2,171	3,028
TOTAL	4,622	8,269	12,891

H. PRA and the Forest Sector. The difference between Peru and its neighbor Bolivia with respect to forest sector development is that Bolivia has approximately 2.0 million hectares of forests under certified sustainable management and exploitation. Peru has none. Exploitation of the forest sector, until recently, has been completely informal with no properly established forest concessions. Over the past two years the Government of Peru (GOP) has consciously begun to articulate a policy to stimulate sustainable, certifiable forest concession development and long term management. In support of this emerging policy the PRA project has focused its forestry

efforts in the Pucallpa economic corridor, where social and political conditions are appropriate for attracting private sector business and investment interest in the forest sector. PRA is presently working with several enterprises to attain international certification for several forest concessions.

PRA Pucallpa ESC sales from forest sector products ranks second in importance behind sales of African Palm Oil by OLAMSA. In FY2005 two forestry products companies generated US\$477,871 in sales and created the fulltime equivalent of 127 jobs.

One of the major bottlenecks faced by these prospective forest concessionaires is the absence of concrete experience in completing each of the steps required to secure internationally recognized sustainable forest management certification. To overcome this bottleneck PRA has provided specialized support drawing from consultants associated with the USAID financed BOLFOR project in Bolivia, particularly William Cordero, who has divided his time in Peru between the PDA Project and PRA over past few years. With this support the first 22,000 hectares of managed forest by a private company, MAPESAC, in collaboration with Fondobosque, is expected to be certified in early 2006.

PRA also structured this year an agreement between Sinchi Roca, a native community with communal forest lands and NCS American Forestal, a wood processing firm, for the long term sustainable management of the forest under Sinchi Roca control. As part of this process a custodial system for documenting and controlling each step of the extraction process, from the forest to final consumer, was developed. In addition, the Pucallpa ESC assisted NSC American Forestal locate new buyers as well as introduce new technology in the form of portable sawmills appropriate for sustainable extraction in the Sinchi Roca concession area.

As noted above, PRA ESC Pucallpa made major progress this year with Maderas Peruanas (MAPESAC), a wood processing firm, particularly with respect to forest management (i.e., preparation of a forest inventory and census, a forest concession management plan as well as MAPESAC's first annual operational plan). This work, coupled with the preparation of a custodial system to document and control timber extraction and processing will shortly enable MAPESAC to become the first Peruvian firm to be internationally certified by SKAL (Holland).

PRA Pucallpa has worked with Alpi Rosa SAC since 2003 and has helped move Alpi Rosa closer to international forest certification. This year PRA technical assistance helped Alpi improve its management of the 42,000 hectares of forest under its control which included the preparation of a forest inventory and census, a forest management plan, and Alpi's first annual operating plan. This work will enable Alpi in 2006 to ensure that its timber extraction and processing practices are sustainable. With PRA support Alpi is working with SKAL to secure international certification which we expect to be concluded and approved during 2006.

With MAIL SAC, a Peruvian wood processing firm, PRA Pucallpa initiated work in 2005 to improve mill operations and efficiency and initiated the work required for MAIL to secure international certification of the 45,000 hectare concession under its management similar to the certification processes already undertaken by MAPESAC and ALPI ROSA.

Working closely with the PDA Project, the World Wildlife Fund (WWF) and the NGO AIDER, PRA has launched a major initiative to improve forest management practices and secure international certification for forest concessions controlled by five indigenous Shipiba communities (Calleria, Preferida, Puerto Belen, Pueblo Nuevo and Curiaca). These indigenous communities control some 35,000 hectares of forest land. GSA Terra Sistem (Germany), with financing provided by WWF, is the responsible international certifying agency.

In general this work leading to international certification for sustainable forest management practices, for both timber processing firms and indigenous communities, will continue to both deepen and expand during 2006. PRA Pucallpa will continue its work with the PDA Project, PRA enterprise clients and indigenous communities to bring more and more hectares under internationally recognized sustainable forest management practices in Ucayali Department.

I. Results and Perspectives from PRA's Economic Service Centers (ESCs)

II. Ayacucho. During FY2005, the Ayacucho ESC exceeded its targets for sales and job creation with sales of \$1.54 million and the creation of 902 permanent jobs. The ESC reached 85.5% of its annual investment targets, with new investments of \$128,500 to develop snow peas (*holantao*) and essential oils.

Figure II-19: Ayacucho ESC FY2005 Results

ESC	Net Sales (US\$)	Net Employment	Investments (US\$)
AYACUCHO	1,537,175	902	128,519

The Ayacucho ESC's portfolio during FY2005 included 27 clients, four of which represent approximately 55 percent of the ESC's sales (the *Consorcio Papa Buena*, the *Asociación de Productores de Holantao y Afines* (ASPRHOA), *Intipa Flowers* and *Julian Curo Bendezu*, which produce and commercialize potatoes, snow peas (*holantao*), and avocado. Household goods are the ESC's third highest selling product, after potatoes and snow peas.

Sales. The Ayacucho ESC was able to exceed its FY2005 sales targets with US\$1.54 million in sales, in large part due to the consolidation of artisan businesses such as *Raymisa*, *Lesley Exports*, *Allpa* and *Berrocal*, as well as the importance of *Intipa Flowers* in the development of snow peas in the region.

Employment. The ESC exceeded its FY2005 employment target by 8.9 percent, with 902 jobs created.

Investment. The ESC reached 85.5 percent of its FY2005 investment target, with investments totaling US\$128,500 by *Intipa Flowers* and ASPRHOA for the production of snow peas.

Exports. Exports account for 48 percent of the ESC's sales for the period, representing a significant increase over last year. This increase is primarily attributed to *Intipa Flowers* and ASPRHOA. Because these businesses are highly labor intensive, they represent 71.16 percent of the wages generated in the corridor. Additionally, all of the PRA-induced investments in the corridor for FY2005 were made by clients who produce for export. The top exporters are snow pea (*holantao*) businesses such as *Intipa Flowers* and ASPRHOA, and producers of household

goods such as *Raymisa* and *Lesley Exports*. These clients account for 92 percent of the \$743,685 in exports from the corridor.

I2. Cusco. The Cusco ESC has been the second leading ESC both in terms of performance (results vs. targets) and in volume of sales.

Sales. The ESC's FY2005 sales reached \$4.5 million, exceeding its annual target by 8.6%. This sales figure represents an increase of 47% above last year's results.

Figure II-20: Cusco ESC FY2005 Results

ESC	Net Sales (US\$)	Net Employment	Investments (US\$)
CUSCO	4,516,428	1,973	0

The ESC's FY2005 results reflect a diverse portfolio comprised of approximately 30 businesses, 12 of which were incorporated during the last year. Five businesses (*Cerámicas Kantu*, *Piscifactoria de los Andes*, AICACOLOR and CECOVASA) represent 60 percent of the ESC's annual sales.

Employment. PRA-supported businesses in the corridor generated 1,973 jobs in FY2005, reaching 85 percent of the ESC's annual target. The *bixina* natural colorant business with AICACOLOR has been the main contributor to employment results with 730 jobs created. Additional support to this client to identify and develop new products could result in significant employment generation in the corridor.

Investment. Although the ESC reported no investments of significance for the period, there is a good deal of investment underway that was not completed by the end of FY2005. *Piscifactoria de los Andes* is in the process of installing four modern cage modules (with eight cages per module), an infrastructure investment valued at US\$349,5000, with the help of PRA. In addition, the company plans to invest US\$87,000 in machinery and is currently evaluating a possible investment to build a new processing plant.

Exports. 57.6 percent of the ESC's total FY2005 sales correspond to exports, mainly of coffee, natural colorants, trout, wool and household goods. This represents an important increase in exports, and is largely due to the addition of *Piscifactoria de los Andes* and CECOVASA to the ESC's portfolio, as well as an increase in AICACOLOR's sales. As in the case of Ayacucho, the businesses that produce for export are highly labor intensive, and represent 85 percent of ESC's employment results.

I3. Huancayo. The Huancayo ESC had the third highest sales in FY2005, with sales of US\$5.8 million, and exceeded its target by eight percent. Even more impressive, however, are the ESC's FY2005 investment results, which reached 327 percent of the annual target. The Huancayo ESC and the Cusco ESC, have the highest percentages of sales destined for exports.

Figure II-21: Huancayo ESC FY2005 Results

ESC	Net Sales (US\$)	Net Employment	Investments (US\$)
HUANCAYO	5,803,132	1,556	1,765,442

Sales. Clients *Piscifactoria de los Andes*, *Granja Orihuela*, *TALSA* and *Vivero Los Inkas*, which produce trout, chicken, flowers and artichokes, respectively, accounted for 68 percent of the ESC's FY2005 sales. The Huancayo ESC expects these products to remain the dominant businesses in the corridor, however, recent investments and expansion plans by *TALSA* and *Agromantaro* lead us to believe that the artichoke business will gain importance in the upcoming year. We also anticipate a recovery of the coffee business in the area of La Merced.

The last quarter of FY2005 saw a significant increase in sales with respect to the same quarter in FY2004. This increase is largely due to sales of *Piscifactoria de los Andes*, the artichoke sales of *Grupo Huancayo*. and the sales of the *Cooperativa Agraria Cafetalera Satipo*.

Employment. The businesses supported by the ESC generated 1,556 new jobs in the corridor, or 52 percent of the annual target. One explanation is that one of our principal clients in the corridor, *Piscifactoria de los Andes*, does not generate the same amount of labor as other businesses, such as coffee, textiles, flowers, and artichokes. An expected increase in coffee, textiles, and artichoke sales in the upcoming year should increase job creation.

Investment. As mentioned above, the ESC reached 327 percent of its annual investment target. Clients *Agromantaro* and *TALSA* invested a combined total of US\$2.5 million for the construction of two artichoke processing plants. In addition, investments by *Piscifactoria de los Andes*, *Granja Orihuela* and *Carsant* in the trout, chicken and tailoring sectors respectively, were also significant.

Exports. Exports make up 66 percent of the Huancayo ESC's FY2005 sales, higher than any other ESC. This strong export focus reflects the nature of the ESC's principal businesses, essentially *Piscifactoria de los Andes*, *Agromantaro*, *TALSA*, and the coffee business in La Merced. These exporting businesses represent 80 percent of the ESC's FY2005 employment results.

14. Huánuco. *Sales.* The Huánuco ESC generated US\$737,000 in sales in FY2005 through its support to businesses such as potatoes (*papa capiro*), flowers (*hortensias*), and fruits (*granadilla*). These results represent only 41.37 percent of the annual target. This shortfall is explained by lower than expected growth in the potato business with Frito Lay as well as lower than expected results in hard yellow corn in the region. Another contributing factor was the difficulty in identifying businesses and/or investors to inject dynamism into certain businesses in the area of Tingo María, such as fruits and coffee. In the upcoming year, the presence of two important canned artichoke exporters, *Agromantaro* and *TALSA*, in the region should allow the ESC to meet or exceed its targets for FY2006. Both have been working successfully in the Huancayo Economic Corridor and have extended their operations to Huánuco this year. Between both businesses, 500 hectares of artichokes are expected to be completed in the upcoming year, which would not only allow the Huánuco ESC to reach its targets for sales and jobs, but possibly for investment as well.

Figure II-22: Huanuco ESC FY2005 Results

ESC	Net Sales (US\$)	Net Employment	Investments (US\$)
HUANUCO	737.226	357	0

Employment. The performance for job creation is similar to Huanuco's performance in sales. Only 357 jobs have been created out of the 993 that had been projected for this year. This represents 37% of the goal. As was mentioned in the case of sales, we expect to reverse this situation next year with the ongoing artichoke businesses led by TALSA and Agromantaro.

Exports. The PRA-supported businesses in the corridor produce mainly for the national market (with the exception of some hortensia exports). PRA expects Huánuco's exports to increase next year with the incorporation of TALSA and Agromantaro, two producers of export quality artichokes, in the ESC's business portfolio.

I5. Pucallpa. *Sales.* The Pucallpa ESC continues to surpass its annual targets. The ESC exceeded its FY2005 sales target by five percent with US\$3.76 million in sales.

Figure II-23: Pucallpa ESC FY2005 Results

ESC	Net Sales (US\$)	Net Employment	Investments (US\$)
PUCALLPA	3.755.982	1,300	533.497

Within a relatively small portfolio of 10 businesses, the most important clients in FY2005 were OLAMSA (*palma aceitera*), SEM PERU (hard yellow corn), and NCS American Forestal. The ESC's forestry-related clients make up the single most important sector in the corridor. In the upcoming year, the ESC will look to incorporate new clients, further consolidate the hard yellow corn business, and expand sales of our clients in the forestry sector.

Employment. The businesses supported by the Pucallpa ESC generated 1,300 new jobs (969 of which were created by OLAMSA) during this period, representing 65 percent of the annual employment target. With the growth of OLAMSA and the wood businesses, the ESC expects to reach its employment goals for the upcoming year.

Investment. The Pucallpa ESC met its investment target with the significant investment in palm oil (OLAMSA) and hard yellow corn (SEM PERU).

I6. Tarapoto. *Sales.* The Tarapoto ESC reached 72 percent of its FY2005 sales target with US\$2.1 in sales. Three businesses account for 85 percent of the sales results: *Agrícola El Biavo* (rice), ALSELVA (cotton) and *Agroforestal* (rice). The presence and success of *Agrícola El Biavo* has energized the entire industry in the corridor, increasing the number of hectares under production as well as the quantity and quality of milling and processing facilities. Many hectares of agricultural farmland that had been abandoned due to the absence of buyers is now under production once again. Similarly, milling facilities that were abandoned or under-utilized have been re-activated. With this re-activation of the region's milling capacity, producers expect to be able to sell at a higher, pre-determined price. Growth in this business, as well as the cotton business with ALSELVA, should permit the ESC to meet or exceed its targets for next year.

Figure II-24: Tarapoto ESC FY2005 Results

ESC	Net Sales (US\$)	Net Employment	Investments (US\$)
TARAPOTO	2,144,559	1,145	0

The ESC added six new businesses to its portfolio in FY2005, mainly related to rice and cotton. Of these, the most important is expected to be *Romero Trading*.

Employment. The ESC attained 69 percent of its FY2005 employment target with 1,145 jobs generated in FY2005. Clients *Agrícola El Biavo*, ALSELVA and *Agroforestal* account for 92 percent of the ESC's FY2005 employment results.

Exports. The businesses supported by the Tarapoto ESC are almost entirely focused on the national market. Exports of cotton and *almizcle* accounted for six percent of the ESC's sales.

17. Huancavelica. The Huancavelica ESC is financed by the company *Minas Buenaventura* through a GDA arrangement with USAID and receives technical assistance and support from the PRA Project. FY2005 saw strong sales and investment results for the ESC.

Sales. The Huancavelica ESC's FY2005 sales reached US\$1.1 million, representing 93 percent of its annual sales target and a 146 percent increase over FY2004.

Figure II-25: Huancavelica ESC FY2005 Results

ESC	Net Sales (US\$)	Net Employment	Investments (US\$)
HUANCABELICA	1,075,352	200	177.273

Four of the ESC's 21 active clients account for 71 percent of its FY2005 sales results. They are: *Asociación de Promotores Alpaqueros de Huancavelica* (alpaca fibers); *Federación de Asociaciones de Productores Agropecuarios Acobamba* (legumes); *Comité de Criadores de Camelidos Silvestres de Huancavelica* (vicuña); and *Agricultores Huancavelica* (artichokes). These four products yielded the greatest results for the ESC in FY2005.

Employment. Businesses supported by the Huancavelica ESC generated 200 new jobs in FY2005, representing 35 percent of the annual employment target.

Investment. The Huancavelica ESC generated US\$177,273 in investment in FY2005, greater than any other ESC with the exception of Huancayo and Jaén. The municipal enterprise *Piscigranja Municipal de Acoria* and the company SUMAC CHALLHUA made significant investments in trout production, which should result in increased sales in the upcoming years. The *Federación de Asociaciones de Productores Agropecuarios Acobamba*, which produces and markets legumes – the ESC's second most important business – also made a significant investment during the period.

Exports. Huancavelica's principal businesses, fibers and legumes, are mainly for the national market. Exports account for only 9.37 percent of the ESC's FY2005 sales.

18. Peru-Ecuador Border Program. At the request of USAID, PRA opened a new ESC in the northern department of Piura in early 2005. The ESCs in Piura-Túmbes and Jaén are financed by USAID's Peru-Ecuador Border Program and are tasked with promoting business development in their corridors generally, and in border districts specifically, as well as promoting joint ventures between Peruvian and Ecuadorian firms.

- **Jaén ESC. Sales.** The Jaén ESC exceeded its annual sales target by 53 percent with US\$ 5.9 million in sales in FY2005. The two most important clients for FY2005 were *Agrosinor* and *Molinos Selva*, which are both dedicated to the commercialization of rice, despite a significant drop in prices for this product. Other important clients are CAOCA (*yacón*), and Cerro Azul de Bagua Grande (fruits). This year, the ESC has added five new businesses, of which the most promising are noni, pitahaya and coffee processing.

Figure II-26: Jaen ESC FY2005 Results

ESC	Net Sales (US\$)	Net Employment	Investments (US\$)
JAEN	5,900,796	1,531	469,335

Employment. The ESC reached 71 percent of its annual employment target with 1,531 jobs created. The ESC's principal rice businesses, *Agrosinor* and *Molinos Selva*, account for 82 percent of these employment results.

Exports. Given the importance of the rice business, most of the ESC's FY2005 sales were oriented to the national market. In previous years, the ESC's exports were greater due to the coffee business.

Investments. The ESC exceeded its FY2005 investment target by 20 percent due to the investment of US\$469,000 by Rain Forest Trading for a coffee drying facility.

- **Piura-Túmbes ESC. Sales.** In only six months of operation, the businesses supported by the Piura-Tumbes ESC generated US\$413,426 in sales from April – September 2005. In FY2005, the ESC had three principal clients: *Dina Ruidias Valladolid* (limes), *Procesadora SAC* (legumes), and *Corporación Refrigerados Iny* (shrimp). With the growth of these businesses, as well as expected in growth in new businesses such as organic mango and *caupí* beans, the ESC expects to meet its sales targets for FY2006.

Figure II-27: Piura ESC FY2005 Results

ESC	Net Sales (US\$)	Net Employment	Investments (US\$)
PIURA	413,426	101	20,556

Employment. The ESC generated 101 new jobs in FY2005, primarily in the lime business. This represents 24 percent of the ESC's FY2005 employment target, in just six months of operation.

Investment. Client *Procesadora SAC* invested US\$20,556 in a milling and processing facility, representing 26 percent of the ESC's FY2005 investment target.

Exports. Exports of legumes and shrimp account for 44.27 percent of the ESC's FY2005 sales.

Businesses related to Ecuador. The Piura ESC staff traveled to Guayaquil, Ecuador during the last quarter of FY2005 with the objective of attracting businesses to invest and develop joint ventures or strategic alliances with businesses from the Piura-Tumbes ESC. They conducted interviews with the follow companies:

Procesadora Mejía C &A, the second largest exporter of green packed and frozen legumes, primarily exported to United States.

CEPROMAR- Corporación Exportadora de Productos del Mar S.A. which produces and exports seafood to the United States, European Union, and Asia.

ECUAFRUTAS S.A., which is interested in buying fresh limes to export to Colombia. *ECUAFRUTAS* is also a provider of certified pineapple, banana and plantain seeds, which our client CAMPOSUR/DOLE needs to plant 75 hectares of organic bananas for Dole.

Results of the trip:

The firm *Procesadora Mejía C&A* will install a processing plant in Sullana (It has already bought a 10,000 m² plot of land), for which it requires 400 hectares of *frijol de palo*. The ESC is committed to organizing this supply in Cieneguillo, and it will provide technical assistance to initiate the production of the 400 hectares in the first semester of FY2006.

CEPROMAR was interested in the ESC's offer to complete the business plan for the spice *perico congelado*, which will be processed in Paita in a joint venture with our potential client *Mar Azul EIRL* from Piura. To follow up on this plan, the two businesses will meet in the Piura ESC in the first semester of FY2006. The ESC will arrange the contact with the processing company that will build the processing plant.

CEPROMAR is also interested in businesses in exploring new fish species. They bring to the table a selective-capture technology that they have developed and used for many years.

ECUAFRUTAS will provide certified, virus-free seeds for the production of 50 hectares of plantains and 50 hectares of bananas for our pre-client Camposur/Dole. The need for certified, virus-free seed was a bottleneck identified by the Piura ESC. The ESC will provide initial technical assistance for planting and crop management.

SECTION III

PRA Activities and Results in Alternative Development Areas

A. Background of PRA's Role

The PRA Project commenced in 1999 as a USAID/Peru economic growth initiative to generate sustainable employment and increased income in ten (10) economic corridors in the *sierra* and *selva* of Peru east of the Andes. In 2003 USAID/Peru launched an integrated development program in the coca-producing regions of the country designed to back licit economic activity and eradicate the illegal production of coca. The implementation of the voluntary eradication strategy, including responsibility for the development of “framework agreements” with signatory communities, was the responsibility of the Alternative Development Program (PDA), in direct coordination with DEVIDA. The PRA Project was charged by USAID to work closely with the PDA program in the seven principal Alternative Development (AD) Departments and was responsible for promoting the development of licit businesses activities where families in the signatory communities could turn to for support and integrate into their livelihoods, thus making voluntary eradication more sustainable.

To this end in May 2003 PRA established sub-economic service centers (Sub-ESCs) in each of the coca-growing valleys, Aguaytía, Tocache, Tingo María and the VRAE. From 2003 through June 2004, these Sub-ESCs were directly financed and managed by the PRA Project with operations closely coordinated with the PDA. During this period, the PRA Sub-ESCs advised on the process of signing the agreements through identifying market opportunities. The PRA Sub-ESCs attracted entrepreneurs and buyers to these areas and organized supply.

For cost reasons in July 2004 all PRA sub-ESC staff functions were transferred to the PDA Program, with the PRA Lima Office providing support in terms of market contacts, tools, and methodology. This support enabled PDA Sub-ESCs to meet their targets, which were similar to those of the PRA ESCs in terms of generating incremental sales, employment, and investment. Additionally, the newly branded PDA Sub-ESCs were charged with advancing and supervising the production component of PDA Program as defined in each of the framework agreements with the signatory communities. The two projects formally agreed that PRA would supervise the PDA-ESCs in a manner similar to that of PRA ESCs under a decentralized management structure and through evaluation of the ESCs based on the generation of incremental sales, employment and investment.

During FY2005 the PRA Project carried out four central activities to support the sustainability of the USAID/DEVIDA voluntary eradication strategy in the seven priority Alternative Development Departments:

- Identifying and bringing buyers to alternative development areas;
- Testing and transferring technology packages from neighboring areas to alternative development areas;
- Promoting businesses which purchased products not only from alternative development areas but from the broader economy aimed at achieving critical mass and economies of scale which are essential for enterprise sustainability;
- Establishing businesses in areas outside alternative development areas that serve as collection and processing centers for products originating in the priority Alternative Development (AD) districts.

B. The Organization of PRA and the PDA for Business Development in Alternative Development Areas

Promoting business development and attracting the private sector are activities that both PRA and PDA have assumed jointly with roles established during FY2005 as follows:

- PRA, through its experience and contact with the Peruvian private sector, has two central roles:
 - Establish contact and call on private entrepreneurs to establish or conduct business in alternative development areas;
 - Identify specific private sector product demand and channel this information to PDA for organization and development of required supply.
- PDA, through the four PDA Sub-ESCs in the four valleys, works in the development and organization of supply and elimination of bottlenecks that impede or constrain production in accordance with private sector quantity, quality and timing requirements.

PRA and PDA agreed to meet the requisite challenges of business demand and supply requirements and have respectively organized internally to this end.

C. PRA FY2005 Results in Priority AD Districts¹

During FY2005, USAID and the PDA project re-defined the priority AD Districts in accordance with the level of acceptance by communities of voluntary coca eradication. The number of districts initially assigned for PRA and PDA intervention was reduced from 53 to 30 priority AD districts. This section of the report focuses on PRA and PDA FY2005 results in these 30 priority AD districts.

Figure III-1: FY2005 Results in 30 Priority AD Districts (US \$)

Department	Boundary Line	Priority AD districts		TOTAL
		Sub-CSE PDA	CSE PRA	AD DISTRICTS
AYACUCHO	VRAE	412,948	6,408	419,356
CUSCO	VRAE	103,360		103,360
HUANUCO	AGUAYTIA	174,990		174,990
	ALTO HUALLAGA	358,402		358,402
	HUALLAGA CENTRAL			
JUNIN	VRAE	118,756	311,685	430,442
PASCO	ALTO HUALLAGA			
SAN MARTIN	AGUAYTIA			
	HUALLAGA CENTRAL	118,140	135,879	254,019
UCAYALI	AGUAYTIA	1,114,611	461,304	1,575,915
	VRAE			
Total Departments AD		2,401,208	915,277	3,316,484

¹ In FY2005 the number of priority AD districts, as defined by USAID/Peru, was reduced from 53 to 30.

The total amount of new sales generated in the priority AD districts in FY2005 was US\$3.3 million, nearly 80 percent of PRA’s internally established annual target for these areas. Approximately 73 percent of this total (US\$2.4 million) was generated by the PDA sub-ESCs in Aguaytía, VRAE, Tingo María, and Tocache. The remainder was generated by the PRA ESCs in Pucallpa, Ayacucho, and Tarapoto. In many cases, PRA client businesses located in non-AD districts are linked to and buy from producers located within the priority AD districts. This is the case with OLAMSA (palm oil) in Pucallpa-Aguaytía and Romero Trading (cotton) in Tarapoto-Juanjuí.

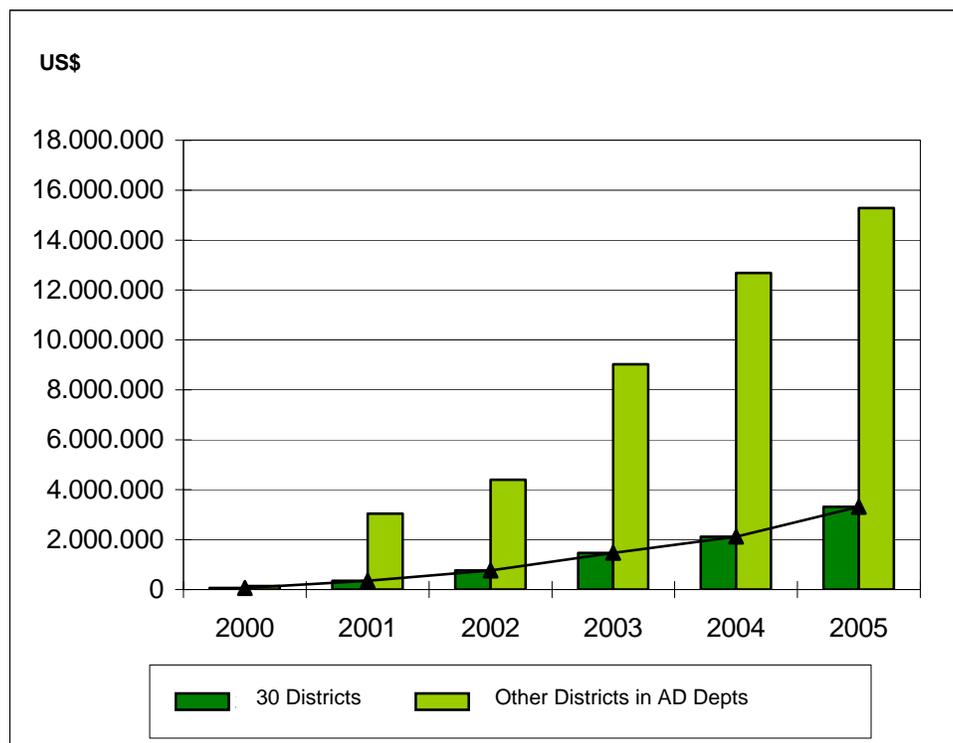
During 2005, twenty-seven percent of sales results in the 30 priority AD districts were attributable to PRA ESCs, which are adjacent to the PDA Sub-ESCs. Many PRA processing or distribution business clients are outside the AD focused areas but buy from producers in the priority AD districts. This is the case of OLAMSA, Romero Trading, and ALSELVA, among others.

The growth rate of sales in the priority AD districts stands out in relation to other project areas. Combined PRA and PDA sales in the 30 priority AD districts were US\$2.1 million in FY2004, while in FY2005 they reached US\$3.3 million, an expansion rate of 57 percent. In the remainder of the districts that comprise the seven AD departments, the sales growth rate was only 20 percent, and the rate in regions that are not part of the seven Alternative Development departments (Cajamarca, Puno, Huaylas, Jaen, and Piura) experienced a sales growth rate of only seven percent.

PRA’s overall sales grew 16 percent from FY2004 to FY2005, while sales in the 30 priority AD districts grew at a rate 3.6 times higher, at 57 percent. Even if the baseline is much smaller, the results show a positive trend over the past year.

The following chart shows how, beginning in 2003, priority AD districts began to gain momentum.

Figure III-2: Evolution of Annual Sales Results in the 30 Priority Districts and the Seven AD Departments



US\$18.6 million in new sales were generated in the seven Alternative Development departments in FY2005, or stated another way, 55 percent of the total annual results of PRA has been AD focused. Nevertheless, PRA annual results include results from graduated, sustainable businesses from the ESCs in Cajamarca, Huaylas and Puno that were closed at the beginning of 2005, but whose results continue to be monitored as agreed with USAID. These three ESCs accounted for US\$6.6 million in sales during FY2005. If these three ESCs are excluded from the total, the seven AD departments represented 68 percent (68%) of PRA project sales results during FY2005. The ESCs in Jaen and Piura, financed by the Peru-Ecuador Border program, represent a significant portion of the difference.

Figure III-3: Sales in AD Departments and Non-AD Departments, FY2005 (US\$)

Sales in US\$ in AD Departments and non AD Departments, FY2005					% Sales in AD Departments/ Total PRA sales
	Department	Priority Districts	Non Priority Districts	Total Department	
AD Departments	JUNIN	430,442	4,716,766	5,147,207	15.14%
	UCAYALI	1,575,915	3,273,869	4,849,785	14.27%
	SAN MARTIN	254,019	2,029,753	2,283,772	6.72%
	CUSCO	103,360	2,092,120	2,195,480	6.46%
	AYACUCHO	419,356	1,593,949	2,013,304	5.92%
	HUANUCO	533,392	784,299	1,317,691	3.88%
	PASCO		788,746	788,746	2.32%
Total in AD Departments		3,316,484	15,279,501	18,595,986	54.71%
Total in non AD Departments		0	15,394,018	15,394,018	45.29%
TOTAL PRA		3,316,484	30,673,519	33,990,004	100.00%

Eighteen percent of total sales in the seven Alternative Development departments, or US\$ 3.3 million, was generated in the 30 priority AD districts, linking 57 businesses to some 7,000 small producers who signed eradication agreements. If the calculations exclude the departments of Junin and Cusco, which have few priority AD districts, and Pasco, where there is no ESC, the weight of the results in the 30 priority AD districts rises to 27 percent of total sales generated by the ESCs of PRA and PDA in the four most important AD departments (Ucayali, Huanuco, San Martin and Ayacucho).

ESCs employment results are generated largely in priority AD districts of Ucayali (56 percent), Huanuco (55 percent) San Martin (17 percent) and Ayacucho (10 percent).

Figure III-4: Employment in AD Departments and Non AD Departments (FY2005)

Jobs in AD Departments and Non AD Departments, FY2005					% Jobs in AD Departments/ Total PRA Jobs
	Department	Priority Districts	Non Priority Districts	Total Department	
AD Departments	UCAYALI	1.451	1.142	2.593	20.1%
	JUNIN	156	1.350	1.505	11.7%
	SAN MARTIN	210	1.062	1.271	9.9%
	CUSCO	20	1.136	1.156	9.0%
	AYACUCHO	110	959	1.069	8.3%
	HUANUCO	450	364	814	6.3%
	PASCO	0	99	99	0.8%
Total in AD Departments		2.397	6.112	8.509	66.0%
Total in Non AD Departments		0	4.382	4.382	34.0%
TOTAL PRA		2.397	10.494	12.891	100.0%

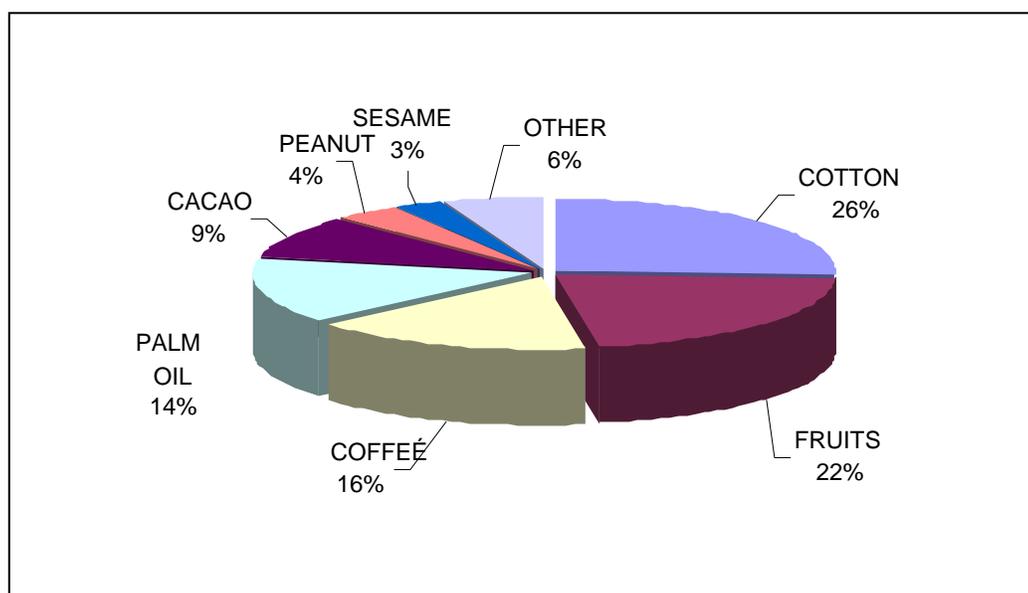
Of the US\$3.1 million in capital investment in FY2005, US\$2.5 million went to the seven Alternative Development departments. Even if the level of capital investment in the 30 priority AD districts was rather small, as shown below, investments in fixed assets in intermediate cities has had widespread impact in the prioritized areas. This is valid even in areas distant from the priority AD districts, for example, the processing plants of TALSA and Agromantaro in Huancayo are interested in acquiring *palmito* and fruits to process during shortages of artichokes in the *sierra*. The same can be said of the processing plants OLAMSA and SEM PERU in Pucallpa which link small producers from the priority AD districts to markets.

Figure III-5: Investments in AD Departments and non AD Departments, FY2005 (\$US)

Investments in AD Departments and non AD Departments October 2004-September 2005 (US\$)					% in AD Departments/ Total PRA Investment
	Department	Priority Districts	Non Priority Districts	Total department	
AD Departments	JUNIN	0	1,748,819	1,748,819	57.11%
	UCAYALI	134,941	463,594	598,536	19.55%
	AYACUCHO	14,705	128,519	143,224	4.68%
	PASCO		16,623	16,623	0.54%
	HUANUCO	14,180	0	14,180	0.46%
	CUSCO	2,295	0	2,295	0.07%
Total in AD Departments		166,122	2,357,556	2,523,677	82.41%
Total in Non AD Departments		0	538,618	538,618	17.59%
TOTAL PRA		166,122	2,896,174	3,062,295	100.00%

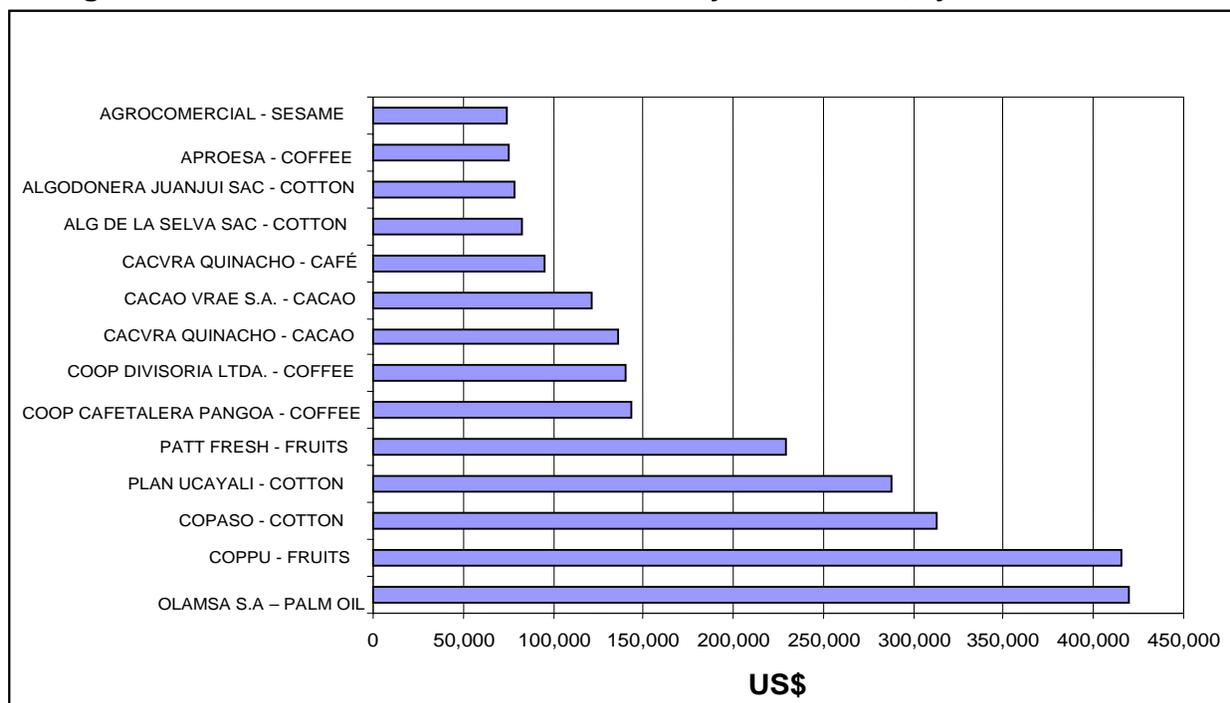
Seven products generated 94 percent of sales in the priority AD districts, notably cotton (26 percent), fruit (22 percent), specialty coffee (16 percent), crude palm oil (14 percent), organic cacao (9 percent), peanuts (4 percent), and sesame (3 percent).

Figure III-6: Main Products from Priority AD Districts (FY 2005)



Some 14 enterprise clients account for almost 80 percent of sales from the priority AD districts centered principally on cotton, palm oil, rice, cacao, coffee, and fruits.

Figure III-7: Main PRA/PDA Clients in 30 Priority AD Districts, by Volume of Sales



D. Description of Main Businesses by Coca Growing Valley

In FY2005, the development of businesses in the PDA areas was managed by the four PDA sub ESCs in Aguaytia, Tingo Maria, Tocache-Juanjui and the VRAE. Business development efforts were oriented toward consolidating productive investments in signatory communities. During this period, work was carried out in 271 communities where private businesses (clients) are actively collecting and purchasing products such as cacao, cotton, coffee, plantain, palm, pineapple, rice, corn, peanuts, and sesame.

The Aguaytia and VRAE sub-ESCs surpassed their annual sales targets due to the greater presence of businesses and availability of supply for the market despite difficult socioeconomic and political environments in both regions. In Tingo Maria, however, businesses are putting down roots more gradually, while in the Tocache area, multiple setbacks, such as the weak presence of the business sector and the insecurity in the area, have impeded efforts to promote business, thus hampering the achievement of business targets.

Businesses in Aguaytia:

- A key client is the *Consortio de Productores de Plátano de Ucayali (COPPU)*, which was formed with PRA assistance and supplies to Frito Lay through Prime Trade, which operates the processing plants and markets bananas and plantains to supermarket chains Wong, Metro, and Santa Isabel. COPPU also supplies 65 tons per month to Tupac Amaru fruit wholesaler, representing 70% of COPPU's total sales.
- The sub-ESC recently added two new clients to its portfolio: *Agroecológico Mundo Animal*, which buys cattle from communities connected to PDA's fodder-producing project and supplies

to Velma SAC; and *Fruta Chambergo*, which supplies pineapple (piña cayena lisa) to markets in Lima and other provinces.

Figure III-8: Main Clients and Products of the PDA Sub-ESCs

ESC	Client Businesses	Main Products	# of Signatory Communities
Aguaytia	Plan Ucayali, COPASO, COPPU, APPSHA, CAC La Divisoria, Exportaciones Sierra y Selva, ASPASH.	cotton, plantain, coffee, palm, palmito	110
Tingo Maria	Heliconias del Huallaga, Patt Fresh, Exportaciones Sierra y Elva, Embasadora Bella Durmiente, Ricardo Arellano Rolando, Chambego, CAC La Divisoria.	flowers, plantain, cacao, coffee, rehydrating water, papaya, pineapple, beans	40
Tocache	APA Fray Martín, Cooperativa Tocache, Exportaciones Sierra y Selva, Inversora Diego, Algodonera Juanjui, Asoc. Prod de Arroz de Uchiza.	cacao, rice, cotton fiber	55
VRAE	CACAO VRAE; CACVRA, Multiagro, Grano de Oro, Botanical Product, APLAVRA, LOPESA, Agroindustria Santa Rosa.	cacao, coffee, peanuts, sesame, rice, kión, plantain, palillo, achiote, corn, mullein	66
Total			271

Businesses in Tingo María:

- One of the most important businesses in Tingo María is the result of work by Patt Fresh, which buys and markets a wide variety of bananas. A former PRA client that has returned to the area to develop businesses with signatory producers, Patt Fresh supplies to supermarkets such as Wong, Metro, and Santa Isabel. The company also provides technical assistance to producers;
- The coffee business in both Tingo María and Aguaytía is led by the *Cooperativa Agraria Cafetalera La Divisoria* whose specialty coffee supply is increasingly more solid. Recently, three members of *La Divisoria* cooperative from the *Hermilio Valdizán* community reached the semi-finals of the Second National Specialty Coffee Competition, with one winning third place.

Businesses in Tocache-Juanjui:

- The *Empresa Algodonera Juanjui* has been working with producers from 10 signatory communities and four adjacent communities and has harvested 18 hectares of “aspero blanco” cotton certified by CORESE/MINAG. Together they will support installation of 2,000 hectares in the next campaign, thus tripling the current 629 hectares of commercial cotton production;
- The *Sierra y Selva* export business had best results in purchases of cacao beans in the Juanjui area, the cacao producers of Juanjui are ready to continue working with organic cacao, especially in the harvest and post harvest phases.

Businesses in the VRAE:

- The coffee and cacao businesses are the largest in the VRAE, where CACAO VRAE and CACVRA have met their shipping schedules. CACAO VRAE exported 400 metric tons of certified cacao beans, with a remaining 50 metric tons to be shipped in October 2005, while CACVRA sold 350 metric tons mainly in the fair trade market at a price of \$1,950 per metric ton, when the bulk market price was quoted at an average of \$1,450.
- Despite a 40 percent drop in coffee harvest, CACVRA met its shipments and above all has managed to strike a deal with Starbucks for 560 quintales. The project will be watching for this to take off next year. The business has negotiated 5,000 quintales of coffee on the specialty coffee market where the bulk price is over \$140 per quintal.
- Fulfilling the coffee and cacao shipments are what has most contributed to VRAE ESCs meeting their assigned sales targets.
- Another important business in the VRAE is the peanut business. This business is moving forward with the participation of three firms and their expansion through the Southern Valley (Anco) and expansion toward the Northern Area (Río Ene), where the product enjoys better conditions for growth and development.
- The firm *Multiagros* is advancing the rehabilitation and adaptation of the peanut processing plant the company bought from PRISMA and it is expected that in the coming months the plant will be up and running to meet the demand for several peanut-based products in tandem with *Agronprex* in the southern area of the VRAE and *Agrocomercial Grano de Oro* in the northern area.
- In the VRAE's sesame business, the client business *Grano de Oro* has taken leadership and has made innovative presentations of products like oil and sesame and pearl sesame, products in huge demand on the national and international market. The business works with producers in 10 signatory communities under the system of financing of inputs and foods for Ene producers, with which they have established a productive sesame chain and supply is becoming steady. Sesame is the fourth product in importance in the VRAE and the first in the Ene area. Its contribution to sales is expected to be higher in the next campaign.
- Despite the continued slowdown in growth of the rice business due to the national oversupply, the firm *Grano de Oro* has secured orders for nearly 50 metric tons of product through innovative packaging, marketing, and classification. As a result, rice has become a real, viable alternative to coca for producers in the Ene.
- Other small but important businesses for signatory communities in the central region are *Palillo* and *El Achote*.

E. PRA's Vision of Long-term Impact on Alternative Development: 2000-2005

This section looks at the medium and long-term impact of PRA business development activities in the seven Alternative Development departments and the original 53 priority AD districts between 2000 and 2005.

As of September 2005, 53 percent of PRA's cumulative sales results have been generated in the seven departments focused on USAID/Peru's and DEVIDA's Alternative Development program. Of the US\$97.9 million generated in PRA's overall new sales through September 2005, US\$52.7 million were generated in these seven departments (Junín, San Martín, Huánuco, Pasco, Ucayali, Ayacucho, y Cusco).

Within these seven departments, USAID/Peru originally prioritized 53 districts for PDA to implement the voluntary eradication strategy and integrated support program. The following table shows cumulative sales results from those 53 priority districts and the seven AD Departments.

Figure III-9: Sales in AD Departments and Priority AD Districts, Through Sept. 2005 (US \$)

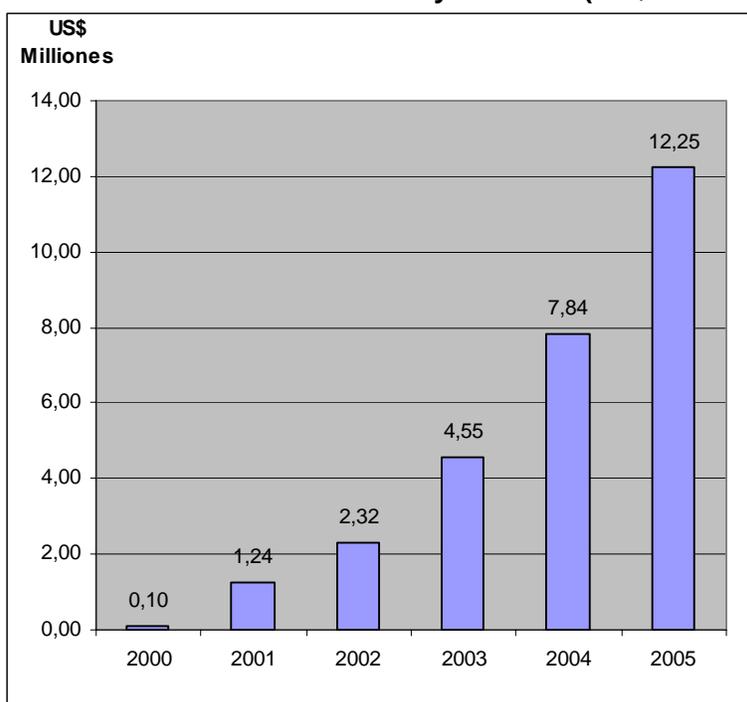
Department	53 Priority Districts	Rest of Department	TOTAL	% Priority Districts/Total
JUNIN	\$584,892	\$13,107,918	\$13,692,810	4%
UCAYALI	3,051,939	8,133,282	11,185,221	27%
CUSCO	293,278	7,757,174	8,050,452	4%
SAN MARTIN	4,167,968	3,315,110	7,483,078	56%
HUÁNUCO	2,739,583	2,369,450	5,109,033	54%
AYACUCHO	1,409,485	3,396,268	4,805,753	29%
PASCO		2,351,636	2,351,636	0%
TOTAL AD	\$12,247,145	\$40,430,839	\$52,677,984	23%

Twenty-three percent of total incremental sales in the seven AD departments were generated in the prioritized districts. If Cusco and Junín are excluded, as they include very few priority districts, the weight of the results in the remaining 48 prioritized districts rises to 37 percent, indicating reasonably robust sales performance considering the difficulty in attracting enterprise activity to these often isolated and conflictive districts.

It is noteworthy that a high proportion of sales results in the departments in San Martín and Huanuco, 56 and 54 percent respectively, come from the originally prioritized districts. Ayacucho and Ucayali register relatively smaller but significant proportions of sales in priority AD districts, 29 percent and 27 percent, respectively.

The following chart shows the aggregate growth of incremental sales of businesses in districts focused on alternative development between 2000 and 2005.

Figure III-10: Cumulative Sales in 53 AD Priority Districts (US\$ million) thru Sept. 2005



The following table shows cumulative sales in the 53 priority AD districts by year, broken down by department.

**Figure III-11: Cumulative Sales in 53 Priority AD Districts, by Department
2000-2005 (US\$)**

Department	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
AYACUCHO	0	8.847	48.529	521.840	912.883	1.409.485
CUSCO	0	0	4.919	160.840	189.917	293.278
HUANUCO	99.412	472.940	1.120.160	1.773.015	2.058.650	2.739.583
JUNIN	0	12.643	55.706	101.263	154.773	584.892
SAN MARTIN	2.038	630.069	776.921	1.291.193	3.040.809	4.167.968
UCAYALI	3.057	111.561	314.431	697.347	1.473.281	3.051.939
Total AD Depts.	104.506	1.236.059	2.320.666	4.545.498	7.830.315	12.247.145

San Martín, Ucayali and Huanuco have made continuous major contributions to sales and Ayacucho also has made important contributions since 2003. Cusco and Junín register lesser results since there are few priority districts in these departments.

Sixty-five percent of jobs created by PRA between 2000 and 2005 have been generated in the seven departments of the Alternative Development Program, distributed as follows:

**Figure III-12: Employment in Seven AD Departments and the 53 Priority Districts,
Through September 2005**

REGION	53 prioritized districts	Rest of Department	TOTAL	% 53 districts/Total
UCAYALI	3.536	3.089	6.625	53%
SAN MARTIN	3.113	2.385	5.498	57%
CUSCO	63	4.646	4.709	1%
JUNIN	241	4.352	4.592	5%
AYACUCHO	603	3.281	3.883	16%
HUANUCO	1.349	1.933	3.282	41%
PASCO	0	1.537	1.537	0%
TOTAL	8.904	21.223	30.126	30%

Typical business enterprises supported by both PRA and PDA in the alternative development departments are inherently labor intensive. Fifty-three percent (53%) of FY2005 PRA/PDA sales were from AD Departments, while 65 percent of total PRA/PDA employment creation was generated in the seven priority AD Departments.

About a third of the employment in the seven AD Departments has been generated in 53 priority districts. If we exclude departments of Cusco and Junín, which for all practical purposes have no priority districts, approximately 41% of total employment creation was generated in the 53 priority AD districts.

The PRA monitoring unit reports investments in fixed assets (investments in assets whose maturity is more than a year) that are considered a direct result of project intervention. In this sense, by September

2005, the entire² PRA project generated US\$8.8 million in new capital investment of which US\$5.7 or 65 percent was made in the seven AD Departments.

Figure III-13: Capital Investment in Seven AD Departments and 53 Priority Districts, Through September 2005

REGION	53 prioritized districts	Rest of Department	TOTAL	% 53 districts/total
JUNIN	15.962	2.533.777	2.549.738	1%
UCAYALI	178.871	1.605.300	1.784.171	10%
SAN MARTIN	622.963	393.240	1.016.203	61%
AYACUCHO	38.465	130.234	168.698	23%
PASCO		107.628	107.628	0%
HUANUCO	36.829	19.425	56.254	65%
CUSCO	2.295	16.116	18.411	12%
TOTAL	895.384	4.805.720	5.701.104	16%

However, as shown in Figure III-13, only 16 percent (16%) of the total fixed capital investment was made in the 53 AD priority districts. There are various explanations for this. Most capital investments – a processing or packing plant, for example – require certain minimum conditions in terms of specialized professional services, communications services, transport, supplies of inputs, water, and energy, which are only readily available in urban or semi-urban locations. Also, as noted in Section I, the perception of risk by potential Peruvian and foreign investors is very high due to frequent strikes, road blockages and terrorist activity in the coca valleys.

A more useful way to view the relationship of capital investment with respect to priority districts is to consider the influence area served by a particular investment as well as the role of intermediate cities. OLAMSA's African palm oil processing enterprise, a long standing PRA client and a new PDA client is not located within any priority district but purchases its palm oil kernels from several priority districts involving thousands of ex-cocaleros. OLAMSA, working with PDA, is presently helping to expand palm oil plantations in priority districts by 1,000 hectares. This expansion of palm oil production would not be possible in the priority districts without the installed capacity of the OLAMSA processing facility several kilometers from any PDA priority AD district. The *Campo Verde* cotton gin in Pucallpa processes cotton from signatory communities in prioritized districts and SEM PERU, a five star PRA client in Pucallpa buys and processes yellow corn from growers and *ex-cocaleros* from several priority districts like Curimaná.

If we exclude departments of Junín and Cusco because of their distance from most AD priority districts, the AD departments of Ucayali and San Martín register the highest level of capital investment. The Department of San Martín stands out with 61 percent of PRA related investment located in priority districts.

The ASELVA cotton gin of the Gerbolini-De la Cuba group is located in Juanjuí, one of the few intermediate cities located in and serving priority AD districts. With SEM PERU the Department of Ucayali has the largest investment in the Selva. SEM PERU operates a \$1.0 million plus yellow corn drying plant in the outskirts of Pucallpa and buys and processes yellow corn from several priority AD districts. Simply put, the success of the Alternative Development Program depends on these and many other agribusiness investments often located at considerable distance from priority AD districts.

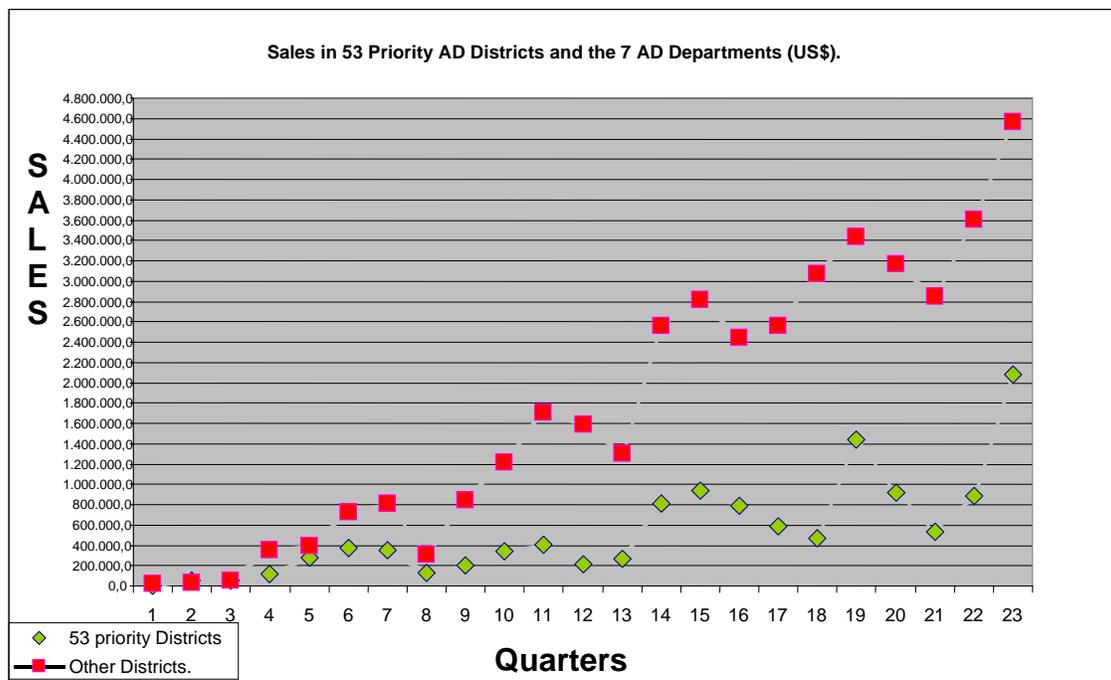
² Without including investments in Huancavelica

F. Relationship between Priority AD Districts and the Broader Economy in the Seven Alternative Development Departments

A central tenet behind the PRA concept is that business results generated in high potential areas (i.e., economic growth corridors) stimulate economic activity in areas with less potential. We believe this PRA tenet is valid for AD priority districts, usually areas with very low economic potential and those immediately adjacent districts, as well as the broader economy throughout the department.³

Figure III-14 shows sales results from the 53 priority AD districts, compared with sales generated in the remaining non-AD focused districts that belong to the seven AD departments (San Martín, Huánuco, Ucayali, Pasco, Junín, Ayacucho and Cuzco). The sales data track very similar trends, as business sales volume grows or declines in adjacent areas and in AD Department as a whole (i.e., red line), sales volume in the priority AD districts grows and subsides in parallel.

Figure III-14: Sales in 7 AD Departments vs Sales Priority AD Districts



Several reasons explain this:

- On the one hand, some businesses have sprung up in non-AD areas, but their scale has called for broadening areas of influence throughout the corridor, including the priority AD districts. Such is the case with cotton in Pucallpa-Aguaytía, and Tarapoto-Juanjuí;
- On the other hand, business success in areas of influence and bordering areas of AD diminishes the perception of risk, increases trust, attracts entrepreneurship, and facilitates development of business activity in priority AD districts;

³ An adjacent district is one immediately contiguous to a priority AD district and a district of influence refers to the rest of the districts that make up the department and are neither prioritized nor adjacent.

- Likewise, business success along bordering areas and areas of influence generate positive externalities and economies of scale throughout the region in product marketing, supplies of input and data, as well as technical assistance and communications. These successes create an environment ripe for businesses by reducing transaction costs and stimulating growth of licit activities in the priority AD districts.

An analysis of these two variables using linear regression offers us the following estimate:

$$\text{Sales in priority AD districts} = 0,3094 (\text{Sales in non-priority districts})$$

(t = 13.5)

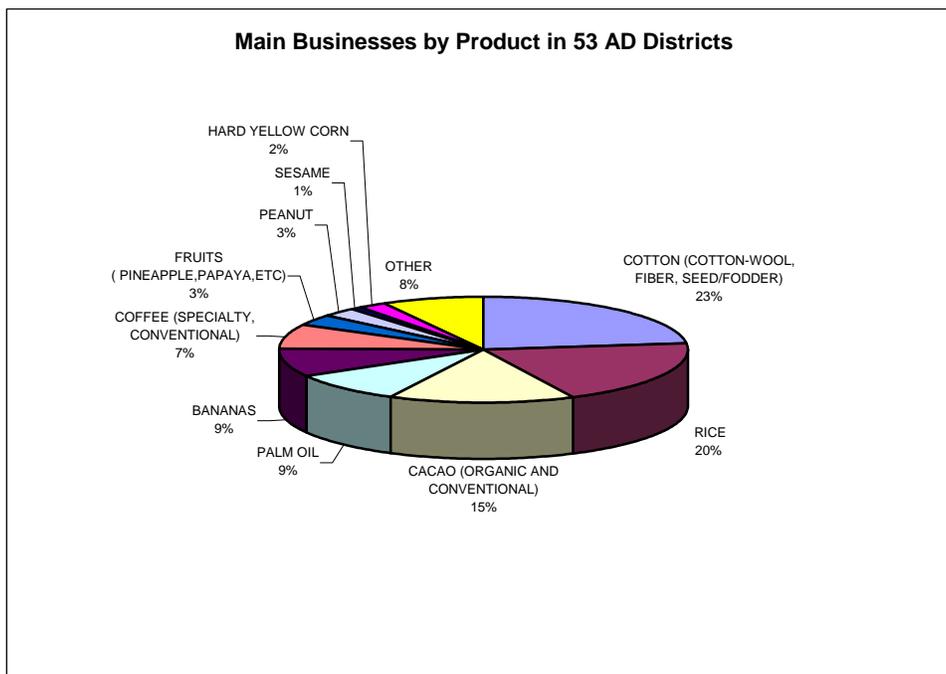
<i>Regression Statistics</i>	
Coefficient of multiple correlation	0,870079225
Coefficient of determination R ²	0,757037858
R ² adjusted	0,709418811
Margin of error	241606,1
Observations	22

Thus, for each dollar generated outside priority AD districts within the seven AD departments, 31 cents are generated in the priority AD districts.

G. Main Products 2000-2005

Eighty-nine percent of sales through September 2005 in the 53 priority AD districts came from transactions in nine products: cotton, rice, crude palm oil, plantain, cacao, coffee, fruits, peanuts, and hard yellow corn.

Figure III-15: Main Products in 53 Priority Districts



It is interesting to note the preponderance of sales from annual crops with short growing seasons such as cotton, rice, plantain and other fruits, as well as peanuts and hard yellow corn. Income from these crops is complemented with income from perennial crops with longer gestation periods and longer growing seasons such as palm oil, coffee, or cacao. The latter three crops have received extensive technical and financial support from PDA in the priority AD districts as part of the eradication agreements. Given the longer gestation periods involved with these crops, a marked increase in sales from this investment should begin to appear in FY2006 and beyond. PRA's focus has been with enterprises specializing in marketing annual crops, as well as some longer term crops such as palm oil and coffee that were already under production, while PDA has tended to focus, as a result of the eradication agreements, on the perennial crops. In this sense, PRA efforts in promoting businesses with short-term results and incomes nicely complement PDA's focus on longer term perennial crops.

SECTION IV

PRA Public-Private Partnership (PPP) Component

A. Executive Summary

Due to significant budgetary constraints, on September 15, 2005, USAID/Peru instructed PRA to wrap up the Public-Private Partnership (PPP) component - CLIN2 - by the end of March 2006, once the Amazon Central highway concession transaction and the design phase of the Port of Callao PPP transaction are completed. Notwithstanding the fact that PRA's PPP component is being closed 17 months ahead of schedule, it will have achieved major results under challenging circumstances. In fact, it will have achieved the lower results threshold of the PRA contract for CLIN 2: four out of six PPP infrastructure projects. This is a major accomplishment particularly given the size and scope of at least two of the PPP transactions completed. Moreover, PRA will only have spent roughly 50 percent of its original PPP budget.

With the remaining time and budget, PRA could have conceivably completed a minimum of two more major PPP transactions. Some of the possible projects may have included the Fernando Belaunde Terry road between Tarapoto and Tingo Maria, 450 km that cuts through the coca producing region of Alto Huallaga; the badly needed water and sanitation infrastructure services in cities like Pucallpa, Huancayo, and Tingo Maria; the Red Vial #1 in Piura, a 445 km project that is part of the Plan Binacional Peru – Ecuador; and others.

Thus far, USAID's support to the Government of Peru's (GOP) efforts to increase the supply of basic infrastructure services to facilitate enterprise development, improve productivity and competitiveness, and spur economic growth within the alternative development areas of the country, through PRA's PPP component, has resulted in the following:

Completed:

- A signed 25-year concession agreement with a private consortium to finance, construct, rehabilitate, operate and maintain 964 km of national highway (IIRSA Amazon North - AN) between the cities of Paita, in the department of Piura on the Pacific coast, and the river port of Yurimaguas, in the eastern department of Loreto. This pioneering PPP will mobilize more than US\$200 million from the Peruvian private capital market to finance the construction and rehabilitation of the highway over the next four years. The Peruvian Government, by turning to the private capital market for the required investment financing, will lessen the pressure on the GOP's fiscal budget, freeing scarce tax-generated resources to be focused on other public sector priorities such as education and health;
- A comprehensive feasibility study, project appraisal and plan of action to develop four rural electrification projects, including transmission and electricity distribution in the VRAE, distribution in Tocache, and complementing the ongoing distribution project in Ucayali.

Ongoing:

- The technical, financial, and legal transaction design and implementation of a 30-year, US\$100 million concession (IIRSA Amazon Central – AC) to finance, improve, construct, operate and maintain 847 km of national highway between the cities of Lima, on the Pacific Coast, and Pucallpa in the eastern department of Ucayali, and the city of Huancayo in Sierra;
- The transaction design of the concession of the South Container Terminal of the Port of Callao, the largest port serving Peruvian cargo; and
- The preliminary technical and financial transaction design for a concession to rehabilitate, build, operate and maintain the 450 km Fernando Belaunde Terry (FBT) road between the cities of Tarapoto in the department of San Martin, and Tingo Maria in the department of Huanuco.

Important and unique accomplishments have been attained in the process of completing and delivering the abovementioned PPP initiatives:

Ground-breaking financial structuring:

- A US\$60 million partial credit guarantee (PCG) was designed and negotiated with the Inter-American Development Bank (IDB) to facilitate the financing of the more than US\$200 million Amazon North concession. The PCG will not only allow the concessionaire to obtain better financial terms, but will facilitate access to the domestic capital market;
- A revolving US\$60 million bridge loan was designed and negotiated with the Andean Development Corporation (CAF) to ensure the prompt initiation of construction of the Tarapoto - Yurimaguas segment of the Amazon North concession while long-term financing is obtained by the winning concessionaire through bond issues in the domestic capital market;
- Two infrastructure bonds to finance the Amazon North and Amazon Central concession projects were simulated and rated by a renowned credit rating agency to ensure their creditworthiness.

State-of-the-art concession contracts:

- A "second generation" concession contract with significant improvements over similar PPP contracts for other concessions in Peru's transportation sector, which incorporates industry-specific international best practices and innovative risk mitigation mechanisms, was developed for the Amazon North concession and is being adapted and improved for the Amazon Central transaction;

- Innovative risk management mechanisms were developed specifically for these two contracts, such as: periodic maintenance cost insurance to reduce volatility in periodic maintenance costs; clauses to protect the financiers in the event of early termination of the contract; minimum revenue guarantee to minimize traffic risk in the Amazon Central concession project;
- The Amazon North concession contract is being used by PROINVERSION as a model for concession transactions that require government subsidies (i.e. concessions that require PAO + PAMO payments), and has already been adapted for the five concessions that make up Interoceánica Sur highway, and for the more than 20 concessions that make up the Costa – Sierra road concession program.

Pioneering environmental management tools:

- The first-ever Strategic Environmental Evaluation (SEE) for an infrastructure project in Peru, complemented with environmental impact assessments for each highway section, were developed for the Amazon North concession;
- A comprehensive set of environmental regulations and penalties for non-compliance were prepared and incorporated into the concession contracts;
- A single comprehensive environmental impact assessment for the Amazon Central corridor is under development;
- Public consultations along the Amazon North and Amazon Central corridors to disseminate the potential environmental impacts of the project and the corresponding mitigating measures were completed in most of the municipalities served by these two highways, as well as in a number of indigenous communities living within their area of influence.

Unparalleled potential economic impact:

- The Amazon North and Amazon Central concessions will guarantee the financing, construction, rehabilitation, and long-term operation and maintenance of more than 1,800 km highway (more than 18 percent of Peru's national highway network.) These will be two of the largest, in terms of length, road concession projects in the world;
- These highways will integrate, along two different routes, the coastal, mountain and jungle regions of Peru and will connect Peru with Brazil, the region's largest economy. More importantly, they will significantly reduce transportation costs and travel time, improve the competitiveness of products and businesses in the area, and provide the foundation for viable alternatives to coca and for a competitive and licit business environment;
- The Amazon North concession's area of influence includes six departments with 24 percent of the country's population and 15 percent of its GDP; the Amazon Central's area

of influence, on the other hand, includes five departments with close to 50 percent of the country's GDP.

Important lessons learned for subsequent PPP transactions:

Some of the main lessons learned in the Amazon North concession process are being addressed in subsequent PPP transactions:

- *Problem:* PROINVERSION opened the Amazon North bidding processes with incomplete technical feasibility analysis and did not allow enough time during the transaction design phase to complete these studies. As a result, there was a high degree of uncertainty among potential bidders with regard to the initial capital investment and O&M costs. Amazon Central concession: The PRA team is conducting an engineering study to review the Ministry of Transport and Communication's (MTC) feasibility studies and determine, as accurately as possible, the cost of the initial investments and the long-term operation and maintenance costs.
- *Problem:* PROINVERSION never established a realistic bidding schedule for the Amazon North concession. The bidding process was opened without having completed either the minimum required feasibility analysis or the detailed preparation of bidding documents. As a result, the original bid schedules had to be modified on several occasions, but never giving enough time to adequately complete the studies. This led to a series of problems in the implementation process. More importantly, we believe the uncertainty generated by the frequent changes in the bidding calendar caused potential investors to hold back from participating in the Amazon North bidding process. Amazon Central: PROINVERSION established early on in the process an aggressive but achievable bidding calendar. The current timeframe is allowing the PRA-PPP team to develop the necessary engineering studies and conduct an aggressive promotional campaign. Adequate timeframes are helping attract not only more firms, but firms that have not participated previously in PPP projects in Peru.
- *Problem at the beginning of the process: negative perception of PPPs.* MTC officials did not believe in the PPP processes since the concessions would mean a reduction in their sphere of influence and possible reductions in ministry staff and budget allocations. Today with the Amazon Central and others: MTC Minister, Jorge Ortiz, publicly acknowledged that the GOP was no longer afraid of budget shortfalls for public works because... "we are now privileged to have the PPP approach. A methodology where the private sector takes on the debt to finance highway construction and the Government commits to pay over the long-term. This approach allows us to build infrastructure, which in the past, using the Fernando Belaunde Terry Road as an example, took 40 years and is still not completed, because budgets were cut or were diverted for political reasons, paralyzing the work for years. Today, through the PPP approach, we are able to mobilize all the required financing (through the private sector) which ensures that projects are not paralyzed and actually move to completion."

B. PPP Component's Main Activities and Accomplishments

PPP Component's Goal: To support the Government of Peru's effort to increase the supply of basic infrastructure services to facilitate enterprise development, improve productivity and competitiveness, and spur economic growth within the alternative development areas of Peru through the design, structuring, negotiation and implementation of four to six PPP transactions to finance, build, operate and maintain major infrastructure projects in the transport (ports and roads) and energy sectors (rural electrification).

Since the PPP program's inception only two years ago, the PRA PPP team has worked actively and closely with PROINVERSION in the following PPP transactions:

Figure IV-1: PRA PPP Transactions

Transaction	Initial Investments	Status as of September 30, 2005
<p>The Amazon North (AN) highway concession is a 25-year transaction to finance, construct, rehabilitate, operate and maintain 964 km of national highway between the cities of Paita, in the department of Piura on the Pacific coast, and the river port of Yurimaguas, in the eastern department of Loreto. The concessionaire is expected to raise approximately US\$220 million in private financing (debt + equity) to cover the initial capital investment costs. In addition, the concessionaire is responsible for the maintenance of the road, in accordance with international service quality standards, for the term of the concession contract at an estimated cost of US\$15 million per year.</p>	<p>US\$220 million</p>	<p>Phase I (design): Completed</p> <p>Phase II (implementation): Completed</p> <p>The Amazon North Concession was awarded on May 5, 2005 and the Concession Contract signed on June 17, 2005</p>
<p>The Amazon Central (AC) highway concession is a 30-year transaction to improve, construct, operate and maintain 847 km of national highway between the cities of Lima, on the Pacific Coast, and Pucallpa in the eastern department of Ucayali. The selected concessionaire is expected to raise approximately US\$100 million in private funding to cover the initial investments and will guarantee the maintenance of the road, in accordance with international service quality standards, for the term of the concession contract.</p>	<p>US\$100 million</p>	<p>Phase I (design): Completed</p> <p>Phase II (implementation): ongoing</p> <p>Award expected in June 2006</p>
<p>Rural electrification: four rural electrification projects, including transmission and electricity distribution in the VRAE, distribution in Tocache, and complementing the ongoing distribution project in Ucayali</p>	<p>US\$10.1 million</p>	<p>Completed</p>

Transaction	Initial Investments	Status as of September 30, 2005
Port of Callao: Transaction design of the concession of the South Container Terminal and possibly the concession of a new minerals berth, and the Muelle 5 Container Terminal	US\$175-\$200 million	Phase I (design): Ongoing The Port of Callao transaction design work is expected to be completed in February 2006

B1. Amazon North (AN) Highway Concession

The Transaction: The Amazon North highway concession is a 25-year PPP transaction to finance, construct, rehabilitate, operate and maintain 964 km of national highway between the cities of Paita, in the department of Piura on the Pacific coast, and the river port of Yurimaguas, in the eastern department of Loreto. The concessionaire is expected to raise approximately US\$220 million in private financing (debt + equity) to cover the initial capital investment costs. In addition, the concessionaire is responsible for the maintenance of the road, in accordance with international service quality standards, for the term of the concession contract.

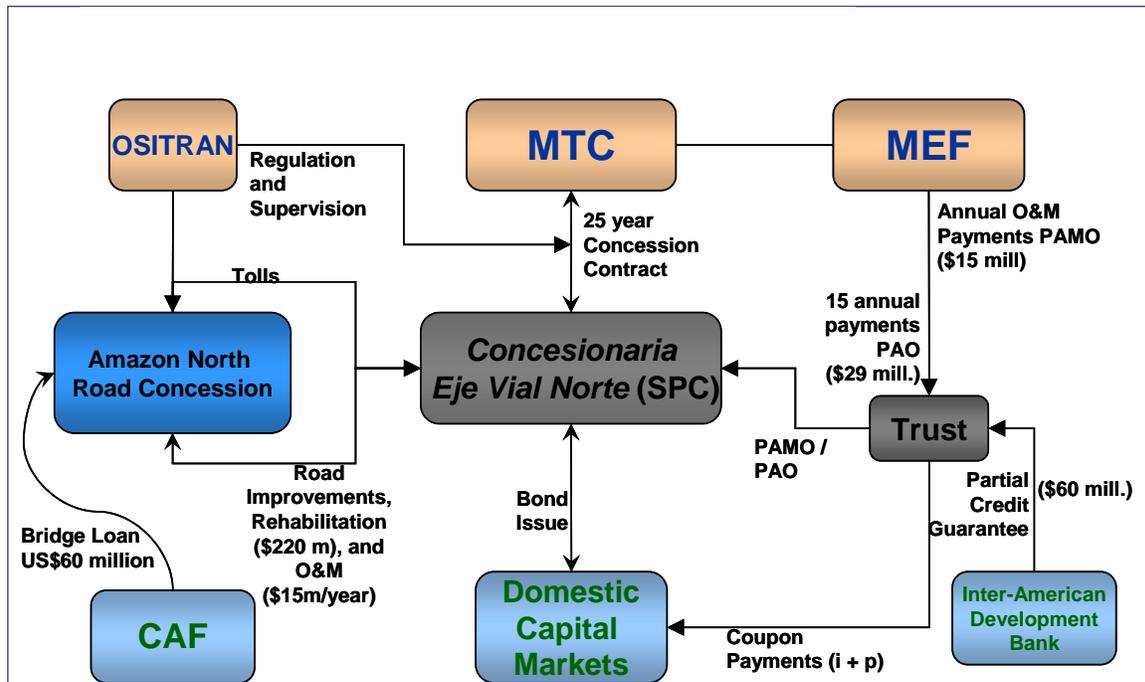
Figure IV-2: Amazon North Corridor



Because the relatively low average daily traffic counts, to make the project financially viable, the GOP will make annual payments to the concessionaire to cover the cost of the initial investments and O&M. The selection criteria used to determine the winning bid was the lowest government subsidy expressed as the present value of the sum of required PAO (Annual payment for works): and PAMO (Annual payment for O&M) payments. As a result of the competitive bidding process, the amounts of government subsidies for the project were the following:

PAO: US\$29 million for 15 years once the road has been built and rehabilitated.
 PAMO: US\$15 million a year for the duration of the concession.

Figure IV-3: Amazon North Transaction Structure



Results: On June 17, 2005, President Alejandro Toledo witnessed the signing of the US\$220 million Amazon North Concession to improve, rehabilitate, operate and maintain 960 km of highway between Peru’s Pacific port city of Paita and Yurimaguas, a river port municipality servicing Iquitos in eastern Peru and Brazilian ports of call along the full length of the Amazon river to the Atlantic. When completed in 2009, the Amazon North highway concession will anchor the first all-weather road and river transport network across South America, greatly facilitating two way commerce between Peru and Brazil and fully integrating, for the first time, Peru’s developed coastal regions with its less developed mountainous Andean region and the extensive tropical region extending deep into the Amazon Basin.

The concession contract was signed between the MTC of Peru and a consortium of Brazilian and Peruvian investors and construction firms, *Concesionaria Eje Vial Norte*, led by Brazilian Constructora Norberto Oderbrecht S.A. and formed by Constructora Andrade Gutierrez S.A., also from Brazil, and the Peruvian Graña y Montero S.A.A. The competition included the Brazilian firm Construtora Queiroz Galvao S.A.

This pioneering public-private partnership will mobilize more than US\$200 million from the Peruvian private capital market to finance the construction and rehabilitation of the highway over the next four years. The Peruvian Government, by turning to the private capital market for the required investment financing, will lessen the pressure on the Government’s fiscal budget,

freeing scarce tax-generated resources to be focused on other public sector priorities such as education and health.

To facilitate the project financing through the Peruvian capital market, the Government structured, also with USAID assistance, a US\$60 million partial credit guarantee (PCG) with the Inter-American Development Bank (IDB). The PCG will guarantee the anticipated annual government contributions to the project.

The Amazon Norte highway concession is clearly one of the most ambitious achievements of the Toledo Administration and a credit to the commitment of the Government to rigorous project preparation and transparent competition. The signing of the Amazon Norte contract follows an extended search by PROINVERSION, with USAID support, for qualified investors and infrastructure operators. The support received from USAID allowed for the successful closure of the Amazon North highway concession transaction. Moreover, the PPP model developed for the Amazon North concession is appropriate for broader application, essential features of which are already being incorporated into the next generation of PPP highway concessions including the Amazon Central highway concession presently under full development with USAID assistance, as well as the five road concessions that make up the Interoceanica Sur highway and the 27 road concessions that are part of the Costa Sierra road concession program.

Potential Economic Impact:

The Amazon North concession project will help significantly reduce transportation costs and travel time, improve the competitiveness of products and businesses in the area, and provide the foundation for viable alternatives to coca and for a competitive and licit business environment. The table below shows the estimated savings in transport costs and travel time for the Tarapoto – Yurimaguas segment of the Amazon North Concession:

Figure IV-4: Economic Benefits of the Amazon North PPP Concession

Before Concession Yurimaguas – Tarapoto 125 km	With Concession Yurimaguas – Tarapoto 125 km	Savings
Transport of Cargo Time: 12 hours Cost: S/. 160/ton Cost: ton/km= S/. 1.28	Transport of Cargo Time: 4 hours Cost: S/. 90/T Cost: T/km= S/. 0.72	 (-70%) (-44%)
Transport of Passengers Time: 6 hours Cost: S/. 25/passenger	Transport of Passengers Time: 3 hours Cost: S/. 13/passenger	 (-50%) (-48%)

B2. Amazon Central Highway Concession

Figure IV-5: Amazon Central Corridor

The Transaction: The Amazon Central (AC) highway concession is a 30-year transaction to improve, construct, operate and maintain 847 km of national highway between the cities of Lima, on the Pacific Coast, and Pucallpa in the eastern department of Ucayali, and the highway connecting La Oroya and Huancayo within the department of Junin. The selected concessionaire is expected to raise approximately US\$87.2 million in private funding to cover the initial investments in two phases:

Phase I (years 1-3): US\$59.90 million

Phase II (years 4-6): US\$27.3 million

In addition, the concessionaire will guarantee the maintenance of the road, in accordance with international service quality standards, for the term of the concession contract. The concessionaire is expected to recover its initial investments and cover the O&M costs through the life of the concession exclusively through the collection of tolls along the corridor.

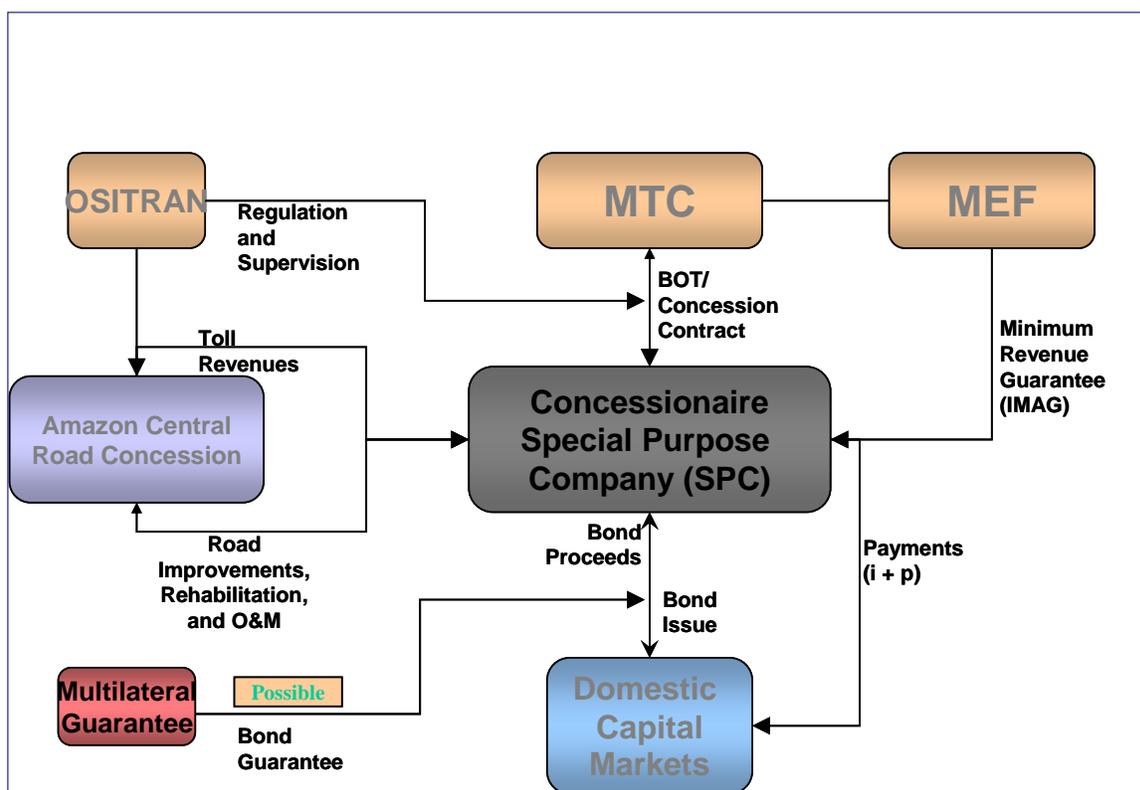
To facilitate the financing of the road, the government of Peru will provide, through the Ministry of Economy and Finance, an optional minimum revenue guarantee for up to 98 percent of the projected revenues. The concession contract is expected to be awarded in June 2006.

Potential issues with the transaction design: The transaction structure may have to be modified in the event that the engineering study presently under development concludes that the initial investments and/or maintenance costs have been underestimated. PRA's preliminary engineering analysis established that 190 km between Chicrin and Huanuco may need major rehabilitation in the near future. This intervention was not considered in the original concession project prepared by the MTC and PROINVERSION. Although our initial investment estimates (US\$87.2 million) already include a provision for a partial intervention in this road segment, the amount may change (up or down) once we have the results of the engineering study under development.



In addition, the initial investments estimates were calculated based on feasibility studies prepared by the MTC. These studies are being updated by PRA and it is possible that the initial investment requirements may increase. If this is the case, the transaction structure may have to be modified to include government subsidies.

Figure IV-6: Amazon Central Transaction Structure



Potential Economic Impact: The Amazon Central concession project will help significantly reduce transportation costs and travel time, improve the competitiveness of products and businesses in the area, and provide the foundation for viable alternatives to coca and for a competitive and licit business environment. The table below shows the estimated savings in transport costs and travel time for the 98 km Tingo Maria – Aguaytia segment.

Figure IV-7: Economic Benefits of the Amazon Central PPP Concession

Before Concession Tingo Maria – Aguaytia 98 km	With Concession Tingo Maria – Aguaytia 98 km	Savings in transport time and cost
Transport of Cargo	Transport of Cargo	
Time: 6 hours	Time: 4 hours	(-33%)
Cost: S/. 50/ton	Cost: S/. 40/T	
Cost: ton/km: S/. 0.51	Cost: T/km= S/. 0.41	(-20%)
Transport of Passengers	Transport of Passengers	
Time: 3 hours	Time: 2 hours	(-33%)
Cost: S/. 20/passenger	Cost: S/. 10/passenger	(-50%)

Amazon Central Transaction's Partial Results:

- An infrastructure bond simulating the possible financial structure for the Amazon Central concession was developed and is being currently being rated by Apoyo/FITCH. The final results are expected by March 2006.
- A comprehensive environmental impact assessment for the entire AC corridor is currently under development. This study aims to perform a diagnostic on environmental components (physical, biotic, human, archaeological, countryside, landscape, aesthetics and environmental relationships to other projects); identify and evaluate possible direct and indirect impacts (negative or positive) on environmental factors that project development activities can bring about, as with the environmental impact on the project itself; the study will also develop an environmental management plan for rehabilitation, improvement, and periodic and routine maintenance on the road to mitigate, control, and compensate for likely disturbances to environmental factors, including preventive and corrective measures, follow-up and monitoring, education and training, compensation and resettlement (if necessary), contingency, abandonment, and restoration. This environmental management tool will ensure that all environmental protection requirements of the GOP as well as USAID, Section 216 requirements, will be met. The study will be finalized by December 2005.
- A detailed engineering study to determine, as accurately as possible, the cost of the initial investments and the long-term operation and maintenance costs. The goal of this study is to design a program for rehabilitation and maintenance, and also to update/assess the real capital investment costs. The following are some of the results expected from the study:
 - A periodic and routine maintenance program;
 - A referential budget for initial investments in rehabilitation, and improvements to asphalted road infrastructure;
 - A referential budget for routine maintenance and periodic maintenance every five years and every nine years;
 - Economic analysis of alternative maintenance strategies through the use of the Highway Design Management 4 (HDM 4) model, considering actions of periodic structural reinforcement approximately every five years and every nine years.The study will be finished by December 2005.
- A demand study targeting investors and financiers was completed in June 2005. This study will complement and enhance the information of an existing demand study of the MTC. This study is crucial in view of the fact that the financing for this road concession is based solely on the projected traffic levels of the highway and the collection of tolls. The study develops new traffic and income projections and provides a clear and precise explanation of the data considered and its level of support. Furthermore, the analysis will provide future investors and financiers with additional background information to enable them to adequately assess the risks associated with the project.

- Development of the concession contract. The second version of the concession contract was developed and presented to PROINVERSION in September 2005. The third version is expected at the end of February 2006.
- Data Room: All existing information and documentation pertaining to the project was gathered and organized in the project's Data Room in PROINVERSION.
- Promotion: PRA is conducting an aggressive local and international project promotion campaign to ensure that this is, for the benefit of the government of Peru, a very competitive and transparent bidding process. Thus far, the PRA team has prepared and published a promotional brochure (teaser) and an information bulletin to more than a 100 firms in the project's database. In addition, through local representatives, PRA has contacted more than 40 firms directly in Chile, Mexico, and Colombia and has conducted or will conduct road shows with the participation of high level government officials in Lima, Santiago, and Bogotá through March 2006.
- Registered firms: Through September 2005, there are seven firms registered to participate in the Amazon central bidding process:

Figure IV-8: Firms Registered for the Amazon Central PPP Concession

Firm	Country
Constructora Málaga Hnos. S.A.	Ecuador
Concar S.A.	Peru
Hidalgo E Hidalgo S.A. – Construcción Y Administración S.A.C. Asociados.	Ecuador
Translei S.A.	Portugal/Peru
Consortio Planova Schahin	Brazil
Constructora Camargo Correa S.A	Brazil
Construtora Queiroz Galvao S.A.	Brazil

- The PRA PPP team agreed with PROINVERSION to the following bidding timeframe:

Figure IV-9: Preliminary Transaction Schedule for the Amazon Central PPP Concession

Activity	Date
Prequalification (Envelope #1)	January 2006
Technical and Economic Proposals (Envelopes #2 and #3)	March 2006
Results of the evaluation of the Technical Proposals (Envelope #2), opening of Economic Proposals (Envelope #3), and award of the Concession Contract	March 2006

B3. Port of Callao PPP Transaction

Background: The concession of all or part of the Port of Callao, the largest port serving Peruvian cargo, was identified by both USAID and the GOP as a PPP transaction of the highest priority in which the PRA project was required to provide assistance. However, due to significant budgetary constraints, USAID was not in a position to fund the complete transaction design and implementation process as originally envisioned in the PRA contract. The estimated cost of the complete transaction design and implementation process for Callao was estimated by PRA at US\$1.9 million.

Since early March 2005, on USAID instructions, the Chemonics PRA PPP Team worked with PROINVERSION to prepare a memorandum of understanding (MOU) to govern and guide USAID's support of the design and implementation of the Port of Callao PPP transaction. Although the first draft of the USAID-PROINVERSION MOU was circulated and discussed with PROINVERSION in mid-March, 2005, it was not until six months later, in mid-September, that an agreement was finally reached.

Several factors influenced the slow evolution of the Port of Callao MOU and the final agreement between USAID and PROINVERSION. These include:

- The absence of consensus on the content of the Port of Callao modernization program among the key involved actors as well as conflicting interests;
- Limited institutional capability within PROINVERSION, as well as its all consuming involvement in the bidding and award of several PPP concessions since March (i.e., Red Vial #6, Amazon North, Interoceanica Sur, Tumbes water distribution system);
- The decision by USAID to fund only partially the Port of Callao transaction when the Government had initially expected USAID to fund the entire PPP structuring work as is the case of the Amazon North and Amazon Central highway concessions; and
- The subsequent need to mobilize substantial counterpart resources by the GOP became a final limiting and delaying factor in the Government's effort to move forward with Callao concession work through mid-September 2005.

Although the MOU was never signed, USAID agreed with PROINVERSION to partially fund the Port of Callao PPP structuring work and instructed PRA to provide technical assistance to PROINVERSION in the initial transaction design phase of one or more PPP transactions within the Port of Callao. USAID agreed to obligate no more than US\$550,000 to complete this work.

Main Activities: Thanks to USAID assistance, the PRA PPP team in coordination with its subcontractor, Nathan Associates Inc., has initiated the following activities:

- Prepare long-term traffic demand forecasts;
- Evaluate port facilities and conduct an operations review. Estimate the capital costs associated with each Terminal by type of capital cost, such as construction of new terminal, expansion of existing terminal, major capital equipment (e.g. cranes and yard system), identifying the investments to be carried out by the private operator and those to be carried out by the GOP (e.g. dredging, access to the terminal);

- Formulate a concession financial model and conduct financial analysis;
- Analyze the port's industrial configuration and institutional framework;
- Prepare TOR for an environmental review;
- Develop a concession strategy.

The transaction design work is expected to be concluded in February 2006.

B4. Fernando Belaunde Terry (FBT) Road

Thanks to USAID assistance, the PRA project has focused on the imperative of completing the FBT since 2001 when it was highlighted in a PRA transport infrastructure report as the key project to unleash the agriculture potential of the Huallaga Valley and Central Peru¹. This year, after years of work by AMRESAM (*Asociación de Municipios de la Región San Martín*), the Regional Government of San Martin, the Provincial Government of Tocache and the FBT Board (*Directorio de la FBT*), which USAID was instrumental in founding, legislation was passed in Congress eliminating the exoneration of the Department of San Martin Department from the IGV tax. The proceeds of IGV tax revenue, estimated to yield 45 million *nuevos soles* per year for 50 years (approximately US\$14 million/year) now flow to a "trust fund" specifically earmarked for the completion of the FBT highway.

Even with this substantial annual funding from the FBT Trust Fund, it would still take more than 10 years to complete the remaining segments of this highway if constructed by the MTC through the traditional public works bidding and tendering process. Nevertheless, this timeframe can be dramatically shortened by leveraging private investment capital through a well structured public-private partnership arrangement. Thanks to USAID assistance, the GOP has this tool at its disposal.

PRA PPP team's preliminary assessment and transaction design work concludes that a PPP for the FBT is a viable alternative with minimum additional government subsidies to cover cash flow deficits after Year 9 of the concession. The main characteristics of the transaction structure include the following:

- 16-year PPP concession;
- Toll revenues estimated at US\$1.2 million a year. The concession requires government subsidies;
- The GOP establishes a trust fund in COFIDE and receives the proceeds of IGV tax revenue of minimum US\$14 million a year;
- The GOP will make annual payments to cover the initial construction plus the operation and maintenance costs (PAO + PAMO mechanism similar to the Amazon North concession transaction);
- The annual PAO plus PAMO payments required have been estimated at: US\$25.12 million. The GOP starts paying after Year 3 of the concession only 50 percent of the PAO+PAMO, and 100 percent after Year 5. The balance of the trust fund after Year 5 is expected to be US\$44 million;

¹ Estudio sobre la Inversión en Infraestructura Vial Prioritaria en Perú, prepared by P. y V. Ingenieros S.A., September 2001.

- The US\$25.12 million PAO + PAMO will be funded exclusively from by trust fund until Year 9 of the concession;
- From Years 9 through 16, the deficit of approximately US\$11 million a year will be funded directly by the GOP as a loan to the trust fund;
- The GOP will recover this loan with inflows to the trust fund from Years 17 through 21 (please see table below);
- Conclusion: the FBT concession is possible with funding form proceeds of IGV tax revenue for 21 years of the 50 that will be received by the trust fund.

Figure IV-10: FBT Transaction Summary Table

Año	Periodo de concesión	Montos que deberán estar en el fideicomiso (a)	PAO+PAMO acumulados (b)	Fideicomiso después de los pagos realizados por PAO y PAMO (a-b)	Periodo	En el Fideicomiso
2006	0	14.000.000		14.000.000		
2007	1	28.000.000	0	28.000.000		
2008	2	42.000.000	0	42.000.000		
2009	3	56.000.000	12.557.888	43.442.112		
2010	4	57.442.112	12.557.888	44.884.223		
2011	5	58.884.223	25.115.777	33.768.446		
2012	6	47.768.446	25.115.777	22.652.670		
2013	7	36.652.670	25.115.777	11.536.893		
2014	8	25.536.893	25.115.777	421.116		
2015	9	14.421.116	25.115.777	-10.694.661	17	14.000.000
2016	10	14.000.000	25.115.777	-11.115.777	18	14.000.000
2017	11	14.000.000	25.115.777	-11.115.777	19	14.000.000
2018	12	14.000.000	25.115.777	-11.115.777	20	14.000.000
2019	13	14.000.000	25.115.777	-11.115.777	21	14.000.000
2020	14	14.000.000	25.115.777	-11.115.777		
2021	15	14.000.000	15.132.166	-1.132.166		
2022	16	14.000.000	15.132.166	-1.132.166		
Total por financiar				-68.537.877		70.000.000

With the completion of the two IIRSA east-west highway concessions and subsequently the north-south FBT highway, the central mountains and jungle of Peru would be, for the first time, fully integrated into the Peruvian economy by all-weather highways. The completion of these highways will certainly lead to an economic boom in San Martin and Ucayali Departments. The completion of the FBT and two IIRSA east-west corridors will finally and forever integrate the mountains and jungle of central Peru into the national economy with all the promise such integration holds for improving the income of millions of small holders, many of whom presently turn to coca as the only crop marketable from a region constrained by limited and poor infrastructure and extremely high transport costs.