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Country Program Evaluation (CPE): Peru (1990 – 2000)

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Executive Summary

In July 1990 when the new government of Peru took office, it faced two major challenges. First, it needed to address the immediate hyperinflationary-macroeconomic crisis, the re-insertion into the international financial community and to defeat terrorism. Second, it needed to find a viable long-term development strategy for the country, one, which could prove effective in dealing with three development challenges.

These development challenges included the following. First, an economy built upon capital-intensive primary product exporting which not only rendered the economy vulnerable to external shocks, (a cyclical problem) but also was unable to generate employment at rising wages (a structural problem). Second, a historical policy pendulum pattern swinging from pro-market which generated output, but not employment and contributed to high levels of social inequality to state intervention (which was temporarily successful in its quest, but led to large macroeconomic imbalances). The third challenge was the absence of successful intermediation of interests and the development of broad inclusive social compacts and their institutional basis in a participatory democratic context.

The country, supported by the Bank among others, embarked on an intensive macroeconomic stabilisation cum pro-market structural reform program. Macroeconomic imbalances were reduced and hyperinflation tamed. With the structural policies adopted Peru went, within a few years, from below the regional average to a pacesetter in pro-market policies. These policies not only contributed to surmounting the immediate crisis, but also appear to have laid the foundation for economic growth. Both domestic and foreign private investment and total factor productivity significantly increased and economic allocative efficiency improved. However, the intensity-speed of the reforms came at a cost. Vertical (with civil society) and horizontal (with the legislative and judicial branches of the state) accountability weakened to facilitate the speed of the reforms.

During the decade, Peru was the focal point for development assistance from both multilateral and bilateral institutions. The IDB was the first multilateral creditor to have its arrears cleared by Peru, and was the largest source of financing for the entire period. The Bank approved 227 discrete operations for Peru. Loans totalled $3.8 billion and non-reimbursable technical co-operation operations amounted to $97 million.

Interviews with authorities in Peru reveal a high degree of satisfaction with Bank's *de facto* program. Indeed it should receive high marks for relevance. The Bank was deeply engaged in virtually all of the important issues facing the country. On efficiency, a review of the Peru portfolio shows a pattern of disbursements, and portfolio characteristics, which are significantly more positive than the Bank's average. This result is indicative of the high local ownership of the program combined with effective collaboration between a very proactive Country Office and the Ministry of Economy and Finance. On efficacy, the picture is mixed: while most policy changes supported by the Bank were achieved, outcome results were less than anticipated. The Bank was relatively effective in promoting policy changes to enhance productivity, strengthen institutions of economic governance, and ensure targeted transfers to the extreme poor (contributing to reducing extreme poverty by almost half), as well as improving access to basic services such as water, education and health. In addition, it contributed towards removing bottlenecks in infrastructure. The Bank's exhortations for improving governance (reform of the executive, promotion of decentralisation) did not lead to policy changes (except for the institutions of economic governance) and the promotion of autonomy of regulatory agencies achieved less than the desired results.

Outcomes expected from the structural policies supported by the Bank produced significantly fewer positive results than had been anticipated. Indeed, with the exception of macroeconomic stability, many of the key challenges at the start of the 1990s remain challenges ten years later. The economy remains dependent on capital intensive, natural resource based, exports. Export diversification has not yet been realised to a desired level, partly due to the economy's transformation being uncompleted, hence today the country is sensitive to terms of trade shocks. In addition, Peru continues to be unable to generate employment with rising real wages and to reduce the level of poverty. The institutional structure of governance in a democratic setting remains weak. Public opinion polls increasingly emphasis the problems of low wages, unemployment, poverty, and the lack of credibility of public institutions. The failure to overcome these structural problems contributed to the surprisingly rapid dismantling of the Fujimori Administration.

These unresolved development challenges remain in the agenda for both the Bank and the country. The extent to which that unfinished agenda is tackled in the coming years will determine whether the 1990s was just another turn of the policy pendulum. Indeed, sustainability is the most difficult area in which offer an informed evaluative judgement. During the post-reform period, during the late nineties, there was retrogression in structural policy stance in practically all areas: tax policy and administration, trade policy, labour market flexibility, and a weakening of the autonomy of regulatory agencies. Nonetheless, public opinion polls suggest that macro-structural reforms appear to enjoy support, and the downturn of 1998-2000 does not appear to have generated widespread calls for a total repudiation of the orthodox model. Thus, for both the Bank and the country, the ability to consolidate existing reforms and tackle the country's remaining structural problems is the "unfinished agenda" which will determine if the 1990s were the beginning of a genuine transformation of the economy and society, and the elimination of the historical pendulum.

I. Country Context and Development Challenges

1.1 A review of Peru's economic and political history establishes three critical points for understanding and evaluating the IDB's efforts in Peru during the 1990s. First, the structure of the Peruvian economy was built upon capital-intensive primary product exporting. This structure rendered the economy extremely vulnerable to external shocks, (a cyclical problem) and created a segmented domestic labour market, which had considerable difficulties generating sufficient employment at rising wages (a structural problem). Combined with geographic and ethnic fragmentation, these economic characteristics produced a society, which was poorly integrated and had been prone to conflict.

1.2 Second, these structural characteristics had contributed to a pendulum pattern in public policy with respect to the economy. The private sector generated output but not employment, and contributed to the maintenance of very high levels of social inequality. Popular discontent with these realities periodically produced governments trying to use the power of the state to correct the imbalances of the private economy. Such governments had been sometimes successful but the state-led growth model had generally proved difficult to sustain over time. Perceived failure of this model led to a restoration of policies aimed at market liberalisation, initialising another cycle of the pendulum.

1.3 Finally, the recurring cycle of failed efforts to generate socially and politically sustainable growth had as a counterpart a political system unable to generate a stable socio-political consensus, which is characterised by a strong democratic institutional basis. This has been partly to exclusion since swings of the political pendulum to the democratic center-left have usually been truncated. Policy changes have taken a toll on public confidence in the country's governing institutions. Political parties have been generally weak and highly personalised, and none of the branches of government enjoys widespread public legitimacy. A significant portion of citizens have little confidence that national political institutions are capable of understanding and representing their interests contributing to a marked tendency for political mobilisation to take place at very local levels through NGOs or spontaneous community institutions. Thus, while interest mobilisation is a durable fact of Peruvian political life, the intermediation of interests and the development of broad social compacts and their institutional basis has for the most part been absent.

1.4 To the above salient and persistent country characteristics has to be added the grave economic and political situation just prior to the nineties. The economy collapsed with a hyperinflation process in place. Basic infrastructure (roads, schools, hospitals etc.) was in an abysmal state. The terrorist movements had taken a high toll not only on human life and strained the country's socio-political matrix but also on economic activity particularly in mining and agriculture. Relations with international creditors were broken due to a unilateral foreign debt service moratorium and direct foreign investment had trickled down practically to zero.

1.5 Given this context, the new Fujimori Administration clearly faced two major challenges when it took office in 1990. First, it needed to address the immediate crisis of virtual national bankruptcy through policies aimed at economic stabilisation and defeating terrorism. Second, it needed to find a viable long-term growth strategy for the country, one which could prove effective in dealing with structural issues such as dependence upon capital-intensive primary product industries, inadequate employment generation, deep and persisting poverty, and the de-legitimisation of national political institutions.

II. *Programming the Bank's Engagement: Diagnosis and Strategy*

2.1 The IDB has long felt obligated to carry out its activities in borrowing member countries on the basis of a formal and relatively transparent process which brings together the opinions and priorities of the borrowing countries with the opinions and priorities of the Bank. Over the years, this process became known as programming.

2.2 For a country program evaluation the first task is to determine the Bank's intent. To unambiguously determine intent, the programming process should use analysis to establish the Bank's own viewpoint on a country and its problems, from which are extracted priorities for Bank action in the country. These actions should be the basis for a dialogue with the country, a dialogue that locates Bank actions within the context of other development assistance activities in order to foster co-operation with other agencies and realise synergies for the benefit of the borrower. Finally, the programming process should anticipate the actual program of the Bank, a program which integrates the full range of Bank instruments, and establishes a broad results framework against which to evaluate the success of the program.[1]

2.3 Formal documental evidence of programming activities can be found in Country Papers (the Bank's programming document *par excellence*), Programming Memorandums (dialogue) and Programming Mission Reports (results of the dialogue).[2] Further, Bank programming intent can also be found in the Trade Sector Loan, approved in 1991, and in a comprehensive socio-economic Report on Peru produced by the Research Department of the Bank in September of 1992. In addition the Bank sponsored an socio-economic reform mission in mid-1990, which focused on issues of sustainable social development.[3]

2.4 The starting point for Bank programming is the analysis of the country and its problems. Such analysis is the basis from which the Bank can develop its own side of the dialogue with a country about problem areas and priorities for action. The quality of analysis in programming documents is variable but are generally primarily descriptive documents rather than analytic. Both problem descriptions and –but to a lesser extent- policy exhortations appear, but the underlying analytical pillars (why are things as they are? why are the proposed interventions the best choice?) are generally absent.[4]

2.5 For example the 1989 draft CPP reviews Peru's macroeconomic crisis, but avoids a deeper look at the causes of the crisis and focuses instead on description of the prevailing conditions in a variety of traditional sectors of Bank activity. Little mention is made of any needed changes in macroeconomic or structural policy. If the 1989 CPP reflected the priorities and orientation of the Garcia Government, the analysis contained in the 1991 Trade Sector Loan epitomised the new policy paradigm of the Fujimori Administration. The loan document articulated the new consensus on Peru's critical need for macro-structural economic reform: the withdrawal of the state from productive activity; the elimination of policy-induced distortions; and the creation of a positive climate for the private sector. Although this "new consensus" had a long and

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[1] Although this normative model can be distilled from official Bank documents, it understates the changing nature of programming normativity, as Bank guidelines, based on Board directives changed during the decade, and hence programming practice.

[2] CPs consisted of: a draft CPP completed in October of 1989 which was never formally presented to the Board; a CPP sent to the Board in April of 1993 (GN-1773-2), a draft Country Paper prepared in April of 1994 (CP-627) which was not sent to the Board, and a Country Paper sent to the Board in April of 1998 (GN-1992-1).

[3] See *Challenges for Peace: Towards Sustainable Social Development in Peru*, IDB April, 1995

[4] Partly this is due to the absence of any reference to economic sector work done. The early nineties are an example where there was synergy between the IDB and the World Bank in this area:, "… the Bank relied heavily on World Bank documents…" from p.1 of "RE3 Comments to OVE's Peru 1990-2000 Draft Country Program Evaluation", 2001.

distinguished intellectual lineage in Peru, the document is no more cognisant of this history than was the 1989 draft CPP. Both articulate their analyses of the Peruvian situation as eternal verities, ignorant of the longstanding struggle among the viewpoints within the country[5]. Nonetheless, the Trade Sector loan document did provide the analytical pillars and the arguments for establishing why the proposed interventions were the best choice.

2.6 The Social Agenda Policy Group Report, contained an extensive analysis of the roots of poverty in the country, focusing both its diagnosis and prescription on the key issue of increasing the economic productivity of the poor. The Report recommended a "socially oriented development strategy" based on decentralisation (to deal with regional disparities), participation and consensus-building (to deal with longstanding problems of political intermediation), and an employment-focused growth strategy centred around domestic food markets and agricultural production (to address both regional disarticulation and low productivity of the sector which held the greatest potential for employing the poor). Although this analysis was far more extensive than anything produced since the trade sector loan, there is no evidence that its conclusions were translated into the Bank's operational program or used as a foundation for the formulation of the Government's policy.

2.7 The second key responsibility of programming is to provide guidance to the Bank in establishing priority areas of activity with the country. Each of the relevant documents contains a section dealing with "Bank strategy" in the country. A summary of the articulated priorities for Bank action can be found in Box 1.

2.8 Three characteristics of Bank programming in Peru emerge clearly from this data. First, the themes defined as "priorities" for Bank action are so broad and general that it is almost impossible to imagine any actions being excluded from consideration as a result of these strategy statements. If nothing is excluded, everything is a priority. Second, there is no attempt to prioritise objectives. A viable prioritisation effort would array the list of possible interventions from highest to lowest priority, yet no mention is ever made of items of lower priority. Use of the term "priority" is always and invariably associated with an item being of major importance. Third, partly given the broadness of the strategic themes, they are remarkably persistent over time, making it difficult to conclude that prior actions had solved problems, which could thus comfortably be taken off the agenda for the future.

[5] The trade sector loan gave this one-dimensional assessment of Peru's history: "During the past three decades Peru's economic performance was hindered by increasing state intervention in the economy and by an inward-oriented development strategy… this and the progressive loss of fiscal and monetary discipline led to a secular real appreciation of the exchange rate and to cyclical balance of payments crises."[5]

Box 1: The Evolution of Programming in Peru	
Articulated Strategic Priority Areas for Bank Activity	**Progress \a**
1989 Draft CPP "Thus, in summary the overall lending objectives are: Dramatically increase foreign exchange earnings, primarily through expansion of exports in mining and industry; Rebuild and expand productive infrastructure; Regain social services lost by dramatic budget cuts of the recent years of debt crisis and internal civil strife, Support the institutional reconstruction and development of government agencies in Lima, and particularly in the other principal cities and in the provinces to more effectively deliver all aspects of the Government's development objectives."	Partially Yes Partially None
The 1993 Peru CPP Consolidation of Macroeconomic stabilisation and structural adjustment program Support institutional capacity building and pre-investment support Privatisation and private sector development, including microenterprise and informal sector firms Poverty alleviation and social programs Rehabilitation of productive sectors and economic infrastructure, particularly agriculture (Par. 3.4-3.8)	Yes Partially Partially Yes Partially
The 1994 Peru CP "The Bank's strategy over the medium term would support the following Government's development objectives: consolidation of the economic reform and state modernisation, social sectors and poverty reduction: modernisation of social and productive infrastructure, and; Agriculture and sustainable development." Para. 3.2.	Partially-none Yes Partially No
The 1998 Peru Country Paper "The basic components of the Bank's country strategy for the period from 1998 to 2000 are as follows: Maintain assistance for the country in the critical areas that will help achieve progress in economic modernisation, with special attention to support for the second stage of the structural reform process, Rehabilitation and expansion of productive infrastructure, financing (direct and indirect) for private investment in both physical infrastructure and the production of tradable goods, And development of an institutional policy framework that will promote judicious management of natural resources (land, water, forests, and marine biomass) and investment in agriculture. Continue contributing to efforts to reduce poverty and increase the coverage and improve the efficiency of social service delivery Support efforts to modernise the Peruvian State	No Partially No Yes Partially

\a given the generality of the strategic themes, this column suffers from the same generality using the ambiguous "progress" rather than "the relevant "results".

2.9 Over the decade of the 1990's, country-programming documents have moved from an almost exclusive preoccupation with lending to a more inclusive description of the full range of Bank operational products. Only by 1998 however, does a CP fully list technical co-operation, MIF and PRI operations and a list of economic and sector work (technical studies and analytic work needed to increase understanding of the country problems and define programs and projects). However, there remains an unsatisfactory integration into an overall country strategy. [6]

2.10 Programming documents' location of the Bank's program within the universe of development finance actors steadily improves throughout the period. However, the documents provide little strategic assessment of the different competencies or substantive priorities of the other actors, nor indicate any potential synergy between IDB efforts and those of other actors.

2.11 The Bank's capacity to formally anticipate the subsequent lending program has improved substantially over the course of the decade. The 1989 draft CPP anticipated a range of lending projects in the productive sectors, which were subsequently abandoned by the change of government. The 1993 CPP anticipated three specific projects, in electricity, basic sanitation and agriculture, but then included a paragraph which accurately captures the flavour of the document as a blueprint for the future:

> *3.27 (iv) Other Possible Programs for 1993-94. In addition to these projects, there are several other areas that could be incorporated in the pipeline…The Bank also has an ample inventory of small projects in areas … that could also be included in the pipeline for 1992-94. These and other programs will be considered in the context of the ongoing dialogue between the Bank and the Government of Peru*[7].

2.12 The 1994 Country Paper continues this pattern although include a much more extensive list of likely future projects. A review of lending in subsequent years, however, finds that only about a third of the operations anticipated in 1994 were actually executed, and many of the projects actually approved were not anticipated in the CP. This same pattern reappears in the 1998 CP, but with an improvement in the ratio of projects anticipated to projects actually approved. Box 2 summarises the data on this issue. The second column may be taken as an indicator of flexibility to unexpected changes. An argument that may be reasonable for the three policy based loans but difficult to sustain for the others, but certainly in concordance with the blueprint.

2.13 The last column of Box 2 is interesting not only because by 2001 most of these proposed projects have disappeared from the pipeline but also why they were never realised is instructive in terms of programming.[8] The first set include projects (Local Government, Barrio improvement, Decentralisation and Municipal Development, Lima Urban transportation) that went counter to what was occurring in the country's political process namely centralisation of power in the executive hence ran counter to strengthening sub-national governments. The second set includes projects (Rural Electrification, Housing, Sanitation, Port Modernisation,) where there was a conflict between MEF and the Line Ministries (and sometimes the Bank). These projects were essentially traditional public investment activities considered inconsistent with the divestiture strategy being followed by MEF. The third set includes projects in the agriculture sector (Agriculture Reform, Selva Development, Environmental Management of the Rimac Basin, and Irrigation) which got caught in the conflict between reform intent of MEF and resistance by the

[6] During the 1990s, there was no integrated work plan or much co-ordination between RE3 and the IIC, MIF, and PRI with regard to programming and missions, but each informed the other of their respective program after the fact. There have been few points of contact or interference. Interview with Jorge Zelada and Jaime Roldán, IIC, November 9, 2000 and Aurora Belmore, Country Coordinator for Peru, November 9, 2000. However, in 1998, the Bank attempted to define a coherent strategy for operations directed at the private sector, by attempting to integrate the IDB family and instruments through active dialogue with the private sector. See *Informe de Misión, Perú: Estrategia de Apoyo al Sector Privado.* September, 1998.

[7] Peru . Country Programming Paper, April 7, 1993. (GN-1773-2)

[8] What follows is a synthesis of interviews with staff from MEF and OD5. This is a partial view, thus has to be taken with caution.

Ministry of Agriculture. To the latter has to be added that the President himself, an agro-economist with working knowledge of the sector, acted very cautious. An interesting example of this conflict is the Sanitation II project. The first project, with PRONAP in the Ministry of the Presidency bypassed municipalities and worked directly with the local water companies, without given right to institutional/political context. However, when working together, they formed an alliance against the new Water Law (a condition of the proposed Agriculture Reform project), in addition, MEF opposed the Sanitation II project. The final set are projects postponed due to the fiscal retrenchment in 1998 onwards (these include FONCODES II, and Rural Roads).

2.14 Although Bank programming documents have clearly improved over the period under review, the results frameworks in these documents remain absent to weak. Rarely is there any quantitative statement about what either the Bank or the country thinks will be the result –the development impact- of proposed actions, which makes it virtually impossible to evaluate the effectiveness of the Bank's program in achieving its (un-stated) objectives.

Box 2: Anticipation of Operations in Programming Documents

	Correctly anticipated	**Not anticipated**	**Anticipated but not done**
1993 CPP	Electricity Basic Sanitation Agriculture	Too vague to evaluate (see paragraph above)	Too vague to evaluate (see paragraph above)
1994 CP	Basic Sanitation Education Microenterprise Road rehabilitation Investment sector loan	Multisector global Credit FONCODES II Debt reduction Public sector modernisation Judicial Administration	Local government Rural electrification Barrio improvements Housing Decentralisation and Municipal development Agricultural Reform Selva development Environmental management Of the Rimac basin Port modernisation
1998 CP	Enesur Microenterprise II Multi-sector credit Wawa wasi Highway rehabilitation Health reform Education II El Niño II Comprehensive financial Management	Financial Sector II Public Finance Sector Loan Redesur Transmission Line Customs Consolidation	Sanitation II Irrigation FONCODES 2000 Alternative development Highways Lima urban transportation Rural roads

2.15 There are two exceptions: First, the trade sector loan, which set out numerical results, expected from trade liberalisation. Second, in the 1995 Programming Mission Memorandum and the 1998 CP, both, which indicate that the Government of Peru had embraced a target of cutting the rate of extreme poverty in half by 2000. The existence of a clear target helped drive both the Bank and the Government of Peru toward achievement of this objective.

III. *The Bank's Program*

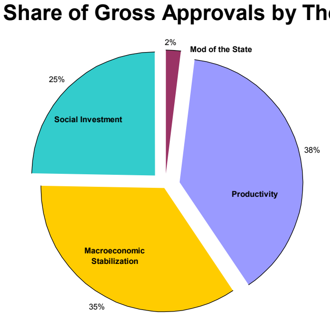
3.1 Partly on the basis of the programming exercises described previously, in 1991 the Bank entered into a period of extensive engagement with Peru, making it one of the most active operational programs over the succeeding 10-year period.

3.2 The Fujimori Administration, which took power in July of 1990, moved swiftly to address the macroeconomic crisis conditions then prevailing. Reversing the position taken during the campaign, the government embraced a tough, orthodox macroeconomic adjustment program of a type then supported by the World Bank, and the IMF. This "Fuji shock" embraced monetary, fiscal and exchange rate policies aimed at macro-economic stabilisation, trade policies aiming at opening the economy, policies to liberalise the agricultural sector, the financial sector and the labour market, and policies aimed at changing the role of the state from producer to regulator.[9] One key objective of the shock program was to restore Peru's access to international capital markets. In this process, the Peruvian government initially focused on the IDB as the institution to lead the restoration of relations with creditors.[10] In the fall of 1990, the Prime Minister of Peru asked the IDB to be the "godfather" of Peru's efforts to normalise it relations with the international financial community."[11]

3.3 With the clearance of arrears, the Bank quickly moved to implement a major program of engagement with Peru across a broad range of issues. On September 18th, 1991, the Bank approved a $429 million trade sector adjustment loan, its largest loan to Peru before (or since), and one done without parallel financing from the World Bank but co-financed by OECF. Over the next 9 years, the IDB approved a total of 227 discrete operations with Peru, 41 loans totalling $3.8 billion, and 186 technical co-operation activities (including MIF projects) for a total of $67 million in convertible currencies and $30 million in local currency. Over this period, Peru was the largest recipient of convertible currency TC, and second only behind Brazil in the total volume of technical co-operation funding.

3.4 The IDB program with Peru over the period can be defined in a number of ways. During the nineties (see Chart 1), Bank's activities aimed at macroeconomic and structural reform accounted for 35% of the program, infrastructure and productive sector activities accounted for 38%, and socially oriented operations accounted for 25% of the program. The 2% of lending volume dealing with modernisation of the state understates its role in the total program of the Bank with the country, and somewhat overstates the actual resources allocated to this function.[12]

Chart 1: Share of Gross Approvals by Theme



Source: IDB Warehouse Database

[9] This type of policy package was later dubbed the Washington Consensus. See J. Williams "In Search of a Manual for Technopls" in J.Williams ed. The Political Economy of Reform, IIE, 1994. Within three years Peru implemented practically all of the 10 recommended policy measures: Fiscal discipline, public expenditure priorities, tax reform, financial and trade liberalization, unification-liberalisation of exchange rates, abolishing barriers to DFI, privatisation, deregulation and property rights.

[10] With the reforms that the government had made already and those agreed upon, Peru got approval for IMF special drawing rights on September 12, 1991. Peru then paid the IDB arrears on September 13, 1991 with funds from an August 1991 soft loan from the Latin American Reserve Fund and a bridge loan from the Peruvian Central Bank. The Paris Club rescheduled Peru´s bilateral debt on September 16, 1991. IBRD arrears, larger than the ones with IDB were cleared in 1993, helped by a bridge loan from Japan. Commercial bank arrears were cleared in 1997 in the context of a Brady Plan.

[11] "Peru. Report of Special Mission, September 12-15, 1990," Memo from Euric Bobb to James Conrow, p. 2, para. 5.

[12] The Government cancelled the largest single loan in this category before any disbursements took place. The loan is included, however, in both of the Appendices and in Chart 1, since the approval took place during the period under review. Note: partial cancellations accounted for 17% of the original amount approved during the period. MOS cancellations accounted for 75% of the approvals in the sector. However, many projects classified into other categories had institutional strengthening components, which suggests an understatement of the MOS category. Cancellations

3.5 Within the nineties the relative emphasis changed. The 1991-92 period was heavily focused on questions of macroeconomic adjustment, with both a trade sector loan and a financial sector loan. Infrastructure (roads and electricity) also emerged as an early theme. Technical co-operation during this period emphasised supporting key fiscal agencies (SUNAT), and on design work for the social stabilisation fund which later became FONCODES. For the following two years, 1993 and 1994, there were continued efforts in infrastructure, with emerging interest in both sanitation and health, as well as multi-sector credit operations in the financial sector. The years 1995 and 1996 saw new lending activity in rural infrastructure, agriculture and education, along with a major effort to promote modernisation of the public service. From 1997 through 1999, the Bank's program included large lending operations responding to *El Niño* emergency, continuing reform in the investment sector, and public sector finance reform, while continuing efforts in infrastructure, education, health and multisector credit operations. The Bank's program in this latter period also began to include projects aimed at the private sector.

3.6 The total number of operations was two hundred and twenty seven separate activities. Many of these operations were small technical co-operation projects. A reduced set of "core" operations, those involving OC loans and technical co-operation projects of US$ 1 million or more gives 67 operations, all significant elements of the Bank's program with the country[13]. This is roughly three times the number of operations by the World Bank, which approved 22 loans for $3.2 billion over the same period. The number and breadth of the Bank's program may raise questions concerning focus as it creates a tremendous challenge to effective execution, particularly in the context of a weak institutional capacity. It did not do so (see below).

The Bank Program in Context

3.7 Before delving into the details of the Bank's operational program for the period, it is important to note that Peru was also the focal point of development finance activity by many other actors. The IMF and the World Bank had significant programs with Peru during this period, and bilateral grant assistance, primarily from the US, Spain, Japan and Italy averaged $500 million per year throughout the period.

3.8 Co-ordination among the different development actors was relatively good. The Japanese Overseas Economic Co-operation Fund and the Japanese Ex-Im Bank co-financed the early IDB adjustment lending[14] There was very close donor co-ordination between the Bank, the World Bank, the IMF, the Japanese Overseas Economic Co-operation Fund (OECF), the Japanese Ex-IM Bank, the Paris Club, and USAID.[15]

3.9 The IDB and the World Bank also worked out a highly co-ordinated approach, in part because officials in the Ministry of Finance had clear ideas about a division of labour among the institutions. The two institutions funded a number of operations jointly, including commercial sector reform, financial sector reform, social emergency funding, debt reduction and the response to the *El Niño* emergency. Although there was a lag in the approval date between the Bank's and the World Bank's trade sector reform and finance sector reform loans, the first of these loans was prepared jointly and the second in close co-ordination throughout the design period.[16] In loans

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in the SI sector accounted for 21% of the approvals. Productivity sector cancellations accounted for 20% of the approvals. Finally, macroeconomic stabilisation cancellations accounted for 9% of the approvals in the sector.

[13] See Annex I

[14] Japan's co-financing of the trade sector loan amounted to US$100 million and for the finance sector loan, US$400 million. See CP-397, *Peru. CPP* 1992, p. 39, para 3.16.

[15] Interview with Izumi Ohno, Director, Division 1 (Latin America and the Caribbean) Development Assistance Department IV, Japan Bank for International Co-operation, in Tokyo, September 28, 2000. Ms. Ohno was the World Bank country desk officer for Peru in the early 1990s. See also, Minutes of a Meeting of the IMF, WB, IDB, Sept. 5, 1990, RE3 files.

[16] PR-1796 Rev., *Perú: Propuesta de préstamo y cooperaciones técnicas para un programa de ajuste del sector de comercio*, 10 septiembre 1991, pp. 7-8, pár. 1.28 and p. 30, para. 2.69; and PR-1832, *Perú: Proposal for a loan and reimbursable technical co-operation for a finance sector adjustment*

for rural roads, education, and health the Banks divided the terrain without co-financing projects, but they did co-ordinate and often went on joint missions.[17] An example of collaboration between the IMF, IBRD, Eximbank, and the IDB was the debt reduction and service loan, which was written without a single mission from the Bank.[18]

3.10 Indicative of the close relationship between the IDB and the World Bank can be seen in Chart 2. With the exception of the 1990-91 period, when the IDB was able to lend but the World Bank could not because of continuing arrears, approvals and net flows (disbursements minus repayments of principal and interest) from the two institutions moved in parallel.

3.11 Donor co-ordination with United Nations system institutions was important in funding technical assistance and pre-investment studies at a time when the Bank could not yet do so. The United Nations Development Program (UNDP) was particularly important in this regard. Funds advanced by UNDP were repaid later from loan proceeds.

3.12 The Bank also took the lead in sponsoring Consultative Group meetings for Peru: a CG on the Peace Program with Ecuador (2000) and CG's on Alternative Development (to the Drug Trade) in 1998 and in 2000, and the Support Group on the Peruvian Economy (Paris Club) which met from 1993-1996. [19] TCs for supporting the preparation of the Alternative Development CGs amounted to US$150,000 for each meeting, and US$100,000 for the preparation of the CG on the Peace Program. The CG for the Alternative Development program raised US$277 million initially and another US$56 million at a follow up meeting.[20] The CG for the Ecuador-Peru Border Development Program, part of the peace process, raised US$973 million for the two countries in donations and pledges for loan commitments for US$1.2 billion.[21]

Execution

3.13 Despite its ambitious scope, the Bank's program in Peru encountered relatively few problems in execution. Chart 3 compares the disbursement profile of active projects in Peru with the Bank average. The chart compares the percentage of funds disbursed for a project with the percentage of anticipated execution time elapsed. The curve shows the Bank average pattern, where projects are slow to get started, then disburse more quickly before another slowdown in disbursements late in a project's life. Active loans in Peru all lie above and to the left of the curve, suggesting that the Peru program was disbursing at a faster rate than the Bank average.[22]

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program, 25 February 1992, p.32.3.19. The mandate to collaborate is in Board of Governors, *Proposal for the Seventh General Increase in the Resources of the Inter-American Development Bank, Report to the Board of Governors*, Washington, DC: IDB doc. AB-1378 (1 de Mayo 1989), paragraph 3.17, pp. 10-11.

[17] Interview with Aurora Belmore, former Country Co-ordinator for Peru and now Acting Division Chief, OD5, 28 December 2000; and Máximo Jeria, Division Chief, SO3, December 20, 2000.

[18] IDB's loan was for $235 million. Simultaneously the IBRD contributed $183 million, and Exibank providing $38 "parallel to the IMF program and $80 million as co-financing with the IBRD.

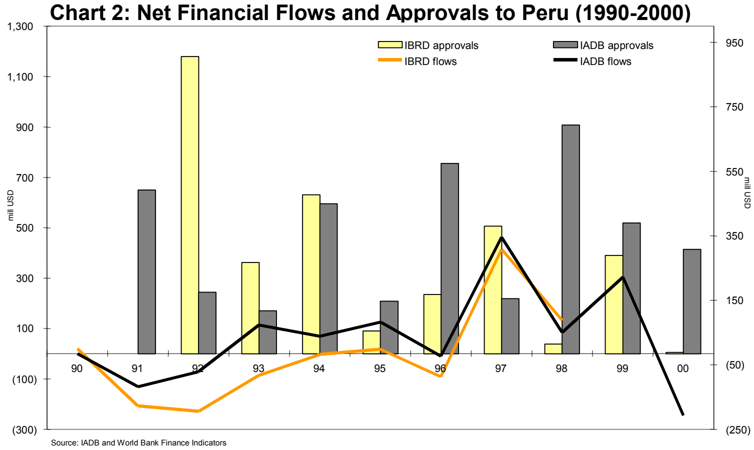
[19] At the beginning of the decade the World Bank sponsored two CG meetings to collect funds for social programs and to support FONCODES.

[20] *Report of the Consultative Group in Support of a Comprehensive Alternative Development and Prevention of Drug Consumption and Rehabilitation Program in Peru*, Brussels, November 11-18, 1998, p.3; and *Report on the Follow-up Meeting of the Consultative Group in Support of a Comprehensive Alternative Development and Prevention of Drug Consumption and Rehabilitation Program in Peru,* Paris, January 26,2000, p. 1.

[21] *Report on Meeting of the Consultative Group in Support of the Consolidation of Peace in Ecuador and Peru*, New Orleans, March 23, 2000, p. 2.

[22] To a large extent this exceptional performance can be attributed to the Investment Unit in MEF which, in general, worked diligently to assure appropriate levels of co-financing and counterpart resources. The Country Office also contributed substantially to the effort by maintaining effective relations with the MEF and with line Ministries.

Chart 2: Net Financial Flows and Approvals to Peru (1990-2000)



3.14 This impression of a well-performing portfolio is confirmed in Table 1, which shows the most recent summary of portfolio performance. Projects in Peru are much more likely than the Bank average to be rated "highly probable" in their likelihood of achieving their development objectives, and "highly satisfactory" in terms of implementation progress.

3.15 The breadth and size of the Bank's program could have resulted in delivery inefficiencies. That it did not can be attributed to the effective collaboration between the pro-active Country Office (which took the lead in anticipating and solving project execution issues) and two units (sector loan unit and public investment unit) –partly financed by the IDB- within the Ministry of Economy and Finance.

Chart 3: Cumulative Disbursement & Execution Times of Investment Projects:

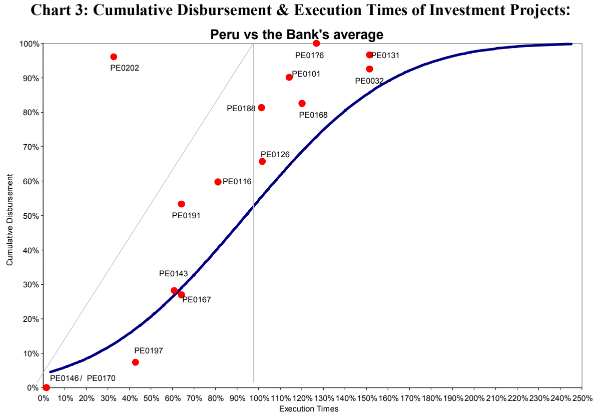


Table 1. Development Objectives and Implementation Progress

Probability of Achieving Development Objectives (% Projects)[1]					
	High	Probable	Low	Improbable	Total N
Peru	18	59	5	18	22
Bank average	13	75	10	2	497
Implementation Progress (% Projects)[1]					
	High Sat.	Satisfactory	Unsatisfactory	Very Unsat.	Total N
Peru	14	54	32	0	22
Bank average	4	72	23	1	497

1 As of December 31, 2000
Source: CC-5644-1, 2001, Performance status of projects in execution

IV. Assessing the Bank's Program: Initiatives and Results

4.1 The objective of this section is to evaluate the Bank's actual program in terms of its outcomes i.e. its development impact. There are, however, some issues of method, which must be dealt with first. The first task, is to recognise that using the benchmark, development impact, at economy-wide or at the specific sector level, is a high evaluation standard. Second, the evaluation has the advantage, hence suffers from, hindsight. Hindsight not only with respect to information that was not available to Bank and project teams at the time but also because an evaluation invariably embodies a "changed" conventional wisdom of the institution.[23] Third, the outcome results of the program can only be fairly evaluated if the country takes the policy steps proposed. You can't fault the diagnosis if the patient fails to take the prescribed medicine. Finally, there is a large and difficult problem of attribution, since many forces were pushing the country in the same direction. With the IMF, the World Bank, bilateral creditors, private investors and a significant element of the Peruvian elite all urging the same policy course, it is virtually impossible to single out the influence of the IDB and attribute specific outcomes to the unique interventions of the Bank[24].

4.2 In the sections that follow, therefore, this document will focuses on the actual implementation of proposed reforms, and looks at the overall effects of the program on the Peruvian economy. It will not attempt to attribute causality to each of the actors, or projects, but will try to note areas in which our common strategies contributed to positive results, and those areas in which progress has been less impressive.

Stabilisation and Structural Reform

4.3 In the area of macroeconomic and structural policy, Peru underwent a major transformation during the early 1990s. The policy pendulum noted earlier swung strongly in the direction of free market economic liberalism, a move encouraged by both advice and financing from virtually all-bilateral and multilateral creditors. Technocrats in the Ministry of Economy and Finance (MEF) designed the initial stabilisation program, with technical and policy support from the IMF and the World Bank.[25] There was clearly significant local "ownership" of the reform program, and a clear political willingness to take on established interests in pursuit of both broad and deep policy reforms. Reform made urgent by and hence facilitated by the hyperinflation in place.

4.4 The IDB initially played a significant role in the reform process, being the first multilateral creditor to have its arrears cleared by Peru, and thus being able to provide finance (the trade sector loan) well ahead of the World Bank. The Bank went on to provide over $1 billion in policy based loans (fast disbursing lending) for stabilisation and structural reform efforts, over one-quarter of the lending program for the entire period.

4.5 In addition to the substantial volume, Policy Based Lending –fast disbursing loans- differed from other types of lending in that the result framework was clearly laid out in the documentation associated with the lending. Since borrowers were being asked to adopt policy measures that often involved short term pain, a good deal of care was taken to describe the anticipated long term gain which will flow from adopting these measures. It was expected that these policies would reduce inflation and interest rates, restructure the Peruvian economy to make it more competitive; reorient it towards its comparative advantages which were seen as export of labour intensive goods; increase growth, employment and wages; reduce poverty; reduce the chronic deficit in the current account; strengthen the banking sector; decrease financial intermediation costs; and stimulate investment and capital inflows.

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[23] An extreme example uncomfortable but relevant for the Peruvian case is the changing conventional wisdom regarding the Bank's role in strengthening democratic processes and fighting corruption.

[24] For example, much of the conditionality of the 1991 trade sector reform loan was met prior to signing the loan. See the Policy Matrix in PR-1796 Rev., *Perú. Propuesta de préstamo y cooperaciones técnicas para un programa de ajuste del sector de comercio, 20 septiembre* 1991, Adendum, pp. 1-10.

[25] The Bank as we shall see financed these technocrats.

Reform

4.6 There are four key characteristics of the macro-stabilisation *cum* structural reform adopted by Peru. First, the high temporal intensity of the reforms was without precedent in LAC.[26] In only five years, using the Lora-IDB Structural Index, Peru went from well below the regional average to being pace setter for the region (see Chart 4). Second, both the stabilisation and reform were relatively "pure", off-the-shelf; hence, they fully embodied the multilateral's conventional wisdom at that time. Clearly, Peru followed the prescription for adjustment. Third, the country attempted simultaneously to implement, both -what would latter be called- first and second generation of reforms (examples of the latter include the successful social security and failed education reform). Finally, almost all of the reforms, particularly during the intense reform stage, 1991-1995, were mainly implemented through presidential decrees, rather than Congressional legislation (see Chart 5). During 1990-1992 there were 37 decrees per month where most were used to "… implement sweeping market-oriented reforms."[27] The gain was speed. The cost of reform speed was high. As Congress began repealing the decrees, and as the Constitutional Tribunal overturned some of the structural reform decrees, i.e. when the checks and balances of the system began to operate, Congress was dismissed and "reorganisation" of the judiciary initiated.[28] Clearly there was a trade-off between the speed of reforms (in turn part of the Bank's and other multi-laterals Policy Based Loans) and the strength of the institutions of participatory governance. Also clearly there was a coincidence between the government and the multi-laterals regarding the relative benefits and costs of the reform agenda.[29]

Chart 4. Level of Reform: Peru, LA median and LA maximum

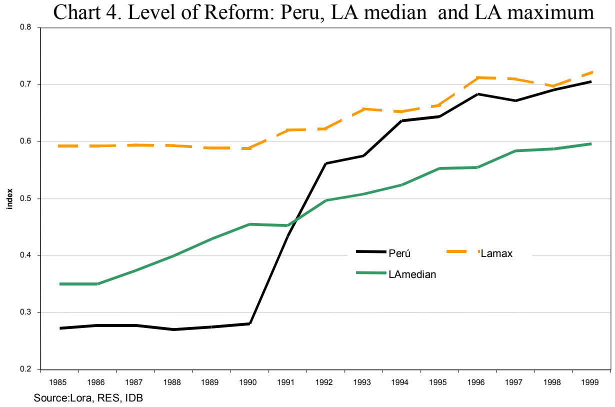
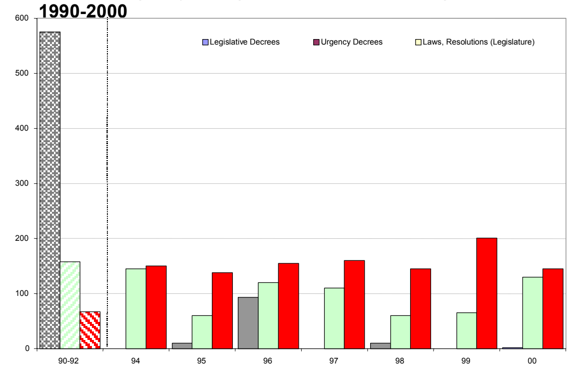


Chart 5: Urgency & Legislative Decrees vs Legislation 1990-2000



4.7 Peru's reforms contributed to impressive success in several areas related to macroeconomic stabilisation. Inflation was subdued (from 7842% in 1990 to double digits by 1992 and continued to fall thereafter), the exchange rate was stabilised, and the fiscal deficit brought under control with improved tax revenue and tough controls on expenditures.

[26] The extent of reform has been quantified by the IDB (Lora 1997) which prepared a set of reform indices comprising trade policy, financial policy, privatisation and labour legislation, from which it derived a composite structural reform index.
[27] See Gregory Schmidt "*Presidential Unsurpation or Congressional Preference? The Evolution of Executive Decree Authority in Peru*" in *Executive Decree Authority*, 1998, eds. John Carey and Matthew Soberg Shugart,
[28] The *autogolpe* was announced on the 5th of April 1992. The Constitutional Tribunal had overturned three economic policy decrees in the previous month.
[29] International lending in the *autogolpe* year was $0.8 billion with $1.2 billion the following year. IDB approvals were $224.5 million (224 separate operations, TCs etc) and 326 million (21 separate operations) in the same years. Should be noted however, that the Bank approved no operations between the *autogolpe* in April and the holding of the elections for the Constituency Assembly later that year.

Box 3: Selected Financial Sector Operations			
PROJECT	**OBJECTIVES**	**COMPONENTS**	**OUTPUTS**
677/OC – PE Financial Sector Adjustment Loan Approved: Mar-92 Amt: 200 M Parallel loan by the IBRD	▪ Reduce state participation in commercial banks ▪ Restructure development banks ▪ Improve the solvency of the financial system ▪ Reform the Central Bank of Peru ▪ Increase financial savings ▪ Improve allocations of financial resources ▪ Reduce intermediation costs	▪ The three tranche loan conditionalities were met in Feb 93, Dec 93 and Dec 94 within the planned timeframe	▪ All public commercial banks were privatised or liquidated ▪ Four development banks were liquidated ▪ Conventional solvency indicators improved ▪ Financial intermediation increased (although mainly dollar denominated) ▪ Portfolio allocations were eliminated and uniform required reserves implemented ▪ Financial intermediation costs reduced
678/OC - PE Financial Sector Reform Amt: 21.8 M Approved: May-92 Parallel loan to 677/OC	Institutional strengthening and technical assistance of the institutions involved in the financial sector operation	▪ Strengthening OSIPITEL (which replaced the original component of strengthening COPRI-Valorization of public banks) ▪ Strengthen the Superintendency of Banks to supervise the financial system ▪ Improve Central Bank's foreign exchange operations	▪ OSIPITEL: a) Installation of computerised system; b) Audits performed; c) New mechanisms implemented ▪ Superintendency: a) increased number of IFs evaluated and b) legal framework for supervision modernised ▪ Central Bank: a) variation of real exchange rate reduced; b) foreign reserves in terms of months increased

4.8 Reform of the financial system, combined with a drastic fall in the inflation rate, restored confidence in financial institutions, leading to both lower domestic interest rates and a substantial rise in financial intermediation. The Bank was very active in this area.[30] In 1992 it approved a PBL and a complementary TC loan. The IDB's operation was co-financed by the OECF and there was a parallel loan by the IBRD. Again in 1999, amidst an economic downturn, IDB repeated the exercise as did the IBRD with JBIC also joining in.[31] There is evidence that the financial sector reforms contributed substantially to the resilience of the sector to withstand external shocks. The country's financial institutions weathered the storm caused by the Russian default in 1998, an outcome at least partly attributable to the reforms supported by the Bank.[32]

4.9 The country's stabilisation efforts not only surmounted the immediate crisis; they also laid the groundwork for future growth. Both international and domestic investment rose strongly. The investment coefficient (Investment/GDP), went from an average of 17.7% of GDP in 1990-92, (not far from its 1970-90 low of 16.0 in 1985), to one of 23.3 % in 1993-98. The growth results of this program were almost precisely those anticipated by the Bank in the 1991 Trade Sector Loan. Chart 6 shows that the actual track of GDP growth was remarkably close to that predicted by the Bank in 1991.

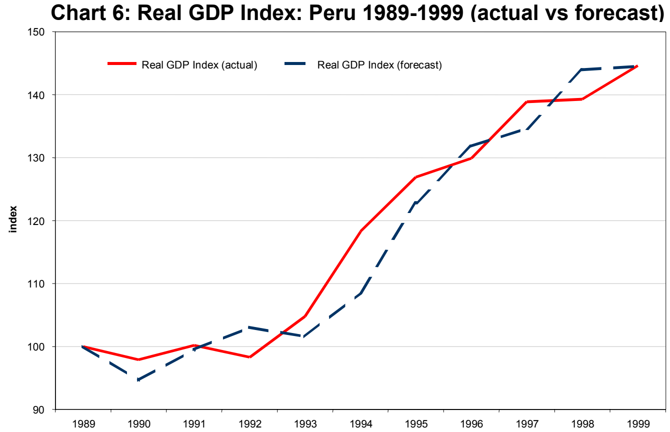
[30] There were 6 MIF operations in this area. See Annex 1.

[31] According to MEF officials, the conditionalities were consistent between the various lenders, and the IBRD took the lead in the reform design.

[32] Conditionality under the Finance Sector II loan required legal and regulatory reforms that "provided the authorities with essential tools for handling the aftermath of shocks to the [banking] system in late 1998 and in minimising the impact of future such crises." PR-2415-1 *Peru. Loan 2295/OC-PE for the second stage of a financial sector reform program. Report on the release of the second tranche and waiver of contractual conditions.* 13 December 1999, p. 2, para. 1.4-1.5. Note however, "In late 1998 and 1999, the fiscal authorities implemented several measures to help banks improve their liquidity…." These measures, involved gross fiscal contributions of about 4.8 percent of GDP (with recovery of resources equivalent to 0.5 percent of GDP as of end-2000". Article IV Staff Report, IMF, February, 2001.

4.10 While impressive, it is important to put the economic growth of the 1990s in context. While the economy recovered the capacity to grow the rate of growth has not reached the levels that it had in 1950-80. The increase in the Peruvian growth rate, during the nineties, is consistent with what has been observed in other countries, where structural reforms akin to those in Peru also have resulted in an increase in the growth rate. Econometric estimates of this effect done by ECLAC (cf. Stallings and Peres, 2000), show an increase of about 0.2 percentage points in GDP growth for every 10% increase in the reform index[33]. In comparison with nine other reforming countries in LAC, Peru in the 1990s did slightly better than the (simple) average of the nine, but it also did better both in 1950-70 and in the crisis period of the 1980s.

Chart 6: Real GDP Index: Peru 1989-1999 (actual vs forecast)



4.11 To be sustainable over the longer term, economic growth must be based on sustained improvement in a country's productivity. Although a target for total factor productivity growth was not set in the Trade Sector Loan, substantial improvement in this area was clearly part of what the reform was expected to produce.[34] In work done by the research department of the IDB (1997) it is argued that structural reforms, and most especially trade reform, should produce not just a one-time bump up of productivity but instead generate a permanent increase in the rate of growth of total factor productivity.

4.12 Chart 7 establishes clearly that total factor productivity growth did improve in the 1990s, and accounted for approximately 24% of the observed rise in GDP over the period. This was a substantial improvement over the 1970s and 1980s, but was insufficient to bring the productivity growth rate back to the levels seen in the 50's and 60's. TFP also grew slower in Peru than in the average of other LAC reforms countries. The expected effects of the reform on productivity were not manifested in Peru, with respect to its historical performance or with respect to its geographical peers. Further, a closer inspection of the nineties shows a disconcerting pattern. During the second half of the nineties, economic growth falls and TFP becomes negative. The fall occurs during a period characterised by stagnation in reforms, and a series of natural and external shocks (El Niño weather disturbance, sharp drop in commodity prices and a liquidity squeeze related to the international financial market turbulence, and the slowing down-partial retrogression of reforms).[35]

[33] The index used differs from the one produced by E. Lora. See S. Morley et al. "*Indexes of Structural Reform in Latin America". Serie de Reformas Económicas*, ECLAC 1999.
[34] The Bank's Trade Sector loan did not specify an target level for total factor productivity growth, but did state "…the foreign and domestic trade reform coupled with more flexibility in the labour market can be expected to produce a more efficient use of the country's resources both through competitive pressures on domestic producers and through the reallocation of resources towards comparative advantage sectors. Furthermore, resources and energies now being used in "rent seeking" activities will be use in productive activities." Paragraph 3.10. It did set a goal for increasing capital productivity (measured by the ICOR) by one third. Paragraph 2.32.
[35] The simultaneity of events makes it difficult to attribute the relative importance of these to the falling TFP.

Chart 7: Accounting for Economic Growth

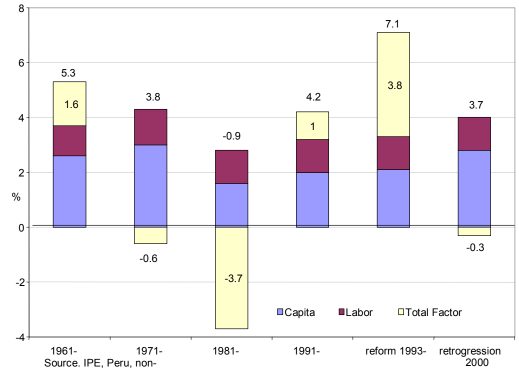
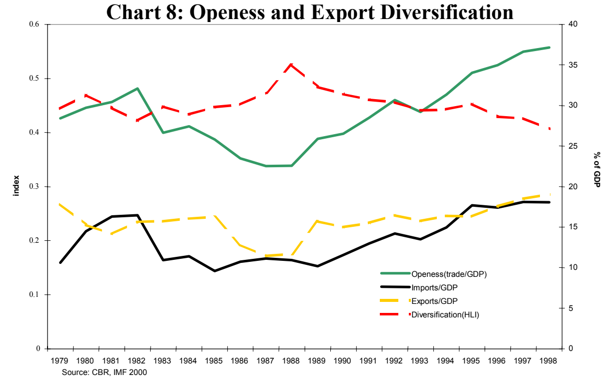


Chart 8: Openess and Export Diversification



4.13 The external performance of Peru during the period was also somewhat less than originally anticipated. Although the country's openness (export plus imports to GDP) did increase dramatically it was due more to an increase in the import coefficient (share of imports in GDP) than the export coefficient (see Chart 8). Their differential change resulted in a deteriorating balance of trade in the post-reform period. This effect needs to be discounted by trade liberalisation's positive effect on productivity and increase in the government's customs revenue.[36]

4.14 The qualitative changes in Peruvian exports were also not entirely in keeping with the Bank's expectations. The increase in exports did not come from the expected sector: manufacturing (other than processing of minerals or natural resources). It came from the traditional sectors: primary goods, especially minerals and industries processing minerals and natural resources. Non-traditional exports as a share of total exports remained essentially unchanged over the decade of the 1990s, while manufacturing exports as a proportion of GNP also showed no improvement. Export diversification –as measured by the Hirschman-Lorenz Index- "has remained remarkably stable during the nineties" (IMF Selected Issues, 2001).[37]

4.15 In summary, the substantial trade liberalisation undertaken by Peru with the support of the Bank has not yet brought about the desired changes in the country's external position. The increased openness of the economy makes it vulnerable to external trade shocks. Partially mitigating this effect is the deeper level of financial intermediation plus the recently created stabilisation fund. Peru's export growth has been disappointing, and the country remains dependent on primary products for approximately 70% of its exports. It must be noted that less access to developed countries markets due to subsidies and non-tariffs barriers have contributed to delay the exports diversification in Peru. On the import side, elasticity of demand remains significantly greater than 1, meaning that a rise in the rate of growth in GDP is associated with an even more rapid rise in imports. Unless financing can be found for the resulting current account deficit, the external

[36] Although other LAC countries experienced a similar post-reform pattern, Peru's external performance was much worse than the nine comparator countries: exports increased less during the decade than comparators, whereas imports coefficients increased more than the comparators. See Stallings and Wilson. Part of this lower than anticipated performance can be attributed to the evolution of the real exchange rate, but more importantly due to "shift effect" from a repressed level of imports, and the surge of capital imports due to the industrial reconversion.

[37] The Hirschman-Lorenz index equals the sum of the squares of each export product's share in total exports, a lower value captures a more diversified export structure.

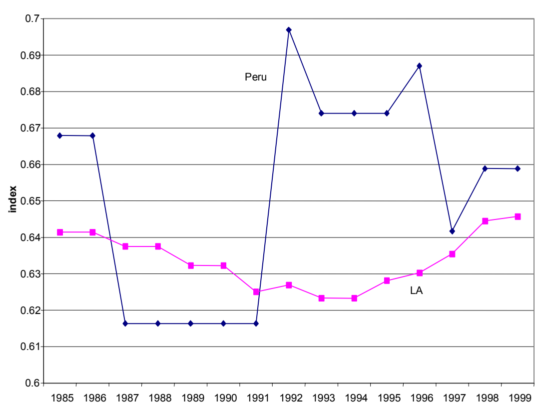
sector establishes a ceiling on sustainable growth, which is well below the growth rate needed to produce sustained improvements in the labour market.[38]

Employment Wages and Incomes

4.16 Ultimately, the political judgement about the success of a macro-structural reform program is shaped largely by its impact on employment and incomes. While predicting that the adjustment program would have a negative effect on both employment and wages, the Trade Sector Loan argued that the reforms would induce "an earlier investment response, and with it, employment creation" (paragraph 3.15). It further noted that "Reducing protection and enhancing labour flexibility increases the relative price of the sectors in which the country enjoys comparative advantage (in Peru, the labour intensive sectors). According to the Stolper-Samuelson Theorem, this results in an increase in real wages" (Paragraph 3.14).

4.17 Further, Peru embarked upon successive waves of labour market reform directed at increasing labour market flexibility such that it was "one of the deepest labour market reforms in LA".[39] Policies sharply diminished firing costs through elimination of job security, introduced temporary labour contracts and changed the severance payment structure. As Chart 9 shows labour market structural reform index passed from far below the LA average to a level above, with partial retrogression during the late nineties.

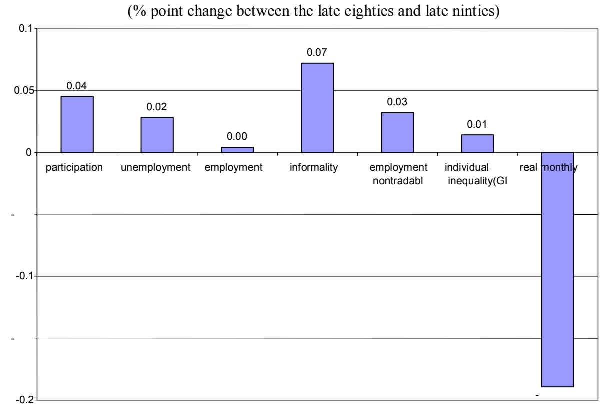
Chart 9. Labor Market Reform



Source. Lora, RES,

Chart 10: Labour Market: change in aggregate labour market performance

(% point change between the late eighties and late ninties)



Source: Diaz et al 20000

4.18 Chart 10 captures the dismal movement in the major labour market indicators from the late 1980s to the late 1990s. Contrary to expectations, employment was practically stagnant while the rate of informal employment grew from 47% to 57% of total employment, and formal employment shrunk from 53% to 43%.[40] Reflecting mainly a rise in the labour force participation rate, the unemployment rate rose over the period. The most dramatic change on the chart, however, relates to income and its distribution. Real monthly family income was substantially lower at the end of the period than at its start, and the level of income inequality at both the individual and household levels increased. A major reason for this pattern can be seen in Chart 11, which tracks the growth

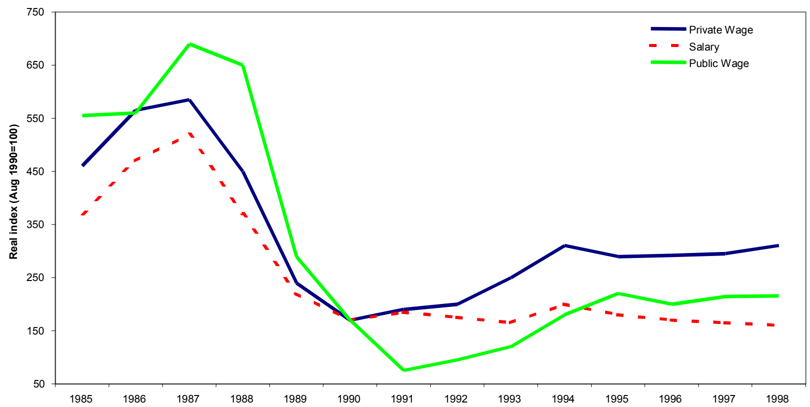
[38] Current account deficit during the nineties was mainly financed by Multi-laterals and DFI in turn mostly due to divestiture of SOEs. Note, recently, a significant proportion of domestic credit was partially financed by short-term external indebtedness of the Banking sector. In the wake of the Russian crisis of 1998, these were not renewed as they fell due, leading to a credit crunch and contributing towards the recession of 1998-9.

[39] For a description of these reforms see J. Saavedra and M. Torero "*Labour Market Reforms and their Impact on Formal Labour Demand and Job Market Turnover: the case of Peru*". IDB, May 2000.

[40] The low generation of employment during a period of high economic growth is due to a low employment-output elasticity of 0.5. "Under current demographic trends… it would take six percent growth of the economy for 20-25 years to reduce total underemployment to low levels." Selected Issues, IMF, 2001. With the same growth rate the reduction would be achieved if the elasticity was doubled to unity, the value in Chile.

of wage incomes over the period. Although the trend in wages follows the anticipated Stolper-Samuelson pattern, the pace of improvement is glacial, leaving wages at the end of the period less than half their value in 1987. Note that such comparisons need to keep in mind the unsustainability of the economy during the late eighties.

Chart 11: Trend of Wages and Salaries



4.19 The reform measures adopted were impressive, as were the results, although the latter fell below expectations. Further, there remains a concern regarding the sustainability of the reforms. As Chart 4 showed, after intensive activity during the early nineties the pace of reform falls after the presidential elections of 1995. What the broad brush reform index does not pick up is that during the second half of the nineties there was partial retrogression in practically all areas: tax policy and tax administration; trade policy; labour market flexibility; and the autonomy of regulatory agencies and a slowing down of divestiture. Of particular concern was the proliferation of tax exemptions and special tax regimes which not only resulted in a revenue loss (of about 2% of GDP) but also the ensuing complexity and non-neutrality of the tax system impaired and weakened the tax administration agency, SUNAT.[41] The result is that Peru's tax effort is low compared to comparable LA countries, and adjustment falls, necessarily on public expenditure.

4.20 There are two potential explanations of the slowing down, partial retrogression of reforms, namely that the second half of the nineties involved the more complex second generation reform and /or the Peruvian government's attitude towards reform shifted against further reforms. In comparing early with the late nineties, RE3 states, " This initial period was characterised by first generation reforms. From then on the government faced difficult trade-offs as they tackle second generation reforms" Not so, as noted in paragraph 4.6 one of the defining characteristics of the Peruvian experience is that the government attempted to simultaneously implement both first and second generation of reforms in the early nineties. An alternative explanation is a combination of factors. "…1) President's Fujimori attitude towards the reform process, especially after the "*autogolpe*" of 1992; 2) the political alignments within the government vis-à-vis the reform process; and 3) the variable leverage the Bank had in Peru as the decade unfolded, especially after 1994."[42]

4.21 Ramifications accompanied the partial retrogression of the policy stance for MEF and for the multilaterals. First, the Bank's new 1996 reform loans came unstuck (public sector reform was cancelled, while ISL, directed at divestiture and regulatory reform only disbursed its first tranche

[41] An attempt at a revenue neutral reform in 2000 backfired. The proposed legislation reduced top corporate and personal income tax rates, the actual legislation enacted reduced the top rates but maintained sectoral and regional tax exemptions.
[42] Quotes are from paragraphs 6, 20 and 21 of "RE3 Comments..".

and the second tranche remained for five years on the books[43]). Second, the IDB and the World Bank returned to the reform agenda in 1999/2000 following the economic crisis starting in 1998.

Productive Sectors

4.22 The second largest component of the Bank's program during the 1990s related to investment lending to strengthen the productive sectors in the country. Traditionally, the Bank had financed productive activity across a broad front, making investments in manufacturing, fishing, agriculture, mining, roads and electricity, and these were the types of operations in the pipeline in the 1989 draft CPP.

4.23 In contrast, productive sector lending during the 1990s was much more narrowly focused. In addition to a number of Multisector operations the vast bulk of such lending went into three areas: road transportation, electricity, and agriculture.[44] Other productive activities once financed by the Bank in the public sector were largely privatised as part of the structural reforms. In this context, it is interesting to note that the Government's privatisation program was handled largely by the World Bank, despite the IDB's more extensive history with productive sectors in the country. This was due to a number of factors. During 1993-95 the IDB shifted from reform to investment lending. The IBRD in contrast maintained engaged in reform. It had funded in 1992 a loan to COPRI for divestiture and followed it with a PBL privatisation adjustment program in 1993.[45] Further the Bank's experience in this area was still relatively incipient at that time[46].

Box 4: Multi-Sector Operation

PROJECT	OBJECTIVES	COMPONENTS	OUTPUTS	COMMENTARIES
852/OC – PE Multisector Global Credit Amt: 100 M JEXIM 100 M	Provide resources to the private sector to finance environmentally friendly projects without crowding out domestic sources Increase connection between financially intermediaries and long term projects Strengthen the institutionality of environmental control	▪ Credit resources to finance private sector investments ▪ Strengthen institutions for environmental control related to the program	Financed 270 projects through 18 financial intermediaries for a total of 466.8 M with the following composition: Industry 25% Tourism 21% Fishery 13% Mining 8% 350 bureaucrats attended seminars on environmental control	Good project design, implemented under a favourable environment due to the rapid growth in investment, the impact of the financial reform, macroeconomic stability and access to international markets. Competition in the intermediary market has been reached. However, sustainability could be compromised due to repayment difficulties associated with El Niño. Regarding environmental institutions progress has been less than satisfactory

4.24 In the road sector, the Bank's projects have generally achieved their expected results. Projects disbursed largely as anticipated, although costs for many of the works exceeded expectations. Substantial investments in the Pan American highway have helped increase traffic and lower costs of internal transport. Rural road rehabilitation has had generally positive outcomes for both farmers and rural commerce [47].

[43] The second tranche of the loan was cancelled in 2001.
[44] The two "El Nino" loans, classified as "social" in this report, went largely for repair of transportation infrastructure.
[45] According to MEF staff, the IBRD had also more experience in privatisation hence was preferred.
[46] The Bank had by the end of 1992 provided nearly US$650 million in fast disbursing PBLs and was reaching the cap for the use of such resources established in the IDB-7.
[47] According to the PPMR of the Bank, of 11 December 2000, the rural roads project has had good results in terms of improving the physical infrastructure, but noted that the loan was also expected to reduce poverty, improve rural living standards, and increase access to basic social services. Results achieved on these objectives were "low to zero".

4.25 Peruvian authorities , however, expressed some concerns with respect to the highways program. The IDB programming highways was so large relative to the transportation budget that counterpart requirements on IDB projects were diverting funds from other priorities. Counterpart problems have surfaced in the latest transportation loan, leading to concerns in the PPMR about implementation progress. Concessions to private firms, a new feature of the latest transport loan, are proving difficult to construct and execute.

4.26 Agriculture holds great development potential for the country, but performance of the sector has been chronically disappointing. During the 1950s and 1960s, agricultural output grew at a slower rate than either population or GDP, a trend which was unaffected by a major land reform program put in place in 1969. During the 1980's, substantial public investment, agricultural subsidies, and a protective trade regime caused a sharp increase in agricultural output, but this was not based on a sustainable increase in agricultural productivity and output collapsed when the subsidies were withdrawn.

4.27 Withdrawing the subsidies was, in fact, a component of the Bank's initial Trade Sector Loan. Both this loan and the later financial and investment sector loans established conditionalities aimed at: ending subsidised and directed credit by closing the *Banco Agrario la del Perú*; the prohibition for the other state Banks to act as first tier lenders to any sector; the freeing of interest rates; and the closing of the Boards that monopolised marketing of agricultural inputs and outputs. Lending for the agricultural sector was shifted to private commercial Banks and to rural credit unions (CRACs: *Cajas Rurales de Ahorro y Crédito*).

Box 5: Rural Credit

The closing of the *Banco Agrario* in the early 1990s left the agriculture sector without subsidised formal credit. In 1994 the Peruvian government supported the creation of a network of Cajas Rurales (CRACs). However some fundamental weaknesses were incorporated in the new system: (i) unwieldy governance structure; (ii) concentration of risk in agricultural activities in a sector with very low profitability, specially in the highland region; (iii) ability to mobilise savings without adequate supervision; and (iv) low level of capitalisation. The majority of these institutions have been in trouble, and some have been closed. However in the late 1990s a small group of them started a process of change attracting local investors as main shareholders or merging with urban NGOs that specialised in micro-finance. These initial steps were supported with the parallel TC of the first Micro-global (and further support has been provided en 1998 with a specific project by MIF). In 1999, the central government passed a decree, which allowed forced refinancing of small agricultural borrowers. The impact of the political measure left many doubts about the future possibilities of the surviving CRACs and the political uncertainty that any financial institution (including municipal Cajas and small NGOs) would face in the provision of financing to agriculture.

4.28 Other conditionalities were not as effective. The government maintained higher tariff barriers in agriculture than those applied to industrial goods. Further additional protection, through variable specific duties, was granted to a limited set of staple crops (wheat, wheat meal, rice, corn, sugar, whole milk and powdered milk).[48] The trade sector loan included the ending of these surcharges as a conditionality, which was not fulfilled. On the whole, however, loan conditionalities were effective in dramatically reducing price distortions and subsidies in the agricultural sector.

4.29 The Bank's diagnosis of problems in the agriculture sector suggested the need for additional changes beyond eliminating subsidies and distortions. Soon after the initial macro stabilisation program was adopted, the Bank began to work with Peru on a major agricultural reform loan. It focused on four key issues: modernising the Ministry of Agriculture, creating a viable system for financing irrigation projects (including the creation of tradable water rights), implementing a rural land titling system, and developing a phytosanitary inspection system to improve the prospects for agricultural exports.[49]

[48] In 1997, an additional 5% tariff surcharge was introduced for 350 agricultural products.

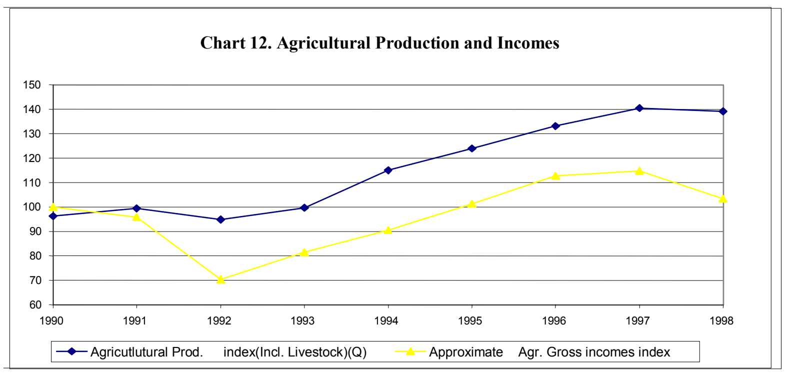
[49] The 1993 CPP emphasised the priority of institutional reform, noting "The agricultural Ministry cannot perform its new regulatory role, and requires an urgent reorganisation and overhaul" para. 2.22.

4.30 As the project went forward, substantial obstacles appeared. The Ministry of Agriculture resisted the institutional reform elements, which were eventually dropped[50]. Tradable water rights, key to the strategy of mobilising private financing for irrigation, proved politically contentious, and were also dropped.[51] The land titling component was broken out into a separate project, which was approved in December of 1995 (PE0037), and the phytosanitary regime was also separately funded (PE0143) in July 1997.

4.31 The Bank's truncated program in agriculture, therefore, combined reform of rural finance institutions (through sector loan conditionalities) with land titling and an export oriented phytosanitary regime. The phytosanitary regime was established and is considered effective, but private rural credit institutions, including both CRACs and commercial banks, credit supply are still hampered by inadequate collateral regime, in a sector with high transaction costs and low profitability.[52] The land titling program is progressing.[53] [54]

4.32 Nevertheless and despite these execution problems, agriculture in Peru has improved considerably over the decade. Agricultural output has grown faster than both GDP and population, reversing the historical trend[55]. Non-traditional agricultural exports have grown faster than traditional ones and Peru posts an agricultural trade surplus (although remaining a substantial net importer of food).

4.33 The principal area of concern is that growth in agricultural output and exports has not been reflected in either rural employment or rural incomes. Formal employment in agriculture has remained static at about 1.1% of total employment through the 1990s, and as Chart 12 shows while agricultural output is roughly 40% higher than it was in 1990, incomes in the agricultural sector ended the decade at approximately the same level as at the start.



[50] Although the Ministry of Agriculture was radically downsized (from 23,000 to 5,000 employees), a recent study has concluded that there has been little progress in moving it or other public institutions dealing with the rural sector to conform with the new policy orientation towards the sector. (Escobar, 2000, pg. 198).

[51] The World Bank took up the irrigation issue, approving a $34 million irrigation works rehabilitation loan in 1996.
[52] Escobal (2000, pg. 201)
[53] The Bank's loan had a goal of 1.1 million titles normalised in 4 years. " The project concluded in June 2000, substantially meeting its objectives, as it legalised close to one million properties", from p. 8 of RE3 Comments.
[54] In addition, , "Peru (partly as a result of Bank support) totally overhauled the legal framework for rural property rights, a process that culminated with the approval of the 1995 Land Law." From p. 8 of RE3 Comments
[55] The fall in the 1979-1990 period was so strong, though, that in 1999 agricultural GDP was only 48% higher than in 1950, reflecting a rate of growth of 0.8% per year, well below that of the population (2.5% according to Valcarcel, 2000).

Poverty Reduction and Social Services

4.34 Peru has long been recognised as having one of the most serious problems of inequality and poverty in the region. In the 1960s, the poorest 40% of the population received 8.8 percent of personal income in comparison to the 14 percent average of 43 least developed countries, and consistently reported poverty rates above 50%.[56] These longstanding problems of poverty and inequality were exacerbated by both the inflation-led economic collapse of the late 1980s and probably in the early stages of the austerity-oriented adjustment program adopted in the early 1990s.

4.35 Concern in the social area and poverty reduction has been a consistent theme in programming documents.[57] Initially the Bank's strategy was to improve delivery systems in basic services that had virtually collapsed during the eighties and support poverty alleviation-reduction transfer programs. The second stage of new forms of organisation, financing, management and provision of services remains on the agenda. While the "elimination" of poverty never appeared in Bank documents, the Government did, in 1995, embrace the goal of poverty reduction, declaring its intent to cut the rate of extreme poverty in half by 2000.[58]

4.36 The Bank pursued a poverty reduction strategy composed of four main elements: direct investment in social infrastructure in poor communities through FONCODES; investment lending with emphasis on rehabilitation (infrastructure and equipment) and preparatory reform-oriented components in health, education and sanitation; microenterprise development to promote productive employment opportunities for the poor; and job-related human capital programs for displaced workers and those with few work-related skills.[59]

4.37 The Bank's largest financial input to the social areas came from two loans to FONCODES (PE0112 and PE0101) totalling $250 million. [60] A $4 million preparatory technical co-operation program financed by the Bank using the Japan Special Fund preceded this investment. The activities of FONCODES were targeted toward the poorest parts –rural- of the country, where they financed local demands for almost all types of community investments. There are a number of characteristics of FONCODES. First, FONCODES was run from the Ministry of the Presidency (as were most transfer programs targeted to the poor),[61] creating a political filter for the resource allocation process. Second, FONCODES financed many types of activities which fell into the areas of responsibility of other line ministries and of regional and municipal governments, creating confusion and, in some cases, undercutting the institutional authority of these public entities. Finally, FONCODES has throughout its life remained dependent upon external donor financing, which raises doubts about its long-term sustainability.

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[56] See Adelman and Morris, 1964.

[57] In the 1993 CPP the Bank made clear its goals in the social area, noting that: "The achievement of a substantial increase in both the access to basic social services, and in opportunities for productive employment that reinforce sustainable development, equitable growth, and environmental protection, should be at the center of the Bank's objectives and strategy for Peru." (GN-1773 para 3.3). The 1993 CPP then laid out a specific agenda of actions which were likely to contribute to their achievement: "specific programs in education, health and nutrition, water and sanitation, and micro-enterprises' development are needed to improve social services, ensure that the poor can take advantage of greater job opportunities, and protect key vulnerable groups that cannot fully participate in the economy." GN-1773-2 paragraph 2.42 The 1994 CP notes that "The GOP is now preparing, with Bank support, an integrated approach to medium and long-term poverty elimination (sic) called the Social Stabilisation Plan…In the medium term, the GOP expects poverty to be greatly reduced, to have achieved universal coverage of basic health and education services, and, very importantly, to have greatly expanded access of the population to new and existing economic opportunities." CP-627, para 2.21

[58] Saavedra Chanduvi in collaboration with Eduardo Maruyama Sasaki, "*Evaluación de la situación de la pobreza en el Perú y de los programas y políticas de lucha contra la pobreza*," report prepared for UNDP, October, 1999, p. 8; and Programming Memorandum, 17 November 1995, p. 5.

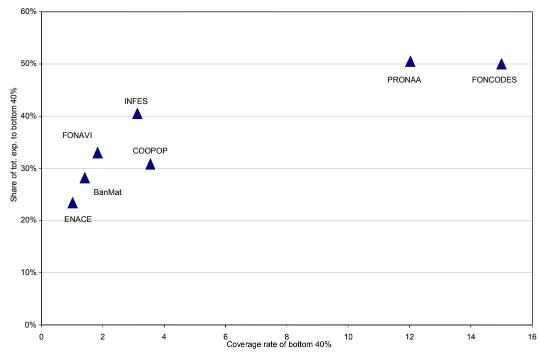
[59] The initial adjustment program, adopted in 1990, did include provisions for the establishment of a social safety net, but little progress was made in developing such a system during the first year of execution. When the Bank resumed lending with the 1991 Trade Sector reform loan, however, it included a significant amount of funding for FONCODES, a social protection program inaugurated by the government in August of 1991. FONCODES was designed to undertake socially-oriented public works in poor areas, producing the double benefit of employment in the short run, and the creation of social assets (schools and health centers) which, in the long run, would address poverty concerns on an ongoing basis.

[60] Both were accompanied by IBRD loans of $100 and $150 millions.

[61] According to Thorp, social transfer funds allocated by the Ministry of the Presidency accounted for 16 pct of central government budget, equivalent to that spent by all other line ministries. P. 24.

4.38 FONCODES has been extensively evaluated. Indicative of the relative effectiveness of FONCODES vis-à-vis other programs are given in Chart 13. It shows the coverage rate (percentage of the poorest 40%, poorest two quintiles, of population reached) vs. target performance (percentage of total expenditures that went to the intended beneficiaries). As can be seen, FONCODES has a high coverage rate and, at the same time, concentrates its resources on the poorest compared to other programs. However, in contrast, the coverage and targeting performance of other anti-poverty programs is meagre. A gross benchmark measure is that for the year 2000 required public transfer expenditure –to eliminate poverty at a stroke-derived from the poverty gap was $318 million (0.59% of GDP). The actual budget for poverty programs was $1,046 million (1.9%), which is *prima facie* evidence of a large potential for improved targeting.

Chart 13: Coverage and Targeting in Peru, 1996



4.39 The Bank's other social programs avoided attempts at premature reforms. They were essentially directed at improving provision –of sanitation, health and education- in the context of restoring the financing levels and their operational capacity. The Bank's programs concentrated on improving infrastructure and equipment and institutional strengthening and studies to lay the groundwork for reform. The Basic Sanitation program, also through the Ministry of the Presidency, was designed to improve water and sewer access by the poor through rehabilitation of 35 smaller water systems throughout the country. As of December 2000, the project had been six years in execution, with a 27-month extension of the final disbursement date, and had disbursed 92% of the funds. Bank monitoring documents on the project indicate the successful completion of components related to changes in laws, rules and procedures, but no information regarding increased access to water and sewage facilities by the targeted beneficiaries.

4.40 The 1993 health loan's objective was to re-establish the Ministry's capacity to deliver health services. The largest component, 55%, was for equipment. It also financed studies to lay the foundation for health sector reform (including the Ministry itself), and re-established information systems. It also financed the design and pilot implementation of the Maternal-Child Health Insurance. A side benefit of the project was the creation of CLASs, institutions for the local organisation and management of health services in poor communities. The follow-up loan, approved in 1999 had the objective to initiate reform, concentrating on Maternal and Child health coverage. It was originally designed as a two-phase operation of $80 and $50 million each, and had a parallel loan from the IBRD. However, the government, prior to signature reduced the loan to 28 million and gutted the main component of the loan, Maternal-Child Health Insurance. The government has continued full funding for the School Health Insurance, which covers all school age children. This priority is wrong since research suggests that the greatest risks to a child's development occur in the first five years of life[62]. Overall public expenditures for health,

[62] The bank has been financing since 1993 first through TC's and through a loan, the WAWA WASI program which provides services (nutrition and some early education) for children of working mothers between the ages of 0-3. The loan 1144/OC-PE (PE-0167) in the amount of US$ 28,800,000.

although rising in recent years, are well below regional averages and those of the eighties and remain tilted in favour of the well off.

4.41 The Bank's lending for education came some years after the World Bank approved a major loan for reform of the primary education system. This reform initially involved a radical decentralisation of education, and was backed by a broad package of reforms approved by the legislature at the request of the President. Despite this backing, the sweeping educational reform foundered in the face of strong public opposition. The IDB program, which followed, took a much more focused approach on improving the quality of primary education. This program has been executing successfully, but there is little data available to assess the significance of its impact. As with health, total governmental expenditures for education trail other countries in the region by a considerable margin and remain slightly tilted in favour of the better off.

4.42 Most of these projects have not been subject to an impact analysis by the Bank.[63] Nonetheless, a crude measure of their success in terms of improving access to basic services can be gleamed from Chart 14. It shows that public perception, in 2000, of the lack of access to water, education and health has fallen during the nineties. However gains in new access to basic and social services between 1994-1997 (see Table 2) do not show a pro-poor bias but were evenly distributed in the population. Further, many of public programs had an urban bias, the largest portion of new beneficiaries live in urban areas.

Chart 14. Public Opinion on Problems in Access to Water, Health and Education.

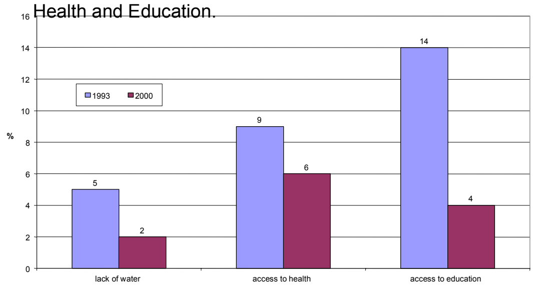


Table 2: Distribution of New Access to Basic and Social Services, 1994-1997

	Water	Electricity	Sanitation	Health
1 (poorest)	20	18	18	16
2	25	25	24	20
3	21	18	20	18
4	18	20	18	26
5 (richest)	15	18	19	19
Urban *	57	72	78	74
Rural *	43	28	22	26

4.43 Finally, the Bank's poverty-oriented lending and technical assistance has provided opportunities for productive employment of the poor in micro-enterprise. The Bank financed two global microenterprise loans, which generally have been considered successful. The Bank supported the transformation of COFIDE into a second tier banking institution and used it as a vehicle for channelling resources, through local banks, for small and medium enterprises through multisectorial global loans. The Country Office ran a program of small projects, and the MIF approved more than $18 million in grant and equity funding for a range of operations dealing with micro, small and medium enterprise. PPMR reports on the multi-sector credit activities indicate that the funds were on lent to small borrowers as anticipated, but there is no information about what the borrowers did as a result.[65] MIF projects have not yet been evaluated.

[63] However, " In health, outputs and outcomes were measured where relevant, and most are reported in the PCR. For example, in terms of public health interventions (such as educational interventions intended to improve food handling among poor families), the impact evaluation (with a case-control design) reports that the prevalence of diarrhoeic disease was reduced by 18.2% in intervention communities. Similar findings were reported for cholera, a major killer in the early 1990s in Perú. In addition, the piloting of the Maternal-Child Health Insurance scheme was evaluated using quasi-experimental methods with resources from the Japanese Trust Fund." P.3 of RE3 Comments.

[64]

[65] The PPMR on the second COFIDE project found that a majority of productive projects financed by the fund had negative economic returns "*Asimismo, si bien la evaluación indica que el proceso puede ser eficiente, los resultados de rentabilidad de los proyectos en mayoría se muestran negativos*." PPMR , PE0101, 7 December, 2000

Box 6: Micro-Global Credit Operation				
PROJECT	**OBJECTIVES**	**COMPONENTS**	**OUTPUTS**	**COMMENTARIES**
958/SF – PE Micro Global Cr Amt: 25 Mill Approved: Oct-95 A parallel ATN/CS-5074 Institutional Strengthening of Entities Involved in the Global Credit Program Follow up Micro Credit Global II 30 M approved in 1998	Increase success to micro credit enterprises Financial intermediaries satisfy credit demand by micro enterprises using additional local resources in a sustainable manner	▪ Micro enterprise credit to micro firms or individuals ▪ Development of an inst. framework for continuous access to credit by micro enterprises and credit technology to Fis ▪ Consultancy and training for environmental issues	▪ 61 loans through 16 FIs corresponding to 52% (5 banks) 42% (CMACs) and 5% (3) CRACs and 1% (1) EDPYMES ▪ 25% of credit was used for assets 75% for working capital ▪ Distribution was commerce 61% services 18% industry 9% agriculture 12% others 2% ▪ Women represented 45% of the clients ▪ Institutional strengthening successful in increasing " Central de Riesgos" with information appropriate for micro credits although technological transfer was unsatisfactory	The CMACs now have assets for more that $100 M and more than 100.000 clients outside Lima. The CMACs, owned by the municipalities, are looking for international private investors. They have been widely recognised as one of the most successful examples of regulated and self-sustainable financial institutions to serve lower income groups. Commercial banks from Russia, East Europe and Latin America and the Caribbean have been using the same credit technologies.

4.44 Taken as a whole, the efforts by the Government and the Bank in the poverty area have produced some concrete results. Peru made relatively steady progress throughout the decade in reducing the number of people in extreme poverty, coming close by 2000 to the goal announced in 1995 of cutting the extreme poverty rate in half (see Chart15). Much of this substantial progress can be attributed to FONCODES and other targeted transfer programs.

4.45 Further, on average the health status and educational attainment of the Peruvian population has improved dramatically since the mid-eighties. In health, average life expectancy increased by 10 years and the total fertility rate was more than halved. While infant mortality rates remain high compared to the Latin American average, they were cut in half from 101 deaths per thousand live births in 1980 to 47.9 per thousand in 1996.[66] Further, these achievements are being maintained. Educational attainment figures also skyrocketed in this period. Health status and educational attainment are the most significant factors affecting well being and human poverty in Peru and will determine future asset accumulation opportunities for the poor.

[66] The data –drawn from the WB's devdata- for the nineties is:

	1990	1999
Infant mortality rate (per 1000 live births)	54	39
Life expectancy at birth (years)	66	69

Chart 15: Poverty and Extreme poverty

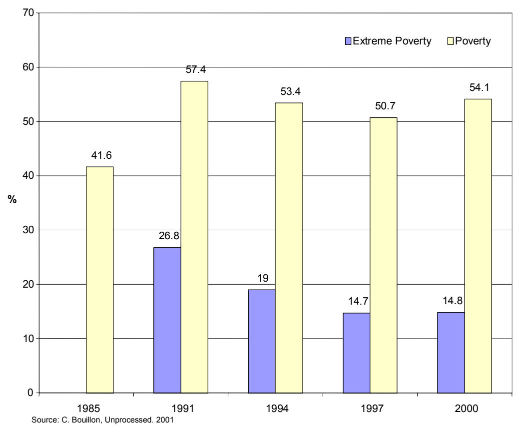
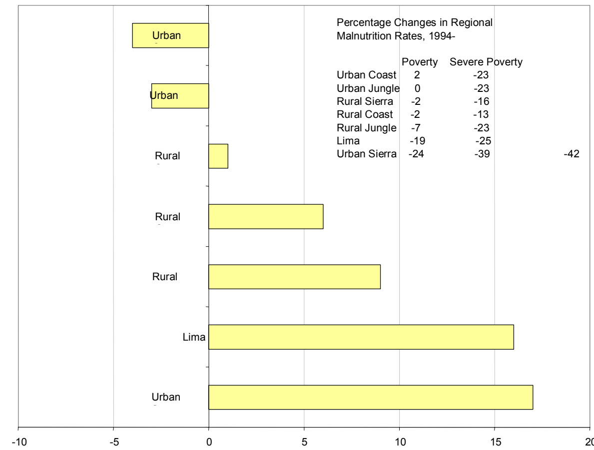


Chart 16: Real per Capita consumption Growth Rates, by Region



4.46 The other part of the poverty story revealed in Chart 15 is less encouraging, for it shows that the overall poverty rate remained essentially unchanged comparing the years 1991 and 2000. The decline in poverty from 1991 to 1997 was reversed thereafter, as poverty rates again began to climb, as the economy began to deteriorate[67]. The stubbornly high poverty rates are troubling. A key factor explaining the poverty pattern is that the high economic growth of the nineties did not translate into an increase in real incomes of low-income groups. Further, the impressive agricultural growth rates did not even translate into employment creation. The latter contributed towards growing regional and urban-rural inequality as well as slower social progress in rural Peru. Chart 16 summarises the growing geographical and urban-rural disparity in three dimensions: changes in poverty, malnutrition and per capita consumption growth rates.

4.47 Two additional worrisome features are the increased risk of poverty of the Quechua and Aymara speaking population, particularly children. The growing disparity between the Quechua/Aymara and Spanish speaking populations[68] was such that by 1997 Quechua/Aymara speaking population, was 49% more likely to be poor than Spanish speaking population compared to the figure of 40% in 1994. Indigenous population has lower education levels, children school attendance rates, and are twice as likely to be malnourished. Their access, due partly to their rural concentration, to basic services (electricity, sanitation, water and health) is not only low but disparity has grown as distribution of new access to basic services, other than sanitation, has had a strong non-native speaker bias against non-Spanish speaking populations. Finally, even controlling for these factors, Quechua/Aymara speaking families have lower consumption rates indicating a lack of a level playing field in the market. Thus the Quechua/Aymara speaking population does not face a level playing field neither for acquiring capabilities nor in terms of opportunities. Further, child labour rates have doubled for children between 6 and 14 and child labour rates have a strong pro-cyclical pattern.[69] The lost increase in human capital has important negative long-term ramifications.

4.48 Taken together, these data suggest that the Government has been relatively effective at implementing targeted transfer programs aimed at the very poor. With respect to the generation of jobs and incomes, the economy has yet to lift families from poverty. Poverty is a structural

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[67] This increase in poverty occurred primarily in Metropolitan Lima, where the increase was almost 10 points, from 35.5% to 45.2%. In other urban areas, the rate rose slightly from 48.9% to 49.8% and in rural areas it increased from 64.8% to 66.1%. Metropolitan Lima was also the site of an almost doubling in the rate of extreme poverty, with an increase from 2.4% to 4.7%. In other urban areas of the country, the rate rose only from 7.6% to 8.4%, but in rural areas the rate declined slightly from 31.9% to 30.1% *Instituto Cuánto*, "*Encuesta nacional sobre medición de niveles de vida, ENNIV-2000," presentación*. Lima, Perú: 31 de agosto de 2000, p. 8

[68] Using language as a proxy for indignity.

[69] See Rodriguez and Abler 1998.

problem caused by the way the whole economic system operates which implies that social-poverty policies are not separate from the overall development strategy. A strategy directed at not only generating income-earning capabilities (education, health, housing, basic services) but also creating opportunities (employment and investment) for using them productively. Increased efficiency and efficacy of targeted transfer programs and strengthening their institutional basis is not enough.[70]

Reform of the State

4.49 The macro crisis of the late 1980s had devastated the public sector. Institutions were in disarray, and the civil service was deeply demoralised by a collapse in salaries, which, in 1992, were 10% of their 1981 level. In fact concern about the quality of the state in Peru has been a persisting feature of the IDB's approach to the country.[71]

4.50 A review of the actual operations mounted (or attempted) by the Bank shows that there were several quite distinct goals in mind with respect to state reform in Peru. First, there was a concern about the quality and capacity of key institutions of economic governance; i.e. those governmental institutions which were essential to the regulation and governance of an economy where the principal impetus was to come from the private sector. Second, there was a broader concern about the administrative capacities of the civil service at large, and particularly with public agencies involved in the provision of critical services such as education, health, housing, and agriculture[72]. Third, there was interest in the quality of the judicial system, particularly in the context of a development strategy placing such heavy reliance on the private sector and, by extension, on the rule of law in the governance of the market economy. Fourth, there was concern about the way in which interests were represented and reconciled by the various agencies of the state, and by the way in which the state communicated with the public. Finally, there was concern that local governments lacked either the administrative or the technical capacity to manage their fiscal/financial responsibilities.[73]

4.51 However, two critical mutually reinforcing factors conditioned the Bank's achievement of the above goals. The first factor was the political dynamics derived from the fight against terrorism. The latter led not only to a significant centripetal force on political decision-making, increased the military's tutelary powers over non-military policy areas, but also led to the weakening of checks and balances of the different branches of the state (horizontal accountability) and between the state and its citizens (vertical accountability). The second ingredient was the unfolding of a particular form of the governance regime of the country, namely a delegative democracy.[74]According to O'Donnell a delegative democracy "…is characterised by the restricted scope, the weakness and the low density of whatever political institutions exist. The place of well-functioning institutions is taken by other non-formalised but strongly operative

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[70] A simple suggestive exercise reinforces this point. Poverty gap in 2000, suggest a required annual transfer expenditure of 0.5% (0.5) of GDP to eliminate poverty (extreme poverty). An increase in the assets of the extremely poor by US$ 3.2 billion with an annual return of 10% would do the same. That is annual expenditure of US$630 millions, spent on increasing human, physical, and social capital of the extremely poor would do the trick.

[71] The 1989 draft CPP cited "institutional weakness" as a principal cause of problems in executing Bank lending. The 1993 CPP noted that "the major deterioration of public sector finances has resulted in a weakened institutional framework in all areas of public administration." (Paragraph 2.4) The 1994 CP noted "pervasive weakness in the executing capacity of public agencies. (Paragraph 2.31), and the 1998 CP cites the need to "modernise the Peruvian State urgently, to build efficient, stable, lasting institutions…" (Paragraph 9 in executive summary).

[72] Peru Country Paper, 1994 "A critical bottleneck for Peru's smooth restoration of economic growth is the pervasive weakness in the executing capacity of public agencies. The problem is more acute in the ministries of education and health…" para 2.31

[73] The 1993 CPP noted concern regarding " uncertainty concerning functions and responsibilities among public sector institutions…lack of clear definition about the duties, role and authority of Regional Governments in relation to the Central and Local governments…lack of institutional capacity to formulate public investment programs…deterioration in the quality of public services transferred to the Regions, due to lack of technical, financial, and organisational resources and capabilities. 1776 para. 2.13.

[74] See *Counterpoints* by Guillermo O'Donnell see also "*Horizontal Accountability in New Democracies*" in *The Self-Restraining State*, Eds., A. Schedler, L.Diamond, and M. Plattner, 1999.

practices-clientelism, patrimonialism, and corruption". p163. Further, "… horizontal accountability is extremely weak or non-existent…" pp166. In fact, delegative practices strove headlong against formal political institutionalisation of congress, the judiciary…" Nonetheless, delegative democracy has the "…advantage of allowing swift policy making…" pp166.

4.52 As we saw previously, swift policy making through presidential decrees certainly fits the Peruvian case. Further, the delegative framework predicts what actually unfurled in the political sphere in Peru and where the IDB would have successes (institutions of economic governance) and failures (public sector reform, decentralisation, reform of legislative and judicial branches of the state) essentially exhortations and projects that attempted to increase vertical and horizontal accountability.

Strengthening Institutions of Economic Governance

4.53 The first priority of the new Fujimori Administration was to establish effective public institutions in areas critical to the success of the adjustment process and the pro-market structural reforms. In each of these areas, the Government sought support from the IDB and the World Bank to establish specialised units within Ministries (to design and implement reforms) or the creation-modernisation of specialised regulatory agencies. The Bank's intervention in this area was a relative success as would be expected from the delegative framework.[75]

4.54 From the Bank's perspective, the key specialised entities within Ministries were located in MEF, with the flagships being the *Unidad de Coordinación de Préstamos Sectoriales* (UCPS) and the Public Investment Unit. They were endowed with substantial resources and support from the outset to manage the reforms, which were part of the conditionalities attached to sector lending. According to both Bank and country officials, these Units functioned extremely well and were key to the success of the macro-stabilisation cum structural reform process.[76] Together they ensured effective co-ordination inter and intra multilateral activity in Peru, as well as within the state, and contributed to better than average execution performance of the Bank's portfolio. Relatively unsuccessful however, were the project implementation units in the Ministries of education, health and agriculture. All shared a number of common characteristics. They were staffed with technocrats, enjoyed preferential access to higher levels of government, were funded with external resources, and were freed from many of the normal bureaucratic rules and procedures. Units within MEF, however differed in one respect; they were led by individuals personally selected and appointed by the Minister of Finance (sometimes with the President's approval) and had direct lines of communication to the highest levels of Government. Further, MEF units were not strictly project executing units, while those within the health, education, and agriculture approached being so.

Box 7: Strengthening Policy Reform Process

[75] The national budget established a special program –FONAFE—to finance specialised administrative units. A 1998 survey by the Ministry of Finance found 89 specialised entities financed by FONAFE in which salaries were 2-6 times higher than central ministries. Data from Ministry of Finance, cited in Carol Weiss *Reinventing the State: Economic Strategy and Institutional Change in Peru*, Manuscript, October, 2000.

[76] According to RE3, "The UCPS functioned well (not extremely well). On several important occasions, it did fail to properly co-ordinate both the design and the effective implementation of policy conditionality with line Ministries and sector agencies (e.g., the case of the ISL). Also the UCPS staff were constantly involved in solving immediate problems for the Minister of Finance ("fire fighting") which distracted them from their presumed first priority of sector reform program design and implementation." See p.7, RE3 Comments.

PROJECT [1]	OBJECTIVES	COMPONENTS	OUTPUTS AND COMMENTARIES
678/OC - PE Financial Sector Reform Amt. 21.8 M Approved: May-92	Inst. strengthening and technical assistance of the institutions involved in the financial sector operation	▪ Strengthen the UCPS of the Ministry of Finance to mitigate weakness of executing units allowing them to fulfil multiplicity of tasks in the reform process ▪ Support UCPS efforts to: a) fuse, liquidate and restructure public development banks ▪ Support MEF in the budgetary area ▪ MEF strengthen the social security reform process (design and implementation)	US$ 2.4 Mill bought professional staff of high quality and efficiency. However, after ten years it still remains dependent on foreign financing.

1 This project had component to strengthen OSIPTEL (Supervisor of Telecommunications) and re-organisation of the Superintendency of banks and improved the Central Bank's ability to administrate foreign reserves

4.55 As mentioned above, the pro-market reforms entailed the creation and/or modernisation of specialised regulatory entities. The Bank's programs supported several of these entities. The Superintendency of Customs (SUNAD) demonstrated impressive growth in customs revenue; in five years collections rose from \$626 million to \$2,723 million, although it in difficult to weigh the relative importance of the effect due to improved administration versus increased revenue due to the increased value of imports (which more than compensated the reduction in tariffs). The Superintendency of Tax Administration (SUNAT) which contributed to an increase tax collection from 6.4% of GDP in 1991 to 13.8% in December 1998.[77] Here again it is difficult to decompose increased revenue due to tax reform (increased tax rates and bases) versus that due to improved administration. Both COFIDE and the Superintendency of Banks and Insurance (SBS) are considered effective and efficient. The strengthening and restructuring of SBS and reform of prudential standards have been important in mitigating the adverse effects of the current banking system crisis. The *Comisión Nacional Supervisora de Empresas de Valores* (CONASEV) provides sound regulatory oversight of capital and securities markets along the lines of the U.S. Securities and Exchange Commission (SEC). However, not all Bank intervention was successful regulatory framework and agencies in water and sanitation, electricity and transport, supported by the Bank's 1996 ISL fell short of Bank's expectations.

4.56 These types of semi-autonomous entities had a number of common characteristics. They all had administrative, technical and budgetary autonomy. Thus they had clear organisational definition, widely-shared agreement as to mission, effective human resource development and incentives (most are subject to private sector labour regimes or special -read non-civil service- regimes), government political commitment, and continuity of management. Most regulatory agencies derive their budgets from the industries they regulate. With the exception of SBS, however, they also shared negative common features, particularly the absence of accountability mechanisms (for example congressional oversight); and their executives had little to no protection from removal.

4.57 This approach to public sector modernisation clearly had some advantages. The MEF units were able to initiate and implement complex reforms, drafting legislation and vigorously pursuing the creation of new institutions. The MEF and the semi-autonomous entities were relatively insulated from the clientelist pressures for both patronage employment and special interest pleading on policy –regulatory issues. Their close association with multilateral financial institutions helped facilitate dialogue and mobilise finance.

4.58 There are, however, some downsides associated with the strategy. As the report of the Bank's Socio Economic Reform Mission noted (mainly referring to FONCODES): "The use of autonomous agencies in the public sector, while understandable in an emergency context, needs

[77] Note however, that the country tax effort remains below comparator countries, this is partly due to the recent proliferation of exemptions and exoneration's implying a tax revenue loss of about 2% of GDP.

serious rethinking to avoid further debilitation of the line ministries and the centralising tendencies which go with continued recourse to such agencies" (page 30).

4.59 There are also concerns about their legitimacy and long-term viability. Autonomy and insulation allow for fast and effective action, but do not compel the building of political constituencies to guarantee survival.[78] This risk is compounded by the fact that many executives of the semi-autonomous entities were appointed, and removed, directly by the President. While in favour, these executives could wield great power, but the fact that they could also be removed at will limits their institutional development and raises the spectre in the public mind that such institutions are being used for narrow political purposes.[79] This has been a recurring theme, for example, in public criticism, in the late nineties, of the tax entity, SUNAT, as a de facto instrument used for political ends. One can go further and argue, despite numerous Bank documents stating the opposite, "… the regulatory agencies did not have administrative technical and budgetary autonomy" and " The regulatory agencies created after the ISL had varying characteristics among themselves but there was a common thread: over time all of them lost autonomy."[80]

4.60 Perhaps the greatest concern with this approach to public sector modernisation is that the model is best suited to the kind of "stroke of the pen" policy changes that characterise the first phase of the reform effort. The so-called "second generation" of reforms shifts from insulated technical exercises to efforts that require careful building of political commitment and consensus among competing interests, a new role for beneficiaries, and much more careful attention to organisational and human resource requirements at the whole organisation or even whole sector level. That is, this strategy and the reforms of the second generation often involve both administrative complexity and political intensity. It also requires a political regime, which is cognisant of the virtue of strong vertical and horizontal accountability. The experience of Peru in the 1990s with this type of reform has been much less successful that the experience with the enclave strategy in building the institutions of economic governance.

Reform of Line Ministries

4.61 The Bank's efforts to promote reform in the large and complex line agencies were far less successful. As noted above, the agriculture sector loan contemplated a major reform of the Agriculture Ministry, which was resisted by the government and eventually dropped from the program. Major reform of the health system was originally contemplated, and legislation was drafted to rationalise the Ministry of Health, but these efforts ultimately failed, and the Bank opted for a more modest intervention aimed at improving local delivery of health services to the poor. Much the same happened with education, where laws were enacted by the executive mandating a radical restructuring of the Ministry of Education and a massive decentralisation of education. These reform also foundered, and the Bank pursued a more limited strategy of curriculum improvement and teacher training. Lack of success was to be expected. It ran counter to the delegative regime, as it would have created checks and balances to presidential power by creating strong decision making centres outside MEF and the Ministry of the Presidency.

4.62 These unsuccessful attempts at reform in the major line Ministries dealing with social issues help explain the tactical choice to pursue these objectives through FONCODES, essentially outside of the existing ministerial structure. Politics doubtless played a role in the establishment of

[78] One scholar noted, describing an earlier Peruvian experiment with autonomous islands if excellence, that autonomy can "be a source of weakness because a state elite is not sustained by constituencies in civil society and therefore is almost exclusively dependent upon its own internal unity and coercive powers. The other side of the coin…is isolation and fragility ". See Alfred Stepan, *The State and Society: Peru in Comparative Perspective.* Princeton: Princeton University Press, 1978 p. 302.

[79] A recent World Bank report noted that presidential delegation authority to autonomous agencies is a process that makes them "relatively easy to create and easy to disable" Shepherd "*Policy Note: Peru's Public Administration and the Delivery of Public Services"* World Bank. 2000 p. 7

[80] See p.7 of RE3 Comments.

FONCODES as an autonomous institution within the Ministry of the Presidency. The acquiescence of the multilateral authorities to this decision perhaps reflected their despair over the prospects of rapidly delivering needed social services through the line ministries. But the decision in turn further weakened those ministries, at least politically.[81]

4.63 As the first phases of economic reform started bearing fruit, however, both the IDB and the World Bank turned again to the issue of civil service reform. Starting in 1993, both institutions began working on a major reform of the Peruvian civil service. Rather than a "micro" focuses on individual ministries and agencies, this was seen as a "macro" reform of the entire structure and function of the civil service.

4.64 As it evolved, the public sector reform program (PE0138) became a frontal and comprehensive assault on the problems of the Peruvian public sector. Components included: i) restructuring: fourteen ministries and/or decentralised public agencies and executing agencies under ministerial budgets; ii) harmonisation of regulatory, operational and organisational framework; iii) streamlining administrative systems: personnel, finance, procurement, accountability systems; iv) separation package for civil servants released as a part of the reform; and v) a major public information strategy to sell the reform to Congress and the public. Ministries undergoing the transformations proposed by the reform were to receive additional resources and the type of operational flexibility enjoyed by the semi-autonomous entities.

4.65 Here, clearly the institutional reform effort involved both political intensity and administrative complexity. In addition, this initiative by definition involved multiple sites of decision-making, placing even greater premium on consensus building. Recognition of these factors was evident. The loan preparation and supporting TCs for institutional strengthening and diagnosis covered a great deal of ground: legislation, organisational analyses, HRD analysis, strengthening of the key executing secretariat in the Office of the Cabinet Chief, and inter-institutional and organisational co-ordination.[82]

4.66 The program, approved by the IDB Board in November of 1996, was an elegant and comprehensive reform effort touching the entire public service. Neither the reform nor the loan was implemented. Failure to implement can be attributed to two main causes. First, the reform proponents failed in the critical task of building public support. According to the PPMR for the project, as the legislation implementing reform (and authorising the IDB loan) neared approval "…inopportune publicity that the program would involve massive public sector layoffs, without specifying which employees would be subject to staff reductions or how they would be handled, magnified fears and resistance by public employees, making the program politically untenable.[83]" Second, and more important, the reform would have created strong institutions within the executive and provided some checks and balances to the Ministry of Presidency. The deepening of horizontal accountability (intra executive) embodied in the reform was ultimately inconsistent with the nature of a delegative regime. Ultimately, the Peruvian government, and the President in

[81] However, in 1994, the Bank turned to the question of medium term sustainability of poverty programs. Through TC 940267 a team was set up to look at this question, particularly the institutional structure. However, as the team's proposal shifted from "strengthening" to "reforming" institutions, the clamour of turf violation by relevant Ministries, including that of the presidency, led to an abrupt dismantling of the team and reallocation of resources. Interview with Ms. A. Belmore.

[82] The project was preceded by a substantial amount of technical assistance in order to prepare the groundwork, including technical co-operation (96-05-10-8) of $1 million in support of the PA Modernisation loan; ATN/SF-4936 in support of diagnostic studies and a legislative review; a diagnosis of the public sector (ATN/SF-4505-PE; ATN/SF-5331 to support the Technical Secretariat, area task forces, and a communications strategy; and ATN/SF-5335 for the design of a compensation and separation package. Much of this TC was cancelled by mutual decision when the loan project was abruptly terminated (not signed)

[83] (PPMR, 1998, p. 24), however, according to RE3, the bottom line was that, "what the program lacked was the support of President Fujimori" see p.6 of RE3 comments.

particular, refused to approve the reform program hence to sign the loan producing the only major loan cancellation in the Bank's entire program with Peru in the 1990s.[84]

4.67 While civil service reform in Peru during the 1990s must be classified as a failure, the Bank nevertheless continues to work in the area of public sector reform. The 1998 loan to support the introduction of an integrated financial management system (PE 0192) was quickly implemented and is functioning well. The large ($206 million sector loan PE-1235) public sector finance reform approved in 2000 also fulfilled its conditionality and disbursed quickly.[85] Both were aimed at identifying and encouraging sound public sector management practices in line ministries, using the regular budget process to establish performance monitoring and contracting. This may result in a gradual improvement in the quality of public spending over time. Both of these loans increased the power of MEF vis-à-vis line ministries and its ability to manage more effectively the resource allocation process. Both avoided creating countervailing powers either horizontally or vertically.

Decentralisation

4.68 Throughout most of its history, Peru has been a highly centralised country. Power has been concentrated in Lima, and, within Lima, concentrated further in the hands of the President. Decentralisation has been on the agenda of the country since the 1979 constitution established that country was to be divided into 12 regions, each autonomous entity with power to levy taxes, and pass their own legislation. Theoretically all public sector assets, except those declared to be of a national character, were to be transferred to the regions. Implementing the Constitution required separate legislative actions for each region, a process not initiated until 1988, as one of the outgoing acts of the Garcia administration. The Bank was thus confronted with a new, partial, and as yet untested regime of decentralisation at the outset of the 1990s. In addition, the draconian counterinsurgency battle during the nineties led to increasing centralisation and militarisation. This was not an environment propitious for carrying out the Bank's conventional decentralisation or decentralised (through municipalities) programs.

4.69 Decentralisation was a constant theme in programming documents.[86] The Bank began work in 1992 on a municipal development program (PE0118), which was designed to strengthen the capacity of municipal governments to manage their responsibilities. The program was dropped from the pipeline in 1993, however, shortly after the Constitutional Referendum. Indeed, the failure to develop decentralisation programs is attributed to the government, "The government… tried to reduce and even block efforts made by the Bank and the World Bank in this area."[87]

4.70 From 1993 on, local development was managed through central programs such as FONCODES, and the Sanitation program, rather than through a deliberate policy of strengthening local administrative capacity. This was an important decision, for it has meant a persisting pattern of

[84] Popular lore has it that the president asked "why a reform". Spectacular failure in public sector reform was not confined to the IDB. The World Bank approved a sweeping loan for reform of the judicial system in 1997, which was also cancelled when it became clear that the government lacked the legitimacy and authority to carry out the project (see below).

[85] It did lead to a hot debate within the Bank. Essentially two mantras came into direct conflict, on the one hand, the mantra of accountability and transparency versus, on the other hand , the mono-mantra of autonomy. The issue was whether the regulatory agencies could be subject to performance contracts or not. PE-1235 , proposed that they should be subject to contracts on a voluntary basis. As the debate raged within the Bank, Peru modified its budget such that quarterly fiscal surpluses of the regulatory agencies were automatically transferred to the national treasury.

[86] The 1989 draft CP noted the need to "..support the institutional reconstruction and development of governmental agencies in Lima,…and in the provinces to more effectively deliver all aspects of the Government's development objectives." A Programming Mission Report in May of 1994 emphasised "the need to establish clear definitions of the role of the central government, intermediate and local governments, particularly in reference to the delivery of education, health and other social services, and to strengthen both regional and local entities." Finally, the 1994 draft CP noted that: "The GOP foresees greater community involvement in administration and control of social services and will have to increasingly rely on local governments through the decentralisation process. Therefore, strengthening the administrative capacity of the municipalities and provinces and promoting local community organisations are fundamental tasks to be included in the GOPs Social Stabilisation Plan" (paragraph 2.22.)

[87] See p.7 of RE3 Comments.

weakness in units of sub-national government. Several of the reforms promoted at the national level, most notably in education and health, were based on the principle of decentralisation, but not through municipalities.

4.71 Although no programs have yet been developed to strengthen decentralised governmental institutions, the 1998 CP mentions the need to undertake "preparatory activities for modernisation of the public sector at the provincial and district levels" (Paragraph 10 in the executive summary). Work in this area constitutes one of the major "unfinished agenda" items left over from the period under review.

Legal Reform

4.72 Reform of the legal system in Peru has been both a political battlegrounds within the country, and the focus of action by a variety of development finance institutions. Peru's justice system entered the 1990s discredited and in crisis. For decades, it had been "increasingly characterised as corrupt, incompetent, inefficient, or simply irrelevant,"[88] lacking both adequate infrastructure and public respect. Citing this history Fujimori Administration dissolved the court system in 1992, and set about a top-down restructuring of the entire judicial apparatus. The decree law of April 1992, gave the President almost unlimited power to appoint and remove judges. This power was used extensively in the following months, and generated a strong backlash both inside and outside the country[89]. Partly in reaction, to this backlash the government proposed a new constitution in 1993, which restored the formal legal independence of the judiciary.

4.73 Shortly after these events, the Bank's 1994 CP noted the need for an "independent, equitable and efficient judicial system" (paragraph 2.34), and indicated that the Bank "would consider helping the Peruvian judiciary in the process of strengthening the administrative functions of the Executive Council of the Judiciary." (Paragraph 3.8). The Bank began to work with the World Bank on a joint program for judicial system modernisation.

4.74 Concerned about the climate of confrontation between executive, legislative and judicial branches, the IDB decided not to support an ambitious reform, opting instead for a modest project focusing on access to justice for the poor. This proved to be a wise decision. The World Bank went ahead with a $22.5 million Judicial Reform Project covering a wide range of legal system reforms in December of 1997. In March of 1998, however, the Fujimori government persuaded Congress to pass a new law sharply limiting the independence of the judicial branch, precipitating a mass resignation of all seven justices on the National Council of the Judiciary. The World Bank loan never disbursed was cancelled in September of 1998.

4.75 The IDB justice project, approved a month before the World Bank's reform loan has however not completely escaped the problems affecting the Peruvian judiciary. Conflicts between various branches of the legal system, combined with problems in the executing agency have blocked execution[90]. The project has consistently been rated as "unsatisfactory" in implementation progress, and in 2000 it was decided to reduce the size of the project from $20 million to $11.5 million, and to cut the number of Basic Justice Modules programmed from 83 to 43. Further, although the project was carefully designed with good performance indicators, no data has been collected by the Bank or the Executing agency to determine whether it has had the anticipated effect of increasing the access of the poor to the judicial system.

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[88] Linn A. Hammergren, *The Politics of Justice and Justice Reform in Latin America: The Peruvian Case in Comparative Perspective* 135 (Westview Press: Boulder, CO: 1998

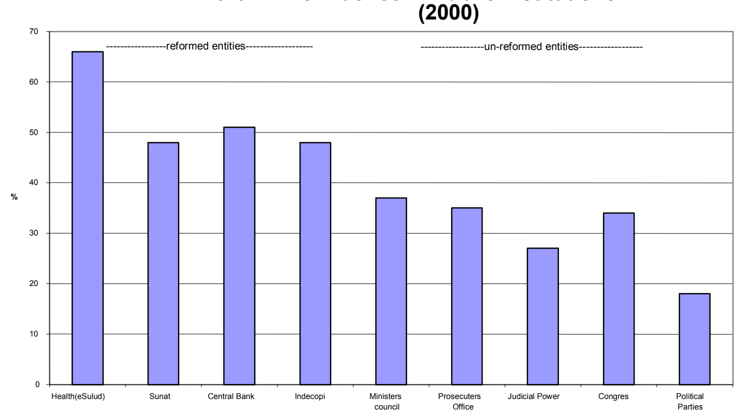
[89] A commission of prominent jurists from Argentina, Italy and the United States that visited Peru in September 1993 to review key features and projected reforms of the justice system in Peru concluded that the effect of these measures "has been to grievously erode, if not eliminate, the institutional independence of the civilian judiciary." Report of the Commission of International Jurists on the Administration of Justice in Peru, November 30, 1993.

[90] According to the December 1999 PPMR, execution was hampered by " *Los múltiples, constantes y disfuncionales cambios de personal en la Unidad Ejecutora, afectan el ritmo de ejecución del programa y la calidad de los productos*." PPMR/ISDP as of Dec. 31, 1999.

Box 8: Justice Access for the Poor				
PROJECT	**OBJECTIVES**	**COMPONENTS**	**OUTPUTS**	**COMMENTARIES**
1061/OC PE Modernisation of the Judicial Administration Program Approved: Nov 97 Years in exec: 3 Cum Disb.: 87% Extension of Final Disb.: 9 months Cancellations (%): 43%	Improve access, efficiency and quality of justice to the first and second level for poor populations living in marginal zones. Set basis for the development of justice policy that improves the protection of women and minors living in the same areas.	▪ Construction of 43 basic modules for justice (originally 83) ▪ Improvement for protection of women and minors through justices of peace ▪ Development and implementation of a communication program	▪ X basic modules constructed ▪ 820 peace justices trained for gender issues and women nominated as peace justices ▪ 332 workshops realised	This program suffered from the confrontation between justice, public ministry and a weak executing unit resulting in lack of allocation of counterparts funding, delays in international licitation and delays in obtaining a legal framework for basic modules. The program was reduced from $20 Mill to $11.5 Mill

4.76 A summary evaluation of the Bank's work in modernisation of the state must balance the considerable success in strengthening the institutions of economic governance, with disappointing efforts in a systemic public sector reform.

Chart 17. Confidence in Public Institutions (2000)



4.77 Public opinion polls in 2000 (see Chart 17 that gives a snapshot) reinforce this assertion. They suggest higher confidence in reformed-modernised institutions of economic governance and little to no confidence in general in the Executive (as proxied by the Council of Ministers), Judicial and Legislative branches.

V. Concluding Summary of Findings

5.1 Country program evaluations are designed to offer evaluative judgements on four major issues: the relevance of the program; the efficiency with which it is carried out; and the efficacy of the program in bringing about needed changes in the country; and the sustainability of the initiatives launched as part of the program.

5.2 To carry out such an evaluation there is the question of the Bank's intent, as captured in Bank's programming documents. A review of the Bank's programming activities in Peru, however, shows that Bank analysis is generally weak, providing a poor foundation to the Bank's side of a development dialogue. Integration, location and anticipation all improved over the period, but a coherent result framework for Bank operations continues to be absent. Bank's intent thus is difficult to discern.

5.3 Interviews with authorities in Peru, however, reveal a high degree of satisfaction with Bank's *de facto* program. Indeed it should receive high marks for relevance. The Bank was deeply engaged in virtually all of the important issues facing the country, offering both advice and financial support in a manner which government officials found helpful in meeting the challenges before them. Although the breadth of the Bank's program raises some concern regarding dispersion of effort, the program did appear to be what the government of Peru wanted from the Bank. The Bank's actual program was clearly responsive to client concerns, but responsiveness sometimes came at the price of an independent view of what needed to be done. In some areas, however, the Bank appears to have been the initiator of the dialogue regarding needed changes, public sector reform and decentralisation, which however did not lead to policy changes. The Banks effective collaboration with the Ministry of Economy and Finance in the area of project execution should be noted.

5.4 On efficiency, a review of the Peru portfolio shows a pattern of relatively timely disbursement of projects, and portfolio characteristics which are significantly more positive than the Bank average. The Bank's program appears to have been well-co-ordinate with other development finance institutions, both multilateral and bilateral, yet there remains a strong sense of local "ownership" in the areas addressed by the Bank program.

5.5 On efficacy, the picture is more mixed. In the macro-structural area, the Bank was effective in promoting policy changes, but those changes produced fewer positive results than had been anticipated. Stabilisation was achieved, confidence was restored, and growth resumed. Essential infrastructure was built with Bank support, and the private sector resumed investment in many critical areas.

5.6 But employment and incomes did not improve in the manner anticipated. Keeping in mind the unsustainability of the economy during the late eighties, a comparison between mid-eighties and late nineties shows that real wages declined, and labour income inequality (individuals and households) worsened. During the nineties although employment generation took place, unemployment did not fall, partly due to the rise in the labour supply. Furthermore, the country remains dependent on primary product exports and growth is constrained by balance of payments issues, which the Bank had hoped the country could transcend. Partly as a result of Bank actions, significant progress has been made in reducing extreme poverty, however, the overall poverty rate has remained essentially unchanged over the decade, and remains higher than the level of the mid-eighties. In contrast the average health status and educational attainment of the population improved dramatically during the nineties. For example average life expectancy increased by 10 years, while infant mortality was halved. Education attainment figures (average schooling years) skyrocketed in this period. Public sector modernisation efforts have generally been unsuccessful, with perhaps the exception of work supporting the institutions of economic governance.

5.7 Sustainability is the most difficult area in which to offer an informed evaluative judgement. From a limited perspective virtually all projects in execution mention severe shortage of counterpart funding as fiscal adjustment forces retrenchment. Recently the government re-dimensioned a large part of loans for judicial reform and the Wawa Wasi childcare initiative. FONCODES has long struggled with the issue of sustainability outside the framework of multilateral support, and prospects here are not clear. In more general terms, the development policy thrust, supported by the Bank, during the nineties was directed at improving allocative efficiency through enhanced macroeconomic stability and a policy environment for market forces. For some commentators, the unfinished agenda is a further deepening and strengthening of pro-market reforms.[91] Within the same perspective a frequent lament is that a partial retrogression of policy stance during 1998-2001 has contributed to falling economic growth and productivity.

5.8 Nonetheless, public opinion polls suggest that the macro-structural reforms appear to enjoy support, and the downturn of 1998-2000 does not appear to have generated widespread calls for a total repudiation of the orthodox model. Government policies supported by the Bank, during the nineties helped address effectively the country's cyclical crisis and economic allocative efficiency. They, failed, however, to address the country's longstanding structural problems. Many of the key challenges at the start of the 1990s—economic diversification, effective governance at national and local levels, adequate employment at rising real wages, expanding the formal sector, reducing the poverty generated by the economy—remain challenges ten years later. For both the Bank and the country, the ability to complete this "unfinished agenda" will determine whether the 1990s were just another turn of the policy cycle or a genuine transformation of the economy and society.

[91] The IMF recently concluded that "… the state of domestic institutions that affect market conditions –weak regulatory agencies, tax system instability, a weak judiciary, and poor protection of property rights…"(p45, Selected Issues, IMF, 2001) continue to hamper private sector activity.

ANNEX I - IDB Operations in Peru

Table 1: Bank Lending for Adjustment and Structural Reform

ID	NAME	APPROVAL DATE	APPROVED US$
PE0029	TRADE SECTOR REFORM	18-Sep-91	439,900,000
PE0033	FINANCIAL SECTOR REFORM	18-Mar-92	221,825,000
PE0103	DEBT AND DEBT SERVICE REDUCTION PROGRAM	13-Nov-96	235,500,000
PE0097	INVESTMENT SECTORAL LOAN	18-Dec-96	150,000,000
PE0201	PUBLIC FINANCE SECTORAL REFORM	17-Mar-00	206,500,000

Table 2: Operations in the Productive Sectors

ID	NAME	Date Approved	Value
PE0025	REHABILITATION/MAINTEN.ROADS PROGRAM	27-Nov-91	210,000,000
PE0018	TRANSMISSION AND REST. ELECT. SUBSECTOR	24-Nov-93	45,000,000
PE0127	PPF:PE0037 AGRICULTURAL PROGRAM SECTOR.	21-Mar-94	1,200,000
TC9409063	GEOGRAPHICAL INF. SYS.TERRITORIAL ZONING	07-Sep-94	1,000,000
PE0131	ROADS REHABILITATION PROGRAM, II STAGE	23-Nov-94	252,000,000
PE0136	RURAL INFRASTRUCTURE TRANSPORT PLAN	15-Nov-95	90,000,000
PE0037	LAND AND TITLING PROGRAM	13-Dec-95	21,000,000
TC9505043	MODERNISATION IN THE FISHERY SECTOR	13-Mar-96	3,000,000
PE0094	AQUAYTIA GAS AND POWER PROJECT	11-Dec-96	60,000,000
TC9603219	HIGHWAY CONCESSION	23-Apr-97	1,300,000
PE0143	AGRICULTURAL SANITATION PROGRAM	16-Jul-97	45,600,000
PE0188	SUPPORT EL NINO WEATHER PATTERN EMERGENCY	19-Nov-97	150,000,000
TC9706427	TRAINING TOURISM DEVELOPMENT IN AYACUCHO	25-Feb-98	1,600,000
PE0102	ENERSUR POWER PROJECT	04-Mar-98	75,000,000
PE0197	ROADS REHABILITATION AND IMPROVEMENT	02-Dec-98	300,000,000
TC9712317	HUMAN RESOURCES FOR TOURISM DEVELOPMENT	03-Feb-99	1,087,000
PE0198	RECONSTRUCTION AFTERMATH OF EL NINO II	15-Dec-99	120,000,000

Table 3: Major Bank Operations Related to Poverty in Peru in the 1990s

Number	Name	Approval	Amount
TC9112096	STRENGTHENING OF FONCODES	18-Sep-91	4,000,000
PE0030	STRENGTHENING OF HEALTH SERVICES PROGRAM	03-Mar-93	68,000,000
PE0108	PPF:PE0032 SUPPORT BASIC SANITATION SECT	30-Sep-93	1,500,000
TC9302473	BID/UNICEF SOCIAL DEVELOPMENT PROGRAM	06-Oct-93	6,300,000
PE0112	FONCODES	22-Dec-93	100,000,000
TC9406267	SOCIAL STABILISATION PLAN	10-Aug-94	1,400,000
PE0032	SUPPORT FOR THE BASIC SANITATION SECTOR	07-Dec-94	140,000,000
TC9409120	ENTREPRENEURIAL SERVICES CENTERS	01-Nov-95	2,918,000
TC9604142	IMPROVEMENT SURVEYS LIVING CONDITIONS	29-May-96	1,740,000
PE0101	SOCIAL DEVELOPMENT COMPENSATION NAT.FUND	19-Jun-96	150,000,000
PE0164	PPF:PE0160 YOUTH WORK TRAINING	02-Aug-96	1,500,000
PE0116	EDUCATIONAL QUALITY IMPROVEMENT PROGRAM	16-Oct-96	100,000,000
TC9504227	TECHNOLOGY TRANSFER	30-Oct-96	1,315,800
TC9604126	SMALL ENTERPRISE ASSISTANCE FUND - FAPE	20-Nov-96	3,500,000
TC9806350	DEVELOPMENT OF PRIVATE SECTOR HEALTH	23-Sep-98	1,670,000
PE0189	MICROENTERPRISE GLOBAL CREDIT PROGRAM II	30-Sep-98	30,000,000
PE0167	CARE AND DEVELOP.OF CHILDREN BELOW THREE	18-Nov-98	46,600,000
PE0146	HEALTH REFORM DEVELOPM. MOTHER-CHILD INS	13-Oct-99	87,000,000
PE0170	SECONDARY EDUCATION PROGRAM	14-Dec-00	120,000,000

Table 4: MIF Projects Aimed at Encouraging Small Enterprise

TC9405110	ALTERNATIVE FORMS OF DISPUTE RESOLUTION	07-Dec-94	1,470,000.00
TC9405243	SUPPORT CAPITAL MARKET DEVELOPMENT	24-May-95	1,730,500.00
TC9409120	ENTREPRENEURIAL SERVICES CENTERS	01-Nov-95	2,918,000.00
TC9504227	DIFFUSION OF INNOVATION UNIT	30-Oct-96	1,315,800.00
TC9604126	SMALL ENTERPRISE ASSISTANCE FUND - FAPE	20-Nov-96	3,500,000.00
TC9607435	INSTITUTIONAL STRENG.OF MARKET ECONOMY	14-Nov-97	423,600.00
TC9902023	INST. STRENGTHENING EDPYME CREAR TACNA	25-May-99	200,000.00
TC9902022	INST. STRENGTHENING EDPYME EDYFICAR	25-May-99	255,000.00
TC9810161	INVESTMENT PROMOTION FOR SMES	21-Jul-99	842,400.00
TC9905052	STRENGTHENING OF CREDIT UNIONS	01-Sep-99	1,000,000.00
TC9905054	STRENG.CAJAS RURALES DE AHORRO Y CREDITO	01-Sep-99	1,500,000.00
TC9905053	STRENG.SUPERINT.BANKS & INSURANCE	01-Sep-99	1,000,000.00
TC9812048	DEV. OF AGRICULTURAL INVESTMENT FUNDS	17-Sep-99	135,000.00
TC9902020	INSTITUTIONAL STRENGTH. PROEMPRESA	17-Mar-00	290,000.00
TC9911183	YOUTH ENTREPRENEURS PROMOTION	20-Sep-00	815,000.00
TC0007029	SNI: PYMES QUALITY CONTROL PROGRAM	29-Nov-00	511,060.00
TC0010022	INDECOPI: PYMES QUALITY CONTROL PROGRAM	29-Nov-00	551,250.00
TC9912027	INNOVATIONS IN EDUCATION ADMINISTRATION	04-Feb-00	14,900.00
TC9811015	SUSTAINABLE ENERGY EFFICIENCY SERVICES	22-Feb-00	750,000.00
TC0001025	SUPPORT FOR INSTITUTO FORMACION BANCARIA	02-Mar-00	15,000.00
TC0001002	METHODOLOGY MARKETING OF WOOD PROD.	04-Mar-00	30,000.00
TC9911038	ENVIRONMENTAL MANAG.SYSTEM IMPLEMENTAT.	22-Mar-00	469,250.00
TC9903010	SMALL RURAL BUSINESS AND RENEWAL ENERGY	24-Mar-00	199,200.00
TC0001010	PROG. FOR REDUCTION OF FAMILY VIOLENCE	17-May-00	400,000.00
TC9901029	GIS DEVELOPMENT IN TRANSPORTATION	26-May-00	750,000.00
TC9911058	FAMILY EXPENSES IN PUBLIC SCHOOLS	08-Jun-00	45,000.00
TC9903036	EDUCATION.INNOVAT.IN THE INDEP. DISTRICT	19-Jun-00	504,144.00
TC0002041	TAX ARMONIZATION IN THE ANDEAN COMMUNITY	20-Jun-00	74,000.00
TC0002046	MACROECONOMIC POLICIES ARMONIZATION	20-Jun-00	85,000.00
TC0002047	FINANCIAL DEPOSITS RE-INSURANCE	20-Jun-00	78,000.00
TC0005056	DISTANCE TECHNOLOGY EDUCATION SYSTEM	09-Aug-00	1,000,000.00
TC9811680	TROUTS MICROENTERPRISE IN TITICACA LAKE	13-Sep-00	270,000.00
TC9811014	SUSTAINABLE ENERGY INDUSTRIAL SECTOR	29-Nov-00	1,190,000.00
TC0009037	SUPPORT MODERNIZ. OF ELECTORAL SYSTEM	14-Dec-00	30,000.00
	Total		24,362,104.00

Table 5: Major Operations in Support of Public Sector Modernisation

TC9107146	STRENGTHENING OF SUNAT	14-Aug-91	5,000,000
TC9304437	INSTITUTIONAL DEVELOPMENT OF THE LEGISLATURE	06-Oct-93	2,700,000
TC9310210	INSTIT. STRENGHTHENIG OF THE MEF	25-May-94	2,000,000
PE0109	RTC CUSTOMS UPDATING	03-Aug-94	1,500,000
TC9409188	STRENGTHENING OF SUNAT – PHASE II	09-Nov-94	2,200,000
TC9405110	ALTERNATIVE FORMS OF DISPUTE RESOLUTION	07-Dec-94	1,470,000
TC9409097	RETRAINING DISPLACED WORKERS PROGRAM	24-May-95	6,000,000
PE0039	PUBLIC INVESTMENT PROGRAMING IMPROVEMENT	21-Nov-95	4,000,000
TC9605265	RETRAINING LABOUR PUBLIC EMPLOYEES	11-Sep-96	1,040,000
TC9605108	MODERNISATION PUBLIC ADMINISTRATION	25-Sep-96	1,000,000
PE0138	MODERNISATION PUBLIC SECTOR PROGRAM	20-Nov-96	58,000,000
PE0168	LOAN TC SUNAT III	22-Oct-97	2,700,000
PE0126	MODERNISATION JUDICIAL ADMINIS. .PROGR.	25-Nov-97	20,000,000
PE0192	LOAN TC INTEGRATED FINANCIAL MANAGEMENT	29-Jul-98	1,500,000
PE0205	CUSTOMS SYSTEM QUALITY CONSOLIDATION	10-Nov-99	1,000,000