RE-330

Country Program Evaluation Peru 2002-2006

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ABBREVIATIONS

BCRP	Banco Central de Reserva del Perú [Central Reserve Bank of Peru]
CAF	Andean Development Corporation
CIAT	Inter-American Center of Tax Administrations
ECLAC	Economic Commission for Latin America and the Caribbean
EFA	External financial audit
EIU	Economist Intelligence Unit
FONCODES	Fondo de Cooperación para el Desarrollo Social [Social Development Cooperation Fund]
GDP	Gross domestic product
GRADE	Grupo de Análisis para el Desarrollo [Development Analysis Group]
INEI	Instituto Nacional de Estadística e Informática [National Institute for Statistics and Information Technology]
IPE	Instituto Peruano de Economía
IPES	Informe del Progreso Económico y Social en América Latina [Report on Economic and Social Progress in Latin America]
MEF	Ministry of Economy and Finance
MIF	Multilateral Investment Fund
OECD	Organization for Economic Cooperation and Development
OSINERG	Energy Investment Oversight Agency
OVE	Office of Evaluation and Oversight
PARSALUD	Health Sector Reform Support Program
PBL	Policy-based loans
PCR	Project completion report
PPMR	Project performance monitoring report
PRI	Private Sector Department
PROSAAMER	Program Of Support Services To Gain Access To Rural Markets
RE3	Regional Operations Department 3
RE3/OD5	Regional Operations Department 3, Country Division 5
SENASA	Servicio Nacional de Sanidad Agraria [National Agricultural Health Service]
SNIP	Sistema Nacional de Inversión Pública [National Public Investment System]
SUNAT	Superintendencia Nacional de Administración Tributaria [National Superintendency of Tax Administration]
WEF	World Economic Forum

EXECUTIVE SUMMARY

This evaluation follows the guidelines set out in the Protocol for the Conduct of Country Program Evaluations (document RE-271-1) and complements the previous evaluation performed by the Office of Evaluation and Oversight (OVE) for the 1990-2000 period (document RE-262). The analysis contained this document focuses on the 2002-2006 period, evaluating the most recent Country Strategy (document GN-2205-1) and supplemental documents. Its universe of projects encompasses those approved during the period under study, as well as previously approved projects that have been executed to a large extent during this period and/or are relevant within the strategy framework established by the Bank with Peru.

The previous Country Program Evaluation (document RE-262) found that the Bank program with Peru had a high degree of relevance, that the authorities were satisfied with the Bank's work, and that the portfolio efficiency level was better than the Bank average. In terms of efficacy, however, the results were less positive. Although progress had been made in many areas, objectives were not met; for example, the Bank program had not been effective in reducing vulnerabilities in the economy or making an impact on employment, income, and poverty levels.

The results of this evaluation broadly echo the previous findings: the Bank's program in Peru was relevant, executing agencies were satisfied with the Bank's work, and the portfolio performed better than the Bank average, although disbursements for the newest projects have slowed down. In terms of effectiveness, once again, the results were not as positive as planned, despite a strongly performing economy.

Given the space constraints, this document focuses on divergences from the objectives the Bank had set for itself—not because of any bias in the evaluation, but because of the inherent requirements of an exercise that seeks to enhance the quality of the Bank's work in the country.

A. Conclusions on the Bank's work in the country

The Bank is a major actor in Peru (the country's leading source of multilateral financing), providing support through loan operations, technical-cooperation programs, and nonfinancial products. During the reporting period, Peru was the country with the second largest number of projects approved, which reflects its importance to the Bank. The officials interviewed generally expressed a positive view of the Bank and acknowledged the work it does in the country, beyond its financial value added. The current administration does have some concerns about the dispersion of the portfolio and the benefits of certain investment loans, as indicated in the recent "Guidelines for Negotiating Foreign Debt Operations to Finance Public Investment Projects" (*Lineamientos para orientar la concertación de operaciones de endeudamiento externo para financiar proyectos de inversión pública*) issued by the Ministry of Economy and Finance (MEF) , which restrict donor intervention areas and set a minimum loan size.

The Bank has made an effort to track and monitor the Country Strategy and projects through a midterm strategy evaluation, programming missions, and portfolio review, together with the project performance monitoring reports and project completion reports, which quite reliably expose project shortcomings in terms of execution, and in some cases, effectiveness. In addition, the support that the Country Office has provided to executing agencies has generally been appropriate, and has in some instances helped to overcome deficiencies in execution.

The period has seen some significant steps forward, which, while yet to bear fruit, show that the Bank's work in the country could be strengthened in the future. One example of such progress is the reengineering taking place at the Country Office. Although no measurable results (or results from which the impact of Peru's business and political cycle can be isolated) are available, preliminary indications from the executing agencies would suggest that it is moving in the right direction. Progress has also been made in strengthening the program of studies in support of country dialogue on the basis of work led by the Office of the Regional Economic Adviser as part of the Country Studies Initiative (which has been operating since mid-2006).

Although the Bank undertakes more programming work with Peru than with other countries, and although the trend has been positive, there are still many ways in which programming, the country strategy, and project design and management could be improved. The following weaknesses were identified at the strategy level: (i) the analysis of problems did not always go far enough in identifying underlying causes; (ii) programming was not focused, and operations were not prioritized based on the import of the weaknesses they were seeking to address; (iii) the detailed analysis done of the successes and failures of previous actions and pending reforms did not form part of an explicit, systematic analysis used as a guide for programming; (iv) risk analysis was incomplete: a number of risks were unsatisfactorily defined, and the mitigation measures introduced have in some cases been insufficient; (v) the selection of triggers has not been directly linked to the identified risks; and (vi) coordination within the Bank and with other donors was limited.

At the country strategy level, baselines have not been consistently included, and not all of the indicators serve to assess the Bank's efforts and its impact, given that in some cases there is a weak direct relationship between the indicators and the Bank's work, little chance of attribution, as well as definitional problems.

At the project level, it was found that: (i) diagnostic studies did not always clearly identify the causes of the problems that the projects were attempting to address; (ii) design in some cases did not consider incentives for actors to implement projects and generate sustainable solutions; (iii) some projects (or project components) did not obtain a viability statement (ex ante) from the National Public Investment System (SNIP), thus delaying execution; (iv) in most cases, risks were not fully identified; (v) the management of these risks has been partial, since the mitigation measures introduced did not meet project needs; (vi) there were significant shortcomings in identifying adequate baselines and indicators; (vii) execution modalities were not always tailored to the institutional capacities of the agencies involved and did not always consider incentives for interagency coordination; (viii) these problems have been independent of the institutional arrangement chosen for project execution; and (ix) during the design stages, there was insufficient coordination with other donors, with other agencies in Peru, and within the Bank.

The weaknesses encountered in terms of strategy, project design, and portfolio management have meant that the effectiveness of the Bank's work has varied from sector to sector. Those sectors that had had positive experiences working with the Bank in the past, and had sound executing units, saw better results than did those wherein the capacity of the agencies involved was not as great and civil servant turnover was higher. In some of these low-capacity sectors, the Bank required its loan operations to be designed to demand a high level of coordination and institutional capacity from its borrowers, thereby generating execution problems that adversely affected the portfolio.

B. Challenges and opportunities

Many challenges face the Bank in its relationship with Peru over the next programming cycle. Dealing with them successfully could mark the difference between generating new business opportunities and ceasing to be a relevant actor.

In the economic domain, there are hurdles to reducing vulnerabilities in the economy and ensuring sustainable long-term growth. Owing to the characteristics of its productive system, Peru has been susceptible to external shocks even during booms. The foundations of the current growth period are not much different, although the diversity of agricultural exports has improved marginally. In the short run, improving conditions to attract a larger number of firms into emerging sectors is a step forward. For the long term, it could be necessary to make inroads in new sectors, in which the State may need to make strategic investments. The Bank could be the natural partner to help the country design its growth strategy.

For this growth strategy to be sustainable in a country that is highly prone to natural disasters, such as El Niño, progress in improving environmental and natural disaster management is of the essence. With a view to preventing human and economic losses, and to conserving and protecting a substantial part of its economic base, it is essential to further integrate the institutional framework that regulates the use of natural resources and to enhance planning, resource allocation, and enforcement of environmental standards.

Financially, Peru is well placed to attain an investment-grade rating. The country's interest in achieving this status presents the Bank with both opportunities and challenges. First, it will have to help the country achieve this rating through improvements in sectors where the raters find weaknesses (the fiscal sector—particularly in tax collection, the capacity of public institutions, and social indicators). Secondly, as the country becomes less reliant on Bank financing, the latter will have to ensure greater value added in its operations, as well as higher quality loans and lower transaction costs.

The public borrowing guidelines recently established by the MEF are turning the challenges of interaction with a more sophisticated client into a reality. These guidelines require projects to be for amounts above US$10 million; to have a main objective other than institution-strengthening; and to serve, at minimum, to improve delivery of an inadequate public service, provide for transfer of relevant international know-how, or add value in terms of their fiduciary benefits.

In the social sphere, Peru still has substantial room for improvement. It needs to dramatically reduce poverty levels; improve health indicators, including the availability of drinking water and sanitation; and raise the quality of education. Medium-term objectives also include job growth and higher returns to education, as well as a reduction in informal economic activity. The government has recognized this challenge and is working on structural reforms to its array of social programs. Human capital constraints deriving from the austerity plan could undermine the quality and sustainability of the reform. Hence, there are wide-ranging challenges in the social sector that need to be addressed—for reasons of equity, to avoid social unrest and political instability, and to ensure the sustainability of the reforms. To avoid the mistakes of the past, the Bank should invest in better understanding the sector so that it can support the country more effectively.

In the context of decentralization, the abundance of resources in certain regions (with the attendant political pressures), and the government's interest in increasing infrastructure spending, it will pose a challenge for the Bank to support the work being done by the SNIP to ensure a higher return on projects. Until now, the decentralization process has been accompanied by fiscal discipline. The battle has not yet been won, however, and the temptation to increase spending (not necessarily under rigorous standards) will only grow. Only a strong SNIP will be able to make certain that the highest-return investments are chosen.

Just as it is essential to ensure the selection of investments offering the highest return, it will be fundamental to enhance the project-management capacity of public agencies' executing units. Otherwise, the scope of the proposed objectives could be weakened and the value of preinvestment studies thus eroded.

The need for a strong SNIP and project management capacity is matched in importance by the need for an appropriate regulatory framework. This will both facilitate the necessary investments and ensure that those investments are made in conditions consistent with the common good. The regulatory framework has been one of the areas in which progress has fallen short of expectations, despite being a Bank concern. The ill-defined regulatory powers assigned to regional governments by the legal framework will pose new challenges and risks as decentralization proceeds.

Lastly, there are challenges in terms of the institutional capacity of executing agencies and their degree of coordination. As they execute projects with less oversight by the Bank and other donors, the weaknesses of national systems will become increasingly evident. The Bank will need to help strengthen these institutions and support the country's development, even where its funds are not directly involved, by providing technical assistance and helping with interagency coordination. This has already proven to be an example of value added by the Bank in investment-grade countries.

C. Recommendations

Given the weaknesses encountered and the numerous challenges facing Peru looking forward, the Bank should primarily endeavor to improve the process of reflection on the country's development problems, the programming process in terms of analyzing the strategic relationship with the country, and the design and management of its products. Accordingly:

- The Bank should help the country reflect on how to: (i) expand its production and export base; (ii) increase tax revenue and streamline the collection process; (iii) increase infrastructure spending; (iv) enhance the quality of education; (v) lower poverty levels; (vi) reduce inequity; (vii) expand and improve healthcare; (viii) improve natural resource management; (ix) help the government strengthen its public institutions, including regulatory agencies and the SNIP; (x) ensure an orderly, efficient decentralization process; and (xi) strengthen the management of public funds and the proceeds of international cooperation loans by substantially reducing the administrative burden. Above all, when the Bank raises these questions, it should reflect on the system of incentives and the decision-making process that give rise to public policies in Peru.

- This process of reflection, which should help the Bank and the country to agree upon a strategy that is consistent with current challenges, takes a different approach than that pursued previously on the basis of sector notes reflecting the Bank's structure rather than the country's fundamental development issues. Recent experience with the Country Studies Initiative can offer guidance on how to structure the analysis of problems with an eye to the future. Moreover, this process can also help the Bank identify its own knowledge needs and thus feed into its training and human resources policy.

- The Bank should help the country in its effort to increase investments at both the national and the regional levels while maintaining fiscal discipline and making efficient use of its resources. It should therefore encourage the process of expanding the SNIP to reach the regions rapidly and thus ensure higher-quality investments. In addition, the Bank needs to support the SNIP's work by collaborating in the designs and feasibility studies for Bank-financed projects. Successful experiences currently unfolding in some sectors (particularly highway infrastructure) could be extended to other areas.

- With regard to the programming process, the Bank should:

  - Specify the composition of the program, prioritizing actions according to their expected benefits, based on the risks faced and the importance of the weaknesses to be addressed. For that purpose, it is essential to make an in-depth analysis of the causes of existing weaknesses in the area—not merely list the problems—and provide a complete, meaningful risk analysis.

  - Focus activity, insofar as possible, on a smaller group of areas of intervention based on the Bank’s comparative advantages. One of the criteria for this could be given by past results, which have proven a good predictor of future success.

  - Expand the Bank's activity beyond the sectors identified in the foregoing point, but only on the basis of clearly defined lending scenarios determined by the most relevant triggers according to the risks identified and execution capacity. The expansion of business lines therefore needs to be preceded by an increase in the Bank's knowledge and in the country's capacities.

- Conduct an adequate risk analysis that factors the weaknesses of executing agencies into the programming process, along with problems of institutional capacity, coordination, and the incentives for actors to move the program forward.
- Accompany risk analysis with mitigation measures, but above all with risk management that makes it possible to head off problems with specific actions and adapt the programming process efficiently.
- Ensure better coordination, both with other donors and within the Bank, in order to capitalize on the synergies of work in certain specific areas.
- Expand the identification of lessons learned that could be useful for determining action areas and modalities, and also for utilizing and designing Bank tools. For example, the Country Office should draw lessons learned from the use of disbursement triggers—a mechanism included in a number of technical-cooperation programs—as they could serve as an input for the Bank at times when it intends to increase the use of tools that incorporate this mechanism, such as performance-driven loans (PDLs).

- It is recommended that the next country strategy include an adequate system of outcome indicators, complete with targets and baselines, to make it possible to assess whether the strategy's development objectives have been met. This system of indicators should be accompanied by the implementation of information, monitoring, and evaluation systems that allow for continuous tracking of the effectiveness of the Bank's work in the country.
- The potential for identifying indicators is not independent of programming. The better the diagnostic study and the stronger the targeting, the greater the chances of finding suitable indicators, with baselines, of the Bank's work in the country. Correlating indicators with lending scenarios and triggers could be an additional virtue.
- Once the program that best responds to the country's needs has been designed, it is important to ensure the efficiency and effectiveness of the corresponding financing operations. For this purpose, at the project level:
    - Diagnostic studies should clearly identify the causes of the reality to be addressed.
    - Diagnostic studies should properly analyze the particular characteristics of each executing agency so as to determine the best way of working in the respective sector.
    - Project design should take into account the incentives facing the actors involved, along with their capacity and the viability and long-term sustainability of the actions.

- During the design process, account should be taken of any necessary measures to strengthen the executing agency, bearing in mind the details of cases involving successful executing units and the lessons learned from implementation of action plans to strengthen other such units.
- The design and approval process should take into account SNIP requirements for declaring project viability, and, during the design phase, Bank specialists should work together with the government officials responsible for declaring viability.
- Risk management should be improved, using evaluation matrices to allow for preventive measures to be adopted at an early stage, and using mechanisms to ensure that those preventive measures are channeled through the right agencies.
- Indicators need to be better designed and baselines more effectively compiled (in due time and form).
- Information and monitoring systems should be generated for Bank projects and adopted by the beneficiary institutions once execution has concluded.

- To ensure appropriate project management, the following are important:
  - The Country Office should continue to move forward with its reengineering process, paying special attention to early identification of weaknesses among executing agencies, providing training and adequate support for project management by the country. It is essential that it maintain support for executing agencies in planning the execution of their projects and for the work of the SNIP in its internal portfolio review process.
  - The Country Office should design a systematic support plan for the General Administration Offices (both those executing Bank projects and those that have yet to do so), this being one of the key examples of value added by the Bank recognized by the country, and thus one of the mechanisms for ensuring that Peru will continue to request Bank financing.
  - Headquarters should also act accordingly, not only in terms of the changes needed during the design phase, but also during execution. For example, the Bank could play a crucial role in providing training, consulting, and technical-assistance services, given State weaknesses in terms of regulation, the administration of bidding processes, service provider management, etc.

Helping the country to reflect on its development problems, improving programming, and continuously supporting project execution and portfolio management will have a substantial impact on the Bank's relationship with Peru, a goal that is in line with the realignment objectives and the New Lending Framework. It is also essential for the Bank to make more strategic use of its lending windows, for instance by using MIF technical-cooperation programs as possible gateways to subsequent larger-scale work in certain sectors.

I. TRENDS IN PERU DURING THE PERIOD

A. Macroeconomic conditions

1.1 At the start of this decade, Peru's per capita income was close to 1996 levels as a result of the recession that occurred between 1998 and 2000; but these levels were substantially higher than those recorded nearly a decade earlier. In the last five years (2001-2005), Peru has enjoyed stable economic growth, averaging 5% per year, with per capita income growing by an annual average of 2.3%.

1.2 The economic recovery process of the last few years has been driven from the outset by the export sector. Current export growth is explained mainly by increases in price rather than quantity, and the composition of exports has not undergone any significant structural change.[1] These exports are associated with foreign capital and create few jobs, so there is no spillover effect of any significance. Trends in real wages and formal employment have consequently not followed the same growth path (Hausmann, 2007).

1.3 In the fiscal sector, public sector accounts showed a deficit at the start of the decade (3.3% of GDP). The trend during this decade has been positive, with a surplus posted in 2006. This healthier fiscal performance has been reflected in a decline of more than eight percentage points in Peru's cumulative gross public debt since 2001, bringing it to just slightly over 38% of GDP at the present time. Underlying the reduction in the debt burden has also been a major improvement in debt quality. Exchange-rate risk has decreased significantly (owing to greater use of local-currency bond issues); interest-rate risk has been reduced (now only 40% of the public debt is subject to variable interest rates); and maturities are much longer (the average having increased from six to nine years). Debt sustainability studies point to an undisturbed scenario unless recent growth patterns change substantially (MEF, 2006).[2] These improvements have resulted in a steadily increasing credit rating for the country, which is now on the verge of obtaining investment-grade status (Powell, 2007).

1.4 Despite the progress of recent years, Peru's fiscal position remains fragile.[3] On the one side, it has benefited from cyclical factors, and tax receipts remain low compared to international standards (and in relation to tax rates).[4] Tax-collection costs are high, and the neutrality of the tax system is low. On the other side, the increase in real spending, beyond the limits of the Fiscal Prudence and

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1 The share of nontraditional agriculture is still small (6%), and the weight of traditional agriculture in the country's growth is one of the main sources of risk according to the Economist Intelligence Unit (2006). Moreover, the concentration of export destinations heightens the probability of external shocks.

2 Part of the problem stems also from increasing expenditure rigidity, which would make a major fiscal adjustment necessary should growth fall below 3% (MEF, 2006).

3 Estimates of the structural debt show that it has remained constant from 2001 to 2005, at around 1.5% of GDP (Instituto Peruano de Economía, 2006).

4 Despite increases in tax receipts, the EIU (2006) considers the country's revenue-generating capacity to be more at risk now than in 2001.

Transparency Law (*Ley de Prudencia y Transparencia Fiscal*), has largely gone to transfers and public-sector wages, thereby increasing expenditure rigidity.[5]

1.5 These increases in current spending have generated a widening gap with respect to capital expenditure, with lower levels of public investment (only 2.5% of GDP in 2005). Accordingly, the decisions made on public expenditure composition have not enhanced the country's competitive position.[6]

B. Productivity and competitiveness of the economy

1.6 Peru's low level of infrastructure spending has led to a limited supply of both basic and production-support services, not only in absolute terms but also when analyzed in relation to its development level.[7] At the start of the decade, there were significant deficiencies in water and sanitation provision, the availability of roads, and the efficiency of ports, for example. Public investment fell short of the expected levels in the transportation, telecommunications, and energy sectors. Available simulations show that the country will need to invest double the current amount every year for the next 20 years, merely to maintain its present growth rate.[8]

1.7 Infrastructure provision was not the only hindrance to the country's competitiveness. Access to credit, barriers to entry for new firms, and technology innovation are all areas in which the country is lagging.[9] Constraints are similar at the present time, and access to credit, barriers to entry, and problems relating to the generation and absorption of technology innovation remain key issues.[10] Moreover, labor market regulations and tax laws are two of the five most significant factors limiting the ability to do business in Peru.[11] The bureaucratic burden not only hinders competitiveness but also encourages most entrepreneurs in Peru to work informally. What progress has been made, such as lowering barriers to entry for

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5 The administration has had to request successive compliance waivers from Congress. As a counterpoint, the transparency of fiscal accounts has increased. See IPE (2006).

6 At the start of the decade, according to the World Economic Forum (WEF), entrepreneurs considered expenditure composition to be inadequate (55th out of 74 countries). Five years later, there had not been any substantial improvement (77th out of 125).

7 To make this comparison, a residuals analysis was performed for a sample of Latin American countries, controlling for levels of GDP and GDP per capita (see Annex 1).

8 For every dollar of the country's exports, nearly one third goes to logistics costs—compared to less than 10% on average among OECD countries (World Bank, 2006).

9 The WEF reports for 2001 showed that the country is one of the lowest ranked in terms of access to credit (72nd out of 74 countries) and access to financing (69th out of 74). In terms of interest rate spread, government expenditure, research and development, and government subsidies, Peru is ranked among the bottom five countries.

10 Entrepreneurs consider that there is inadequate infrastructure supply (93rd out of 125 in the WEF 2006).

11 According to the EIU (2006), highway infrastructure is deficient and has urgent maintenance needs. Although ports have become more efficient, they are uncompetitive in comparison to neighboring countries.

new firms, is still relatively marginal in terms of its impact on the country's competitive position.

C. Environment and natural disasters

1.8 Increasing competitiveness may boost economic growth, but natural-resource and disaster management are crucial for ensuring sustainability. Peru stands out as having a natural-disaster occurrence rate that is twice the Latin American average, as well as the continent's highest fatality rate (Charvériat, 2000). It is estimated that from 2000 to 2004, over 2 million people were affected by natural disasters, representing an annual cost of roughly US$325 million (Larsen and Strukova, 2005). Compounding these natural disasters are the harmful effects of inappropriate human intervention in nature. A recent World Bank study (2006) concluded that the most costly environmental degradation problems, along with natural disasters, represent a cost of 3.9% of GDP.[12] The same study holds that the institutional structure currently regulating the use of natural resources hinders adequate planning, resource allocation, the enforcement of environmental standards, and natural disaster prevention.

D. Social development

1.9 Peru's economic achievements have not been directly mirrored by achievements on the social front. Both in the 1990s and in the current decade, growth has had less impact than expected on poverty reduction and job creation. Total poverty fell from 54% to 51.6% between 2001 and 2004, driven mainly by poverty reduction in rural, mountain, and rain-forest areas. Extreme poverty also declined, from 24% to 19%. Urban areas display lower levels of total poverty (40% in 2004, as compared to 72% in rural areas), and extreme poverty is primarily a rural phenomenon (40% of people live in extreme poverty in rural areas, as compared to 8% in urban areas).

1.10 On the employment front, unemployment rose by 2.7 percentage points between 2000 and 2004, while underemployment increased by 4.6% (Ñopo, 2006). The proportion of jobs in the informal sector remains high, at over 60% of the labor force. As for youth employment, the country is making no progress towards the respective millennium development goal (World Bank, 2006).

1.11 At the start of the decade, water and sanitation infrastructure was scarce both in absolute and in relative terms. Today, despite some improvements, nearly a quarter of the population still has no access to drinking water; half are not connected to a sewerage system, and three quarters of all waste water goes untreated (World Bank, 2006). These levels keep the country's indicators below the expected values.

1.12 Social expenditure increased from 7.9% to 9.2% of GDP between 2000 and 2005, fueled mainly by social security spending, which grew by 30% (Apoyo, 2006).[13]

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[12] The most costly environmental degradation problems are the erosion of farmland, environmental pollution caused by lead, and inappropriate water use.

[13] Education and health expenditure increased by 10% and 15%, respectively.

Nonetheless, public social spending has remained below the levels expected for a country of Peru's economic development. Partly as a result of the level of spending, but essentially because of (in)efficiency, educational quality is among the poorest in the region. In the most recent standardized international tests on cognitive skills in which it has participated, Peru was ranked last out of 41 countries. Although its enrollment rate is high, the country offers very deficient and uneven education services. The achievement gap between students belonging to different social classes is great (World Bank, 2006), but the returns to education are not (Hausmann, 2007). Illiteracy rates are close to 10% and highly concentrated.

1.13 The health sector has seen progress in recent years, but there is plenty of room for further improvement. At the start of the decade, infant and under-five mortality rates were higher than the expected values, and life expectancy was below. The under-five mortality rate remains a problem at the present time. In all cases regional variations are very pronounced.

E. Modernization of the State and decentralization

1.14 The characteristics of the country's public decision-making system explain many of the weaknesses listed thus far. Political decisions in Peru have traditionally been dominated by the Executive, while Congress and the judicial system have not provided an effective counterweight in defining the political agenda and establishing a balance of power. This is a reflection of institutional design, the existence of government majorities in the legislature, and weaknesses among the other political actors. Thus, in many areas, policy formulation has been an arbitrary, unpredictable process resulting in policies that are of low quality, poorly enforced, and easily reversed (Moron and Sanborn, 2004).

1.15 In comparative terms, Peru is among the countries with the lowest measures of capacity of Congress, judicial independence, institutionalization of political parties, and public administration development (2006 Report on Economic and Social Progress in Latin America). On the last point, the country belongs to the group with the lowest indices of civil service quality, with challenges posed by the limited efficiency, functional capacity, and strategic coherence of the corps of public employees (IDB, 2006).

1.16 Sector trends have not been positive either. Based on the World Bank's indicators of public sector governance and capacities, Peru is in the middle or lower half of the ranking in all areas, and its position worsened between 2002 and 2005. According to indicators published by the Economist Intelligence Unit (EIU), the overall effectiveness of the public sector has declined along with institutional, bureaucratic, and regulatory effectiveness. These shortcomings have an impact on the capacity to do business. The 2006 report issued by the World Economic Forum (WEF) shows that inefficient government bureaucracy is the second most problematic factor in doing business in Peru.

II. THE BANK'S PROGRAM IN PERU

2.1 The purpose of this chapter is to assess the relevance and coherence of the program in relation to the country's development problems.[14] The tables included in Annex 2.1 summarize the Bank's programming effort, highlighting identified weaknesses, objectives, and projects both programmed and approved.

2.2 The overall objective of the country strategy was to achieve a "sustained and sustainable reduction in poverty." Its specific objectives were to:

- Raise the economy's productivity and competitiveness;
- Improve the efficiency of social policies; and
- Create a modern and efficient State to serve the population (subsequent programming missions included the term "decentralized" along with modern and efficient).

2.3 Accordingly, the Bank's programming efforts can be grouped together in three program areas: productivity and competitiveness, social development, and modernization of the State and decentralization.

2.4 The strategy did not make explicit the relationship between the specific objectives and the overall objective of a "sustained and sustainable reduction in poverty." As noted in the previous chapter, poverty reduction proved difficult for Peru to achieve during the last decade, even during periods of economic boom and institutional reforms. The strategy should therefore have analyzed explicitly why the Bank's interventions could impact poverty this time, given that no such link had been evident in the previous period.[15]

2.5 Programming was relevant insofar as it identified many of the country's weaknesses and established several of the necessary actions that the Bank would have to implement, and in many cases operations were programmed that made it possible to overcome those weaknesses.[16] There are still aspects of the programming exercise that could be improved, however, and for which the evidence presented in this chapter could be valuable.

2.6 The Country Strategy identified the weaknesses affecting the country, which were consistent with those pointed out by OVE. This identification of multiple weaknesses, however, did not always point to which were the main problems

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[14] For this purpose, an analysis was made of Country Strategy GN-2205-1, the 2004 and 2005 country strategy updates, and the programming mission reports of April 2003, June 2004 (CP-2353-5), and April 2005.

[15] The Country Strategy states that "in the absence of a sustained increase in productivity and opportunities for economic participation, the programs implemented during the 1990s failed to break the vicious circle of poverty and exclusion; nor were they able to provide effective protection against economic crises."

[16] Relevance was analyzed in accordance with the guidelines in the evaluation protocol. Accordingly, it is a concept to be evaluated ex ante, unlike the concept of effectiveness, which is essentially evaluated ex post.

hindering the country's development. For instance, there was no ranking of the weaknesses that would have made it possible to prioritize and delimit the scope of the Bank's work in the country, thereby ensuring a higher return on investment.

2.7 Furthermore, partly as a consequence of the strategy's space constraints, the description of weaknesses proved more a list of symptoms than an analysis of underlying causes. This is important, because attending to symptoms generally requires specific actions for each one, whereas tackling the causes may involve addressing more than one area in a single intervention or may necessitate policy changes. What is more, acting on the causes can increase the likelihood of achieving sustainable outcomes.[17]

2.8 The programming of operations was consistent with the weaknesses mentioned in the strategy and identified the actions to be undertaken in most cases. The fact that 50% of programmed projects were not approved (figures similar to the Bank average) might indicate that the strategy should have prioritized the sectors and areas that were strategically best suited for Bank intervention. This is mitigated, however, by the fact that most of the projects that were approved but not programmed maintain the intervention rationale established in the programming exercise, which suggests that, even with flexibility, the programmed lines of action were preserved.

2.9 Although the objectives of the strategy coincided with those of the government, there is no explicit integration between the activities programmed by the Bank and those of the country, and almost no mention whatsoever of Peru's resource allocation and planning systems, or of the government's evaluation and monitoring systems (or the possibility of strengthening them).

2.10 In terms of the use of the Bank's toolkit, the strategy anticipated the country's financing needs and provided for the possibility of approving fast-disbursing resources to support the reform process. The approval of sector loans was tied to programming in terms of specific projects (the three programmed for the baseline scenario, and two that were not programmed, were approved), and to the general programming rationale. This notwithstanding, there was no exhaustive analysis of the sequence and priority of the reforms, nor a sound institutional analysis on which to base the reforms to be supported by this type of loan.[18] In addition, the large

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[17] For example, in the case of modernization of the State, it was found that there was a "high degree of institutional disorder, as seen in the fragmentation of agencies, entities, and programs." While this disorder does affect the country's development, dealing with it requires fully identifying the causes that have generated it. If the causes of disorder are merely low technical capacity and scarce resources, the recommended action will be different than if there are underlying political reasons and incentives, on which a mere disbursement of funds could have no impact.

[18] A similar concern is reflected in the midterm strategy evaluation report, which recommends that the issue be discussed explicitly in the new strategy and that, as part thereof, a series of issues for programmatic and/or policy-based loans be prepared, to support an ambitious but realistic reform agenda that will be leveraged through those loans.

share of policy-based loans (PBLs) in the portfolio generated controversy within Management.[19]

A. Programming in strategic areas

2.11 The Bank programmed 36 operations for the period and approved 31 (18 programmed and 13 not programmed), for a total of US$2.242 billion.[20] In sector terms, more operations to boost competitiveness were approved than programmed. The importance of this sector is greater when one analyzes the sector distribution of technical-cooperation programs, which also make competitiveness a priority.[21] Despite the importance of the social sector, as declared in the strategy, fewer operations were programmed here than in other sectors (19% of the total) while operations approved accounted for 16% of the total. In the area of reform of the State, 36% fewer operations were approved than envisaged (9 of 14), but this was compensated for in amount by the approval of two sector loans.[22]

2.12 Sector loans have played a key role during the period under review, representing 59% of the approved portfolio (27% corresponded to investment loans and 11% to Private Sector Department operations).[23] The importance acquired by fast-disbursing loans places Peru fourth among countries with the largest proportion of PBL approvals in relation to total approvals during the 2002-2006 period. Fast-disbursing Bank resources covered between 21% and 60% of freely available external financing needs, except in 2003, where no disbursement was recorded.[24]

1. Productivity and competitiveness of the economy

2.13 Just as was the case with the strategy in general, in this sector also no distinction was made regarding the origin of weaknesses (causes), nor was their relative importance established, leaving weaknesses associated with the country's development level mixed with those attributable to government failures.

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[19] The June 2004 mission report stated that the Programming Committee had not authorized the inclusion of PBLs in the loan program for 2005, claiming "the need to develop an alternative approach that uses the various investment instruments that are available." Nonetheless, the mission report also highlighted the Peruvian government's preference for the approval of fast-disbursing resources. Ultimately, a PBL was indeed approved (PE-L1012) in 2005.

[20] The total amount approved in 2002-2006 represents an annual average approval of US$448 million, which is more than the equivalent figure for the previous decade. In terms of projects, Peru had the second largest number of projects approved during the period, after Brazil, revealing the country's importance to the Bank.

[21] In terms of numbers, 86% of technical-cooperation programs are in the area of competitiveness (compared to 55% for the Bank) and 52% of them are MIF operations (compared with 38% in the rest of the Bank).

[22] In sector terms, total approvals have concentrated more heavily on competitiveness (41%), followed by reform of the State (34%) and, lastly, the social sector (25%).

[23] The remaining 3% corresponded to a guarantee program in the transportation sector approved in 2006 (Guarantee Program for the IIRSA Northern Amazon Hub, PE-L1010), which is not analyzed in this evaluation.

[24] The approval of PBLs was not associated with a crisis but with the government's wish to change its debt profile and cover maturities of debt contracted previously.

2.14 The objectives of the projects approved in this cycle are in line with the strategy's objective for the sector (partly because the breadth of the objective declared in the strategy facilitates such coherence), and the approved projects cover multiple aspects of the country's competitiveness.

2.15 Of the subsectors included in this area, the rural sector was not comprehensively analyzed in the Country Strategy such that one might glean from it an overall strategy to support the sector. Nonetheless, from the weaknesses mentioned in various sectors and from the projects programmed, it is possible to infer its importance to the country and the Bank's implicit (and fragmented) strategy for the sector. The approved program reveals that it was one of the most heavily supported sectors.

2.16 In some sectors, such as natural-resource management and regulation, there were discrepancies between the strategy and subsequent action. In the environment area, based on a correct diagnostic and analysis of weaknesses, the Bank identified the need to work on the topics of natural-disaster prevention and support for environmental management. This notwithstanding, only the loan for institutional strengthening of environmental and social management (PE-0233) was approved—in connection with execution of the Camisea project—and it did not aim to resolve the structural problems of institutional organization and environmental management capacity in Peru.

2.17 In the regulatory area, the strategy stated that "top priority will be accorded to ... ensuring that the regulations ... are applied effectively" and that "success in concessions and privatizations depends on institutional development among the concession authority, the regulatory entities, and supervisory bodies." It was argued that the Bank could support private-sector participation in infrastructure under a global program or through specific technical-cooperation operations. Nonetheless, little specific work has been done in the regulatory arena.[25]

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[25] During the period under review, regulatory quality indicators compiled by the World Bank fell by 30%. Similarly, a recent study by the same organization shows that this is an area that still requires substantial short-term improvements (World Bank, 2006).

2.18 For example, with regard to highway infrastructure, one of the priority lines of action consisted of supporting the autonomy and technical quality of regulatory agencies, but no operations under this line were programmed or approved. The omission of support for regulatory bodies and the agency responsible for initiating concessions is significant, because the strategy also stated that it would give explicit support to the Peruvian government's policy to promote greater private-sector participation in infrastructure development.[26]

2. Social development

2.19 The social sector is of fundamental importance in the case of Peru for two interrelated reasons: (i) the strategy's diagnosis recognized substantial improvements in the macroeconomic area that had not, however, led to substantial improvements in the social sphere, which displayed serious shortcomings in both absolute and relative terms; (ii) the overall goal of the strategy was a sustained and sustainable reduction in poverty.

2.20 Although the sector diagnosis covers a vast number of weaknesses, a more rigorous analysis of their causes, especially the sector's institutional shortcomings, would have been useful. Where analysis is incomplete, planned actions can remain at the level of mitigation and fail to resolve fundamental problems. For example, the document states that "Current administration and coordination inefficiencies in social programs are costly," and that "it is essential that coordination among the responsible institutions be improved, and that efficiency be increased in the management, monitoring, and evaluation of social expenditure." Nonetheless, when there is no clear analysis as to whether weaknesses reflect a problem of physical capacities, political will, or organizational capacity, policy recommendations may not always be the most effective.

2.21 To help prioritize problems, it would be important to include data and indicators that illustrate the importance of the central weaknesses to be tackled, such as the transparency and the efficiency of social policy.

2.22 The programmed crosscutting and sector actions were consistent with the objectives. Projects approved in the sector covered most of the actions identified in the strategy, leaving pending specific programs for strengthening expenditure-executing institutions within each ministry.

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[26] In the framework of the competitiveness reform project, the regulation for a new legal framework for the port sector was approved, which had to clearly separate technical and administrative functions of the new port authorities from the regulatory functions performed by OSITRAN, Peru's oversight agency for investment in public transportation infrastructure. Despite these achievements, no work was done in relation to the autonomy of regulatory agencies, nor on strengthening their capacities. Nor was the programmed operation to support private-sector participation in infrastructure approved. Nonetheless, it should be noted that in the area of water and sanitation, the Bank first sought to strengthen sector agencies to later promote private-sector participation.

Regional inequalities

2.23 Social indicators in Peru are not only lagging in general, but every one exhibits widespread regional inequality.[27] Yet the strategy does not consider the need to target actions to enable the Bank to participate in the country's most vulnerable areas. Operations approved in Peru during the period were mixed: while most were not necessarily designed to address problems of regional disparity and do not provide for monitoring of any differential impact, some of the interventions do suggest that the portfolio will have a differential impact (see the table in Annex 2).

Gender

2.24 Although the issue of gender was not explicitly included within the previous strategy as an individually relevant issue, it was included in some of the loan operations, and a number of technical-cooperation programs aimed to include a gender perspective. Moreover, several operations generated outcomes that specifically benefited women, despite not having an explicit objective in this area. Examples included the Wawa Wasi, Integrated Health Insurance, FONCODES III, rural transportation infrastructure, justice, and land titling projects. In the preparatory work for the next programming exercise, Management has explicitly identified the topic of gender as one on which the Bank needs to increase its knowledge.[28]

3. Modernization of the State and decentralization

2.25 Diagnosis of this sector was limited, despite the fact that lessons learned during the previous decade showed it to be an area in need of reforms and in which the Bank could play a fundamental role. For example, mention is made of a generic “institutional disorder” without presenting comparative data or the causes of said disorder.

2.26 Moreover, given that the weaknesses of Peru’s public sector generate government failures that affect all sectors, it would have been fundamental to make a comprehensive analysis of the country's governance issues rather than an isolated analysis of specific sector weaknesses. In conjunction with said diagnosis, a cross-cutting strategy could have been designed for all sectors, to increase institutional capacity.

2.27 The programmed operations do not necessarily reflect the analysis presented in the strategy, which tends to emphasize weaknesses in the civil service or the latest measures taken in the fight against drug trafficking—areas in which the Bank did not plan to intervene. This sector had the lowest percentage of programmed projects

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[27] For example, the strategy paper indicated that “of the country’s 51 poorest provinces, 94% belong to the “sierra” and 6% are in jungle or “selva” regions.” With regard to education, it noted that “quality remains deficient especially in public schools—and even more so in the rural area.” Public health indicators exhibit significant “variety (child mortality in the southern “sierra” or “selva” regions runs at three times the national average).”

[28] The Annex contains a detailed analysis of the Bank's operations and work in this area.

approved (64%). Specifically, in the area of decentralization, which is considered a "strategic priority" by the Bank, two of the programmed projects were not approved.

B. Crosscutting program features

2.28 The Country Strategy meets the established standards and includes relevant information making it possible to identify the Bank's expected role in Peru. There are significant weaknesses, however:

- The Country Strategy sets out alternative lending scenarios along with the respective triggers that would make them materialize. These triggers were used for the baseline scenario (in which certain loans linked to reforms that were not carried out were not approved). Nonetheless, achievement of triggers does not seem to have been decisive for approving all operations. Firstly, monitoring thereof has not been reflected in the programming mission reports. Secondly, a high-scenario project was approved without verification or achievement of the respective scenario triggers.[29]
- With regard to the connection between lessons learned and programming, the strategy analyzes the achievements of previous Bank actions in the country, as well as their failures and pending reforms. Although the analysis of failures may have informed part of the programming process, it did not constitute part of an explicit, systematic analysis of lessons learned that could serve as a guide for the following period. Moreover, in half of the areas mentioned as having reforms pending, no actions were programmed or arguments presented giving reasons for, or explaining the risks of, acting or not acting in those areas.
- The strategy contains a large number of indicators—mostly outcome indicators, grouped for each specific objective—to evaluate the results of strategy implementation, and they are monitored in the subsequent programming mission reports. Although nearly all indicators include targets, only 30% of them have adequate baselines. In addition, as explained in chapter IV, not all indicators included in the strategy serve to evaluate the work done by the Bank and its impact. The main reasons for this are that: (i) their direct relationship to the Bank's work is tenuous; (ii) their potential for attribution is low; and (iii) they are not adequately defined.
- The document includes an analysis of the risks of strategy implementation and the corresponding mitigation measures. Nonetheless: (i) in some cases, risks are poorly defined; (ii) the risk analysis is incomplete; for example, risks that materialized and affected execution and/or the impact of the strategy were not included; (iii) mitigation measures for some of the risks have been incomplete or inadequate; and (iv) no clear relationship has existed between the risks and the strategy's triggers.

[29] The triggers were "the proven financial capacity of the subnational entities and compliance with fiscal standards in force."

III. EXECUTION OF THE BANK'S PROGRAM IN PERU

3.1 This chapter analyzes the efficiency with which the Bank's operations were implemented.[30] In general, it can be said that the quality of execution of operations in Peru lies slightly above the regional average. Nonetheless, certain weaknesses reveal themselves at times of larger-than-foreseen disbursements, as well as with slower disbursements for the newer projects and major cancellations. These weaknesses need to be monitored closely in the near future to prevent them from becoming significant constraints on the Bank's action in the country. The reengineering that is taking place in the Country Office could help to solve some of these problems.

A. Preparation and execution of operations

3.2 The average project preparation time (from introduction through the pipeline to approval) in Peru is less than the averages for the Bank as a whole and for the Andean countries in the 2001-2006 period. Fast-disbursing loans exhibit the largest difference with respect to the rest of the Bank: their preparation phase in Peru is 50% shorter than the average for the Bank's sector loans in the period analyzed.

3.3 Execution takes longer than envisaged at the time of design. Investment projects completed in Peru during the period took an average of two years longer than expected, but this delay is one year less than the average for all Bank projects in the same period. Historically, Peru's disbursement pattern has been better than the Bank average.

3.4 The disbursement efficiency curve suggests that the pace of execution has slowed in recent years. The curve shows that in general, new investment projects are disbursing somewhat more slowly than the average for Bank investment projects for which the same amount of time has elapsed since their signing; in contrast, those that are more than 15% disbursed (approved between 1999 and 2003) are executing faster than the Bank average.[31]

3.5 The time projects are taking is of growing concern to the Peruvian government and is one of the reasons for imposing stricter guidelines on foreign borrowing. According to the MEF guidelines, the portfolio of externally financed public investment projects is currently being executed over longer periods than those supported by the technical studies that determined their viability, and this situation leads to higher commitment fees, higher administrative costs, a questioning of the magnitude of the social benefits attributable to the projects, and a delay in delivering the public service to be provided.

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[30] The universe considered in this chapter also includes operations that have been executed to a large extent during the period under review, even if approved in previous periods.

[31] The projects for fruit fly control and eradication and for modernization of the Office of the Comptroller General (PE-L1007 and PE-L1002), approved in 2005 and 2004 respectively, are an exception.

3.6 The Bank's monitoring systems show that the percentage of projects with poor ratings in terms of implementation and fulfillment of the assumptions in the project performance monitoring reports (PPMRs), as well as the percentage of projects on alert status under the Project Alert Identification System, are somewhat lower than the corresponding Bank averages. Peru's performance with regard to problem projects (those with a low probability of achieving their development objectives), however, is similar to the Bank average.

3.7 According to submitted external financial audits (EFAs), which measure project fiduciary risk, the Peru portfolio also has a better profile. The percentage of EFAs (number and amount involved) giving a good rating and the percent of EFAs with a bad rating in one period corrected in the subsequent period are both above the Bank average.

B. Strengths and weaknesses of execution

3.8 The execution of operations is affected by many factors, including project design, project risk analysis, the capacity of executing units, cancellations and restructuring, and the quality of monitoring systems.

1. Project design

3.9 Among the projects analyzed, design weaknesses have caused delays in execution. For example:

- In some cases, design problems have resulted in slow approval of projects by the SNIP, and have even made it necessary to reformulate them. One example is the state modernization and decentralization program (PE-0217), for which viability studies had to be done after the loan had been signed, taking more than two years to be completed and approved by the SNIP. As a result, less than 10% of resources have been disbursed more than three years after approval.[32]
- Changes in leadership, which should have been taken into account during design, have in some cases led to substantial delays. For example, in the institutional strengthening program for the Peruvian Congress (PE-0220), repeated changes in the Presiding Officers of Congress have generated successive project restructurings and low levels of execution three years after approval.
- Project designs that require the formation of multiagency management teams, or require coordination between several entities or ministries for execution, have also in some cases led to substantial delays. In the case of the

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[32] In many cases, the work of the SNIP during the feasibility analysis has been beneficial, playing a key part in improving final project design. For example, an agricultural services project (PE-0234), despite having already been approved by the Bank, was not approved by the SNIP, and then underwent substantial design improvements introduced by MEF staff at the request of the SNIP. Both the executing agencies and the Bank itself acknowledged that this was for the better.

decentralization program (PE-0217), the relationship between the Ministry of Finance and the National Decentralization Commission was dysfunctional at the start of the program. The same has been true of the relationship between these entities and the Ministry of Transport and Communications, for which reason the fulfillment of one of the conditions precedent is still pending, as the institutions involved are unable to reach an agreement on the management contract.[33]

- The use of Bank tools that might not be the most appropriate for the specific case in question can give rise to delays owing to the difficulty of adapting them to the reality of the country and of achieving consensus among the executing agencies. Such has been the case, for example, with the sector facility for the foreign trade policy development program (PE-0219).

3.10 Execution delays have in turn generated other, secondary problems that have caused even greater delays: given the high level of turnover among civil servants, delays increase the likelihood of changes in policy direction, and that executing agency management teams get altered, thereby producing further delays owing to lack of capacity, retraining, etc.

3.11 Not all projects have been weak on design. Those that have progressed to second phases have been less vulnerable, with improvements being made on the basis of lessons learned from the first phase. For example, techniques perfected during the first stages of the agricultural health development (PE-0143) and land titling and registration (PE-0037) programs, which improved outcomes and lowered costs, were incorporated in the respective second phases. In the case of the FONCODES III program (PE-0193), given the political dealings observed in the previous phases, attempts were made to prevent professional and management positions from being filled by unsuitable personnel by establishing mechanisms to promote job continuity.

3.12 Action in the highway infrastructure sector may be one of the best examples of the impact of the learning process that occurs by accumulating experience through successive projects in a sector. This process has made it possible to develop fluid, coordinated relationships between transportation specialists at Headquarters and the Country Office, leading to systematic, joint monitoring of operations, and helping new projects to incorporate into their design lessons learned as well as changes in aspects that were not dealt with properly in previous operations.

2. Risk management

3.13 Risk analysis has been weak in most of the projects analyzed. The deficiencies encountered include cases of incomplete or inadequate risk identification, and the introduction of mitigation measures that did not succeed in responding to needs.

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[33] As the PPMR indicates in its section on lessons learned, an in-depth institutional evaluation should be performed before designing the program's execution mechanisms, with special care being taken during the design to include a coordination entity.

3.14 Projects that were affected by unforeseen risks include: (i) the agricultural health development program (PE-0143), where unforeseen technical and political factors adversely affected much of the program; (ii) phase II of the multisector credit program (PE-0191), where changes in the country's macroeconomic and financial conditions eroded the demand for project resources; (iii) the youth labor training program (PE-0241), in which a change in the executing unit management team resulted in the project's politicization and consequent paralysis; and (iv) FONCODES III (PE-0193), which failed to anticipate changes in the government's social protection policy, which ultimately influenced the cutbacks suffered by the project.

3.15 In other cases, there were problems of risk conceptualization. For instance, there are risks, which, if they materialize, invalidate the very design of the project in question. For example, (i) if the beneficiaries of an agricultural services project "will not have sufficient technical capacity to meet demand requirements in more dynamic markets or will not have enough capital for production-related upgrades," when this is the project's objective; (ii) if certain conditions of a PBL are not fulfilled; (iii) if "targeting of beneficiary groups [does not] meet clearly defined technical requirements;" or (iv) if in a departmental roads project, regional governments prefer to continue with force account management instead of outsourcing, when the latter was one of the key project objectives.

3.16 Also identified are risks that should be "mitigated" during the project preparation stage, either in the design or through prior and/or complementary actions. For example, in a large share of the projects analyzed, risks included difficulties in coordination between the project actors (executing and subexecuting agencies). Later, at least six of the projects had execution problems precisely because of weak coordination between executing agencies.[34]

3.17 The mitigation measures accompanying the identified risks have not been useful in all cases, e.g., in those relating to coordination weaknesses between actors. The FONCODES program has still not succeeded in solving the coordination problems between the Social Development Cooperation Fund (FONCODES) and the line ministries with regard to infrastructure works (World Bank, 2006). In the decentralization project (PE-0217), the introduction of an "execution structure that coordinates participating institutions" failed to mitigate coordination problems—one of the main causes of execution delays.

3.18 Part of the shortcomings of the risk analysis and the proposed mitigation measures stems from an incomplete analysis of sector capacities, the country's needs, the incentives facing the parties involved (or those that might become involved), and the sociopolitical context in which the operation will be implemented. In some projects, the analysis of actors and incentives goes no further than identifying the existence of "political will" among the officials present at the time of design. This "political will" may not be sufficient, however, for the execution of programs or the

[34] Examples include the following projects: PE-0219, PE-0107, PE-0233, PE-0126, PE-0101, and PE-0167.

sustainability of their achievements, since the tide may later turn when there is a change in actors. For instance, in the case of the institution-strengthening program for the Peruvian Congress (PE-0220), as indicated by its PPMR, the lack of multiparty commitment, actions by the vice presidents, and incentives facing the line officials have impaired execution, weakening the "shield" envisaged by the program.[35] Also, in the State modernization and decentralization program (PE-0217), the delay in congressional approval of major laws relating to modernization of the State (the Civil Service Career Act and the Executive Power Act) and the administration's halt of the decentralization process have delayed the start of a number of activities.[36]

3. Executing units

3.19 The design of execution models affects the efficiency of operations. In the case of Peru, weaknesses in executing units have led to execution problems irrespective of the institutional arrangement chosen (external, internal, or mixed units, or the use of specialized agencies for procurement of goods and services).

3.20 Examples of execution problems under different types of arrangement can be seen in the access to justice (PE-0126), Wawa Wasi (PE-0167) and land titling and registration (PE-0107) projects. As these three projects have no mechanisms to maintain stability among top staff, all have been more susceptible to political pressures that have made their execution more difficult. The justice project had an internal executing unit. The Wawa Wasi project created an ad hoc unit for the Bank project that is now also executing projects with government funding. The land titling project has an external, temporary executing unit, which poses a challenge in terms of sustainability, since it is executing a task that will need to be performed beyond the end of the project.

3.21 Programs have been identified—foreign trade policy development (PE-0219) and support services to gain access to rural markets (PE-0234)—in which management of the loan proceeds was assigned to the General Administration Offices in the respective ministries, in an attempt to strengthen the internal capacities of public agencies. Nonetheless, these offices' lack of familiarity with the procedures required for international cooperation projects and their slowness in processing transactions have caused difficulties and delays in project execution, particularly during the initial phases.

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35 Some of these issues had been raised when the project was submitted to the Loan Committee. The Research Department comments asked how the incentives facing legislators would affect the impact of the Bank's projects in the area, and suggested that it might be important, for this or future operations, to have a more complete impact analysis, with the aim of assessing whether the conviction and goodwill towards modernizing Congress and making its activities more transparent held by legislators during the design phase would be sustained during project execution.

36 These are some of the main reasons given in the PPMR for the unsatisfactory implementation-progress rating.

3.22 The hiring of a specialized agency did not help speed up disbursements or facilitate project execution. For example, in the case of the project to strengthen the tax administration (SUNAT) (PE-0223), use of the Inter-American Center of Tax Administrations (CIAT) to procure goods and services has caused additional delays.[37]

3.23 Not all projects have had problems with their executing units. For example, the units under the National Agricultural Health Service (SENASA) and Provías have demonstrated great efficiency in executing Bank projects.[38] Both were created as independent units under their respective government agencies, have worked on various IDB projects, and today are practically internal offices of those organizations. In the case of SENASA, the fact that it benefits from the existence of a law that protects the tenure of its top staff has given it great stability.

4. Cancellations and restructurings

3.24 For the group of projects analyzed, cancellations have amounted to over US$500 million.[39] Restructurings and cancellations affect project efficiency and effectiveness, and increase the country's borrowing costs. In general, the reasons (which are expanded on in the next chapter) include: (i) the inclusion of components that were not politically viable or required high degrees of coordination or commitment; (ii) the appearance of risks that were not effectively mitigated; and (iii) the scale (oversizing) and advisability of the loans.

5. Project evaluability and monitoring

3.25 The evaluability indices calculated by OVE for projects approved between 2001 and 2005 show a relatively low average level of evaluability in terms of goal and purpose (40% and 45%).[40] Evaluability has improved over time, however; there has been an improvement in the projects approved in recent years vis-à-vis those approved in 2001 and 2002.

3.26 Among the evaluability problems encountered, failings were more significant in terms of including baselines than with regard to targets (see table in Annex 3).

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[37] According to the PPMR, the use of specialized agencies such as the CIAT in the execution of this type of program needs to be analyzed more carefully to avoid execution delays.

[38] This is confirmed by a recent Development Effectiveness and Strategic Planning Department report (2006) that states that SENASA and decentralized Provías are sound and stable, having highly developed management systems and very effective management of the procurement and contracting cycle.

[39] In 2000, the Wawa Wasi project (PE-0167) suffered a cancellation of US$18 million. In 2001, US$120 million were cancelled from the project for reconstruction following El Niño II, US$60 million from the health sector reform project, US$74 million from the sector investment loan, and US$33 million from the program to improve the quality of secondary education. During the 2002-2006 period, US$250 million were cancelled from projects under execution—accounted for largely by the cancellation of US$150 million from the highway rehabilitation and improvement program and US$70 million from FONCODES III.

[40] The evaluability completeness index only includes investment projects (excludes Private Sector Department operations and PBLs) and evaluates the existence of baselines, milestones, and targets.

Another of the weaknesses detected, which is mentioned in the 2005 portfolio review report, is the absence of adequate execution monitoring systems, which is likely to have affected 50% of projects active at the start of 2005.[41] In the case of the Private Sector Department (PRI), although a monitoring system is being implemented, it does not record all indicators included in the loan documents for Peru.

3.27 Despite the existence of weaknesses in most projects, in some cases very complete monitoring systems were implemented. One success story is that of SENASA's executing unit, which, during the project (PE-0143) implemented a monitoring strategy with beneficiary participation, and also developed an integrated system for planning (with logical frameworks), monitoring (costs tied to targets), and evaluation that covers the organization's activities throughout the country (the Integrated Planning System, or SIP). Another example is phase II of the land titling project (PE-0107), which implemented a program impact monitoring system that included a baseline survey, two annual monitoring surveys, four in-depth studies, and an evaluation survey.

C. Coordination with other development agencies

3.28 The evidence found shows some successful cases of coordination with other agencies, though they were specific to certain projects and nonfinancial products and were generally more indicative of the existence of good personal relationships between IDB staff and that of the other organizations than of more sound, institutionalized processes. Such was probably the case, for example, in the competitiveness reform project and rural road infrastructure projects, which featured highly coordinated work with the Andean Development Corporation (CAF) and the World Bank, respectively, and between Camisea and the CAF. There has also been successful coordination with the World Bank through the Health Sector Reform Support Program (PARSALUD).[42]

3.29 In other cases, there was no explicit, strategic coordination with respect to the areas on which each of the donors intended to concentrate. Low levels of coordination diminish the chances of capitalizing on the synergies of collaboration. Although the MEF undertakes some coordination work in externally funded operations, this is no substitute for the greater coordination effort that could be made among external donors, particularly at the level of operations within sectors being supported by them simultaneously. For example, World Bank operations in the irrigation and

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[41] The April 2005 portfolio review report mentions problems of evaluability and the weakness of monitoring systems, indicating that the generation of data on effect and impact indicators is still limited, and the lack of baselines and integrated monitoring systems in certain projects makes it hard to measure their development contribution.

[42] In the PARSALUD program, intervention in the health insurance system involved coordination between the two banks (IDB and World Bank), which were each assigned four health directorates, though they shared the same executing unit.

drainage sector could benefit from greater coordination with the Bank's agricultural and rural development projects.

3.30 The potential gains from coordinated work between the main development agencies in the country may not be minor, given their participation in Peru. Between 2002 and 2006, the World Bank approved a nearly identical number of operations (29 compared to the IDB's 31) for a total of US$1.58 billion, 30% less than the IDB. In the same period, the CAF approved US$3.093 billion, 38% more than the Bank. CAF disbursements to the country were similar to those of the Bank.

D. Country Office reengineering

3.31 Although there are as yet no results that can be attributed to the reengineering process (still less, results from which the impact of Peru's economic and political cycle can be isolated), the evidence suggests that beneficiaries have a positive view of the work done by the Country Office.[43] They have given specific examples where the action of the Country Office has had a positive impact on project performance, particularly through the organization of workshops, meetings, and technical support.

3.32 The exercise, which was supported by Regional Operations Department 3 (RE3), began in 2002 with the aim of reshaping the support given by the Bank to the country over the course of project execution in two main areas: planning systems and supervision and monitoring systems. The most significant changes included increasing interaction with the MEF by establishing quarterly portfolio review meetings of the Bank, the MEF, and executing agencies; introducing annual planning exercises (to prepare annual work plans); and initiating a process to transition from the ex ante review system to ex post oversight of the procurement of works, goods, and consulting services.[44] Country Office resources would be targeted to the worst-performing projects.

3.33 Among the most innovative changes is the execution of MIF operations under the Program of Delegation of Authority. This allows the Country Office to independently prepare and approve MIF operations for up to US$100,000, incorporating innovative design and execution mechanisms, especially in the areas of procurement and disbursement triggers. As of February 2007, this latter mechanism had already been incorporated into 15 of the 30 MIF operations in execution.

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[43] The improvement between 2004 and 2005 in the indicators of average time from receipt of communications to the sending of a formal reply, and the average time from the receipt of disbursement requests to their processing, may be a reflection of the contribution of the changes introduced in the Country Office to the positive view held by beneficiaries.

[44] Indicators of the number of formal letters issued (in connection with investment loans and technical-cooperation programs) per dollar disbursed show an improvement between December 2004 and December 2005: a 37% reduction in the case of investment loans and 55% for technical-cooperation programs.

IV. RESULTS OF THE BANK'S ACTION IN THE COUNTRY

4.1 This chapter analyzes the effectiveness of the Bank's work in Peru. The evidence shows that the success stories have generally been in areas where systematic work has been undertaken over a period of time (building on previous successes) and where the country's management capacity was stable. In other areas—generally where a thorough risk analysis was not undertaken, where there was no beneficiary capacity, and where incentives against reforms faced by the agents involved were not taken into account—the work of the Bank has not been so fruitful.

A. Effectiveness of the Bank's action in the productivity and competitiveness sector

1. Create conditions to raise competitiveness and productivity

Indicator	2002 Baseline	Target	2004	2005	2006	Trend	Target met	Source
Average economic growth index	5.2%	Above 4% as of 2004, with sustained trend	5%	6.4%	8%	+	Yes	BCRP
Growth competitiveness index	3.87 (57th place, below the median)	To achieve at least the median for the indicator in 2006	3.78 (67th place, below median)	3.66 (68th place, below median)	3.89 (65th place, below median)	+	No	WEF
Observance of fiscal limits of the Fiscal Transparency Law	Not observed	Observed	Partly observed	Partly observed	Partly observed	+	No	Law 27245 and MEF
Tax income/GDP	12%	14% in 2007, yearly increase in indicator as of 2003	13.3%	13.6%	14.9%	+	2007 data not available	BCRP
Credit/GDP	25% in 2002	30% in 2006	19.4%	17.6%	16.9%	–	No	BCRP
Ratio (X+M)/GDP	26% in 2002	30% in 2006	33.4%	37%	41.4%	+	Yes	BCRP

4.2 As the table shows, the strategy's indicators for the sector are mostly trending upward, even though the established targets have not been met in all cases. The most favorable trends have been seen in indicators that rely on economic trends and those that have benefited from a favorable international situation.

4.3 Irrespective of their trends, the indicators included in the strategy do not allow for the Bank's work and impact in the sector to be directly assessed. The main reasons for this are that in some cases:

- There is a weak direct relationship to the Bank's work in the sector (e.g. tax revenues and compliance with fiscal rules).
- The potential for attribution is low (e.g. the country's economic growth or degree of trade openness).
- The following are not adequately defined: (i) tax revenues would need to be measured after controlling for the cycle and changes in tax rates and/or bases;

(ii) in the case of the Fiscal Prudence and Transparency Law, it should be indicated whether all or only some of the components need to be fulfilled.[45]

4.4 Similarly, there was a lack of indicators to more adequately show the impact of the Bank's work in the sector. For example, no indicator of the trend in the country's infrastructure was included, despite the many operations programmed and approved in the sector.

4.5 Aggregate results show that there is still a long road ahead. Improvements in macroeconomic indicators were driven more by international prices for traditional export products—mainly minerals—than by any significant change to the export bias.[46] WEF competitiveness indicators such as the one included in the table do not show any clear improvement. Moreover, infrastructure levels have not improved substantially, particularly in areas directly related to increased business productivity.

4.6 These aggregate results contrast with specific progress made in the implementation of a number of measures to enhance private-sector competitiveness, many of which received Bank support. For example:

- The average time to enforce a bank guarantee was reduced by 82% thanks to the creation of seven commercial courts (PE-0239).
- The time needed to complete bureaucratic processes to start up a business decreased by 75%, largely because transactions can now be done on-line (PE-0239).
- An average saving of 54.8% in agricultural pest control was generated for farmers by replacing chemical with biological control mechanisms. In 2004, the aggregate savings were US$19 million (PE-0143).
- An incremental benefit of US$20 million was generated in 1998-2005 in the coastal regions of Tacna and Moquegua as a result of fruit fly eradication (PE-0143).
- Cost reductions of US$5.7 million were achieved in 2000 as a result of the eradication of foot and mouth disease (PE-0143).
- There was a slight increase in activity on the land market, along with a substantial rise in the market value (and in its variation) of titled land (PE-0037 and PE-0107).

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[45] The fact that the choice of the targets assigned to indicators is not usually justified often casts doubts as to their relevance.

[46] According to a World Bank study (Guasch and Polastri, 2006), the healthy macroeconomic results posted by Peru in the last five years have not been matched in the competitiveness sphere. There is ample room for regions other than Lima to become key engines of growth and job creation. To guarantee sustained expansion and diversification of exports, Peru should focus on enhancing competitiveness and ascending the value-added chain, moving from production and exports based on commodities to new products with greater value added.

- Travel times on the Pan-American Highway and internal roads were cut by 20% and 30% respectively, and operating costs were reduced by 30% (PE-0131).
- In the case of the Camisea project (PE-0233), although for the moment the only achievements are at the output level (2,590 customers connected to the gas network, three natural gas stations installed, US$264 million in royalties paid to the government), quantifiable impacts in terms of cost savings in energy and transportation are anticipated.

4.7 There are also a number of projects that may well have had an impact, but no information exists to confirm this. The fact that the foreign trade policy development project, for example, developed the Foreign Trade Priority Agenda (APCE), the National Strategic Exports Plan (PENX 2003-2013), or sector operating plans, does not guarantee that these have played a role in increasing exports and opening up new markets, although nontraditional exports to the main trading blocs have risen (which is one of the selected impact indicators).

4.8 In view of the above, there would seem to be somewhat of a contrast between the achievements of the Bank's action in this strategic area and the aggregate trend in the country's competitiveness. There could be several reasons for this. Firstly, as mentioned above, indicators at the strategy level may not be suitable for capturing micro-level improvements. Secondly, some of the Bank's actions are likely to show more sizeable impacts in the future. Such is the case of the reduction in the time it takes to start up a business, the outputs of the Camisea project, and pest eradication activities that are still underway. Thirdly, some of the specific short-term achievements may not necessarily entail long-term competitiveness gains unless related weaknesses are overcome. Fourthly, some of the Bank's interventions in this area may be generating outcomes that are more "social" than "productive," e.g. the land titling and rural roads projects. In the latter case, for example, although they have had a positive impact on transportation conditions and access to social services among poor rural dwellers in Peru, they have not helped to improve aspects relating to the productive activities of those individuals.

4.9 The difficulties encountered by some of the Bank's interventions also restricted their impact to some extent on overall competitiveness in Peru. An example is the second phase of the multisector credit program (PE-0191), where, despite the disbursement of nearly US$200 million, only 34% had been extended as credits to the private sector at the date of the project completion report (PCR). This was due to a hardening of the stance adopted by banks in response to the financial crisis, and due to the growing influence of the corporate bond market, which reduced the demand for loan funds. In the case of the youth labor training program (PE-0241) supposed mismanagement of funds and allegations of politicization—which are currently under investigation by the Public Prosecutor's Office—led to a de facto suspension of disbursements soon after the project had started.

4.10 Design problems may have also limited project impacts. For example, in the case of phase II of the land titling and registration project (PE-0107), a number of stakeholders indicated that a prior effort to issue identity documents in the areas to be titled would have been vital, as the failure to do so excluded many poor households from access to a property title, and thus reduced the program's impact. In addition, a training component could have been included to inform farmers of the benefits and use of property titles.

4.11 Lastly, weak coordination between operations, both between investment projects and with PRI and MIF operations, is likely to have undermined the Bank' potential impact.

1. Coordination of the Bank's interventions in the sector

4.12 According to documents from a number of projects, not all possibilities for coordination between the Bank's interventions in the sector have been exploited. Examples include the agricultural health development program (PE-0143) and the land titling program (PE-0107), which did not benefit from positive complementary effects with other projects in the same or related sectors.[47]

4.13 Coordination with the MIF was also limited. The inclusion of a MIF cluster program as a condition of the sector competitiveness reform program (PE-0239) was not the result of work that had been coordinated from the outset. This led to a delay in approval of the MIF program (PE-M1005); and ultimately the condition was considered fulfilled owing to progress made in the area by another MIF cluster program already under execution.[48] Further, the sector has not seen MIF technical-cooperation programs exploited as possible gateways for subsequent work on a larger scale in certain sectors.

4.14 An even clearer example of the coordination problem is present between the public and private sectors of the Bank. As the OVE evaluation of the Bank's direct private sector lending program (document RE-303) found, there is no strategic inclusion of PRI operations within the Bank's strategy with the country, which results in specific activities that do not necessarily maximize the impact of the Bank's work. In the case of the environmental sector and Camisea, a joint, coordinated activity could have produced a more strategic operation to consolidate Peru's environmental management capacities in general, and not just those linked to Camisea.

[47] The PCR for the agricultural health development program (PE-0143) highlights as negative factors for obtaining effects: the absence of complementarity with other programs and projects in the sector or other related sectors, and the constraints on implementing a comprehensive strategy for the agro-export sector that could take advantage of program synergies. Along the same lines, one of the evaluations by the Grupo de Análisis para el Desarrollo [Development Analysis Group] (GRADE) of the rural land titling project recommends that levels of coordination with other productive programs in the rural domain be enhanced, to yield positive complementary effects that are not currently seen.

[48] Although the loan document indicated that a MIF program would be prepared to elaborate on and develop the cluster program (without specifying which MIF program was meant), already in 2005 it was understood that the MIF program that would fulfill the condition was PE-M1005 (Cluster Promotion Program), though in the end it was not considered for fulfillment of the condition owing to the delay in its preparation.

B. Effectiveness of the Bank's action in the social development sector

2. Improve the efficiency of social policies

Indicator	Baseline	Target	2002	2004	2005	Trend	Source
Average annual growth rate of per capita GDP		Above 1.8%	3.70%	3.70%	5.00%	+	Central Reserve Bank and INEI
Social spending/GDP	7% in 2002	11% in 2006	6.22%	6.25% (1)		+	2005 Programming Mission Report
GINI coefficient	0.493 in 2000	Improvement	0.525	0.525 (2003)		–	ECLAC
Private investment in drinking water and sanitation in at least two municipios outside Lima		Year-to-year increase as of 2004			Implementation not begun		
Number of housing subsidy beneficiaries		Increase as of 2004	688 (2003)	1,195	9,861**	+	MIVIVIENDA fund
Social spending in depressed areas using the FONCODES methodology		Targets to be included in loan documents	890 million soles	1.01 billion soles		+	FONCOMUN transfers. 2005 Programming Mission Report
Shortfall in access to healthcare among the rural poor		Reduction of shortfall	0.131	0.145		–	2005 Programming Mission Report
Total immunization		75% in 2006			N/A		
Percentage of rural poor that have completed secondary education	20% in 2001*	25% in 2006		11.60%		+	2005 Programming Mission Report

* The baseline was reduced to 11% in the 2005 Programming Mission Report. No changes were made to the target.

** The total attributable to the Bank is less, having financed 3,791 minimum housing units, 1,029 basic housing units, and 37 homes on their own plot.

4.15 As the table shows, progress has been made, but there are also issues pending in areas of Bank intervention. While the per capita GDP growth rate has exceeded the target, and the number of housing subsidy beneficiaries has risen, the increase in social spending and the percentage of poor people in rural areas that have completed secondary education remain far short of the established targets; and the Gini coefficient and the deficit in terms of poor people's access to health services have not improved.

4.16 The indicators that were included in the program do not offer a comprehensive view of conditions in the sector:

- Official, up-to-date information that would allow for these indicators to be evaluated is lacking. For instance, no official data have been published on poverty and income distribution for after 2004.
- Some indicators are not fully defined. For example, there is no indication of how to measure the gap in health access for the rural poor, which are the depressed areas used for the FONCODES indicator, or at what government level social spending should be analyzed.

- The verification method and information source for the indicators is not clearly established in all cases. For example, the data on social spending differ from those in other available sources, so the definition is not necessarily the standard one.[49]

- The capacity for attributing results to the Bank's action is low (per capita GDP growth and income disparity).

4.17 Achievements in the sector related to the Bank's work include:

- In the health sector, under the PARSALUD program (PE-0146), institutional childbirth increased, particularly in rural areas, with home-based deliveries falling from 69% to 40% between 1995 and 2004.[50]

- In terms of the allocation of social spending (the action area of four PBLs): (i) targeting improved in the community kitchen, school breakfast, and *Vaso de Leche* ("glass of milk") programs, and in Integrated Health Insurance enrollment; (ii) equity visibly improved in the management of education spending and implementation of a teacher evaluation system; (iii) budgetary protection improved, ensuring greater execution of the investment component of programs included in the social spending protection scheme.

- Furthermore, the earlier phases of FONCODES achieved outcomes which, given the similar characteristics of the new phase of the program,[51] could be indicative of the potential impact of FONCODES III: (a) in the education sector, FONCODES interventions generated: (i) an increase in school attendance by school-age children; (ii) a 34% increase in student enrollment; (iii) a 1% increase in the number of classrooms and a 1.6% increase in the number of grades; and (iv) a 15% increase in the probability that a school will offer secondary education (Paxson and Shady, 2002); (b) in the health sector, FONCODES interventions helped to lower the likelihood of diarrheal disease among children by 3%; and (c) as a byproduct of FONCODES investments, home values increased by 2,000 nuevos soles (Apoyo 2002).

4.18 The impact of the interventions has been diminished because of design and risk management problems that affected the programs in the sector either directly or through cancellations and restructurings.

4.19 A noteworthy example of design weaknesses is provided by the Wawa Wasi program (PE-0167). No prior study of demand for the services to be provided by the program was conducted, and, as a result, the neediest population groups failed

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49 For example, figures for social spending in relation to GDP are different if a study by the Grupo Apoyo 2006 is used, which found that social spending represented 9% of GDP in 2002 and 9.2% in 2005.

50 The impact was greater in the case of non-Spanish-speaking expectant mothers and those with less education, although the result is not statistically significant in the first case.

51 The main difference in FONCODES III with respect to the earlier phases is the higher degree of decentralization. This did not substantially affect the type of project to be financed.

to be incorporated into the program. In addition, the caregiver-mother intervention model, which did not guarantee training and adequate incentives, had only a minor impact in terms of early childhood stimulation (Cuanto Institute, 2004).[52]

4.20 Inadequate management of program risks, in terms of both identifying them and formulating appropriate mitigation measures, undermined potential results in this sector, either because of cancellations and restructuring or through execution delays. In the case of FONCODES III (PE-0193), the program failed to anticipate the change in the government's social protection policy approach; and in the case of the secondary education program (PE-0170), although it envisaged the introduction of a new cycle within the Peruvian education system, it failed to include among the risks that political changes might bring about substantial changes in conception of the reform (given constant changes of authorities). These situations caused partial cancellations and restructuring.

4.21 Among the impacts that cancellations had on the ability of programs to accomplish their development objectives were:

- Secondary education program (PE-0170): The *Bachillerato* component of the project was cancelled, which meant that the activities intended to strengthen a means of linking graduates of the basic education system with higher education and the labor market were not carried out.
- FONCODES (PE-0193): Cancellations had a major impact on the ability of FONCODES to channel resources toward social and productive investments and the rehabilitation of social and economic infrastructure, translating into 30% and 60% reductions in the respective targets.

4.22 A case where a cancellation had an impact on execution was the health sector development program (PE-0146), in which the mother-child health component came to be wholly executed by the Peruvian government under the Integrated Health Insurance (SIS) system.[53] The result of this restructuring has been mixed: Given the initial absence of a clear government policy, project execution was delayed for over three years, with the consequent lack of beneficiary coverage, but

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[52] The impact evaluation for the program shows that it did not have a significant impact on malnutrition and immunization among program participants, compared to nonparticipants, because there was a high level of rotation and low exposure to the program among children, and deficient knowledge, attitudes, and practices with regard to health, nutrition, and early stimulation among both beneficiary mothers and caregivers (Cuanto Institute 2004).

[53] There seem to have been several reasons for the cancellation. First, the loan was approved while President Fujimori was in office, but implementation only began during the transition presidency. Second, the amount of the loan was more than the total amount of externally sourced funding that the executing ministry could contract in a reasonable period of time. The government therefore decided to finance the program mostly out of National Treasury funds and leave only part of the external resources to finance the investments and reform activities. Moreover, an article of the Constitution was invoked which states that current expenditure cannot be funded externally.

because the national government took charge of financing the insurance from the outset, program sustainability was achieved.

4.23 The health sector project, along with the Wawa Wasi program, are examples of Bank-supported initiatives with sustainable outcomes. In the former case, as mentioned above, the government took over financing of the program from its inception. In the latter case, the program is already incorporated within the activities of the Government of Peru and receives National Treasury funding. Nonetheless, there are other initiatives whose sustainability could be in difficulty, such as teacher training, in which there has been an abrupt reduction in the number of activities since external funding came to an end.[54]

C. Effectiveness of the Bank's action in the State modernization sector

3. Modern, efficient, and sustainable State and public institutions

Indicator	Baseline	Target	2002	2004	2005	2006	Target met	Source
Institutional quality index		Attain the median index in 2006	4.24 (49th place, < median)	4.28 (< median)	4.27 (59th place = median)	4.36 (60th place, above median)	Yes (?)*	WEF
Balance and sustainability of the finances of decentralized agencies (preparation of studies).		Preparation of studies					?	
Index of the perception of regulatory efficiency and autonomy		Attain the first quintile of the index in 2006					(?)**	WEF
Territorial financial information system		Its existence as of 2004, which includes at least 50% of expenditure of the country's regions and municipios				Implemented in all local governments. 80% had registered their expenditure in the system in 2006.	Yes	MEF***

* The country has moved above the median despite falling in rank, because eight countries were added to the sample, seven of which were below the median. Without the change in the sample with respect to the previous year, Peru would have been below the median.

** The indicators have changed. The nearest measures would be institutions and market efficiency. In both cases Peru is below the median.

*** http//:www.mef.gob.pe/siafgl/files/que_es_siafgl.pdf

4.24 As can be seen in the table, problems in the design of indicators included in the strategy do not allow for the impact of the Bank's work in the country to be measured. Firstly, two of the indicators relate to outputs rather than outcomes. Secondly, the WEF indicators are difficult to attribute to the Bank's work; their behavior depends on trends in the country itself and elsewhere, and also on the formation of the sample and indicators.

4.25 It is also difficult to establish a direct connection between changes in the sector and the Bank's work, because the Bank made no effort to measure program outcomes. For example, despite having worked with the revenue collection agency on several

[54] As reported in the PCR for program PE-0116, and in the document on the public expenditure monitoring and evaluation system 2005, the percentage of teachers who participated in at least one training activity dropped from 19% in 2000 to 1% in 2004, partly owing to the conclusion of the bank-financed program.

occasions, it did not set up a system to properly calculate the organization's efficiency gains.[55]

4.26 Some of the impacts seen at the aggregate level for the sector (related to the execution of a series of PBLs) indicate that significant progress has been made in the fiscal sector in terms of reducing the deficit and the public debt. Social spending has increased, and the increase has been preserved in times of crisis. Modern management systems have been established, and there is greater transparency in public accounts.[56] Nonetheless, in many areas of the Bank's work, the expected progress was not achieved, and there is still a shortfall to be overcome, as shown by the World Bank, IPES 2006, and EIU governance indicators presented in chapter I.

4.27 In terms of specific outcomes of the Bank's investment projects, the evidence is scant, since most of them are still under execution. In the case of the program for modernization of the justice system (PE-0126), access to justice among vulnerable beneficiary population groups has improved, and properties surrounding the basic justice modules have risen in value.

4.28 The Bank's activities in the sector showed two very different patterns, partly reflecting the tools used and partly the areas in which it attempted to work and the execution modalities chosen. On the one hand, it acted through fast-disbursing loans (particularly in the fiscal sector and with execution by the MEF), satisfying most of the conditionalities. On the other, support was provided to the country through investment loans for institution-strengthening (currently under execution by various agencies), which have encountered substantial execution problems (see chapter III).

4.29 Sector loans have been executed rapidly and have had a favorable impact on debt management for the country, since it could count on the funds needed to meet its financial needs. The key to the quick preparation and rapid disbursement of these loans has been effective cooperation between the MEF authorities and the Bank.

4.30 Although sector programs have helped to increase the availability of information and, consequently, the transparency of public accounts, the impact these loans has derived more from their financial relevance than from their relevance as generators or leveragers of reform. There are several reasons for this. First, many of the reforms that were included in the PBLs had already been envisaged by the MEF. Indeed, the PCR for one of the loans (PE-0212) stated that all of the matrix conditions had already been fulfilled when the operation was presented to the Board of Executive Directors, so disbursement was immediate.[57] The same happened with

[55] The midterm strategy evaluation is forced to use phrases such as "no quantitative estimates of the contribution exist," "it is reasonable to say that the outputs generated by the program contributed significantly to this outcome," etc.

[56] The public-sector pension systems made a notable contribution to transparency, as they later played a key part in the elimination of the "*Cédula Viva*" regime.

[57] It should be noted that PBLs in Peru not only disburse faster than the Bank average, but they are also prepared more quickly (average preparation time is 50% below the Bank average).

a recent programmatic loan (PE-L1017), for which disbursement was made a few days after approval. In fact, in many of these cases, the associated technical-cooperation programs did not need to be executed for the conditionalities to be satisfied.

4.31 Secondly, even in the case of programs that "leveraged" reforms, sustainability is weak when these have to be maintained by agencies other than the one that secures State funding. Such is the case when there is no orderly sequencing of loans making it possible to sustain the reforms over time (successive PBLs that require the agency to move a bit further in the same direction) or specific incentives that motivate the agencies involved to maintain the reforms (whether through loan operations or technical-cooperation programs). An example of this is the sector program for transparency in and reform of fiscal, social, and judicial policy (PE-0212), whose PCR recognizes that the sustainability of justice reforms was not guaranteed by the program's actions.

4.32 Thirdly, projects that did not change the incentive system underlying the root of the problems have resulted in mechanisms with little capacity to affect reality. For example, tax system reform was unsuccessful because when execution of the fiscal reform program (PE-0211) ended, not only had many tax rates risen (instead of falling) but Congress had not passed the abolition of tax exemptions. This happened because the program did not enjoy the support of the legislature (which benefited from the exemptions), and in a context where the administration had incentives to increase spending.

4.33 The importance of incentives was also clear in the investment loan to strengthen the National Superintendency for Tax Administration (PE-0168), where actions to technically strengthen the organization had been completed, but senior staff had no incentives to modernize and strengthen the management systems. The objectives of increasing tax pressure and enhancing the equity of the tax system were not accomplished because they depended on other actors that introduced new programs of tax breaks and incentives.

4.34 The current loan for strengthening the tax administration (PE-0223) sought to solve some of these problems, but has encountered others related also to the scheme of incentives facing the organization. The loan is not being executed with Bank funds, because the Superintendency has been implementing many of the activities with its own resources; no full-time management team has been established for the project; and there are problems with goods and service procurement.

D. Institution-strengthening components of projects

4.35 The inclusion of institution-strengthening components in projects in the various strategic areas has not necessarily ensured their effectiveness. For example, the executing agencies for the land titling, secondary education, and highway infrastructure projects have recognized that they lack the know-how they need to push forward improvements in this area.

4.36 These problems are not new and were identified by Management in the Country Strategy, which highlighted, among the problems that the portfolio in Peru had been facing, the "lack of ministerial commitment to projects' institutional strengthening components," and recommended ensuring that institutional support have simple performance indicators to assess progress. The midterm evaluation of the Bank strategy conducted by RE3 (April 2006) confirms that the problem persists.[58]

4.37 The government would seem to have a similar assessment of the effectiveness of this type of intervention (by the Bank or by other donors), as can be deduced from the MEF guidelines, which set out that foreign borrowing cannot be requested for projects or programs whose main objective involves institution-strengthening actions.

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[58] The document states that in future, the Bank must prevent the nature of institution-strengthening components in investment loans from being undermined—i.e. the trend towards viewing this component of a project as a way to purchase computers, new furniture, etc.

List of Interviewees

Peru

- Aída Amézaga Menéndez, Chief, Sector Loan Coordination Unit
- Alberto Aching Ashuy, Executive President, ProTransporte
- Alcides Velazco, Manager of Planning and Budget, Provías Nacional
- Angel Marcés, Consultant, Peru Country Office
- Antonio Torres Pérez, Administrative-Financial Coordinator, Program of Support Services to Gain Access to Rural Markets (PROSAAMER)
- Arq. Peral, Infrastructure Office, Ministry of Education
- Betty Sotelo Bazán, Director-General, National Public Borrowing Department (DNEP), MEF
- Carlos Casas Tragodara, Chief of the Advisory Office, MEF
- Carlos Castro Silvestre, General Coordinator, State Modernization and Decentralization Program, Office of the President of the Council of Ministers
- Carlos Chirinos, Director, Sociedad Peruana de Derecho Ambiental
- Carlos Garaycochea Mejía, Coordinator of the Technical Coordination Group, CAMISEA
- Carlos Giesecke, Multiyear Programming Department (DGPM), MEF
- Carlos Oliva, Consultant.
- Carlos Ricse, PARSALUD Coordinator, Ministry of Health
- Carmen Mosquera, Specialist, Peru Country Office
- César Cervantes Gálvez, Director of Environmental Quality and Natural Resources
- César Olea Ángeles, Operations Manager
- Clara Martínez Ríos, Project Coordinator, Strengthening Management of the Public Agricultural Sector component, PROSAAMER
- Christof Kuechemann, Representative, Peru Country Office
- David Hernández Salazar, Social Communication and Support Manager, ProTransporte
- Edgard Zamalloa, Director-General of the Economic and Social Affairs Department, MEF
- Eric Meneses, Director, Conservation International–Peru
- Ernesto Javier Mondelo, Specialist, Peru Country Office
- Félix Canchan, Promotion and Transfer Manager, Provías Departamental
- Fernando Moreira, General Coordinator of program 1591/OC-PE, Comptroller General's Office.
- Gastón Pavletich, Program Coordinator, Institutional Strengthening of the SUNAT, SUNAT, Peru
- Gonzalo Deustua, Specialist, Peru Country Office
- Gonzalo Ferraro, General Manager, Norvial
- Gustavo Cabrera, Chief, Project Executing Unit, Ministry of Education
- Gustavo Yamada, Research Center, Universidad del Pacífico

- Humberto Knell, Camisea Project Coordinator, Energy Investment Oversight Agency (OSINERG)
- Ian MacArthur, Specialist, Peru Country Office
- Jaime Portuguez Arias, Executive Director, Land Titling and Registration Program II (PETT)
- Javier Díaz, Administration Manager, Ministry of Education
- Javier Kapsoli Salinas, Director-General, Economic and Social Affairs Department, MEF
- Jorge Cuba Hidalgo, General Manager, ProTransporte
- Jorge Chávez, Economist, Instituto Peruano de Economía (IPE), Peru
- Jorge Perlacios, Technical Secretary, National Decentralization Council
- José Arista Arbildo, Deputy Minister of Finance, MEF
- José Callirgos, Office of Public Credit, MEF
- José Díaz, MEF Officer Responsible for Emergency Programs. IDB loan manager
- José Ochoa, Project Unit Chief, Project for the Control and Eradication of the Fruit Fly on the Peruvian Coast, SENASA
- José Valderrama, Economist, IPE, Peru
- Juan Luis Reus, General Coordinator, Foreign Trade Policy Development Program, Ministry of Foreign Trade and Tourism (MINCETUR)
- Juan Manuel Leano, Specialist, Peru Country Office
- Juan Miguel Cayo Mata, Deputy Minister of Economy, MEF
- Juan Pablo Severi, Specialist, Argentina Country Office
- Julio Salvador, Hydrocarbons Inspection Manager, OSINERG
- Julio Toledo Hevia, General Coordinator, PROSAAMER
- Karina Olivas Núñez, Sector Loans Coordination Unit, MEF
- Leoncio Mendoza Arroyo, General Accountant, Redesur
- Leoncio Rodríguez, Project Coordinator, FONCODES
- Marcela Benavides de Burga, Andean Development Corporation (CAF)
- Marcos Allende, consultant on the project for institution-strengthening for Camisea, President of Grupo GEA–Emprendimientos Ambientales
- Marcos Ibazeta, former President of the Superior Court of Lima
- María del Carmen Orihuela, Project Coordinator, Information for Rural Development component, PROSAAMER
- María del Carmen Rivera, Chief, Sector Loans Coordination Unit, MEF
- Mariano Castro, Executive Secretary, National Environment Council (CONAM)
- Michael Valqui, Director, World Wildlife Fund
- Miguel Jaramillo, Senior Researcher, GRADE
- Miguel Prialé, Director-General, Multiyear Public Sector Program, MEF
- Milagros Alvarado, former coordinator of the PROJoven project
- Milton von Hesse, Director-General, DGPM, MEF
- Nelson Shack, former Director of Budget, MEF
- Nery Romero, Chief of Budget Unit, Provías Nacional

- Pedro Zavaleta Montoya, Program Coordinator, Institutional Strengthening of the SUNAT, SUNAT, Peru.
- Rafael Capristán, Multiyear Public Sector Program, MEF
- Rafael Millán, Deputy Representative, Peru Country Office
- Raúl Torres, Executive Director, Provías Rural
- Roberto Koc Galleguillos, Chief, Coordination Unit, Land Titling and Registration Program II (PETT)
- Rodolfo Fierro, Coordinator, Institutional Strengthening Program for the Peruvian Congress (1458/OC-PE)
- Silvia Sánchez Huamán, Executive Director of the nongovernmental organization Peruvian Association for the Conservation of Nature (APECO)
- Tomas Delgado, Administration and Finance Manager, Transportadora de Gas de Perú
- Valentín Cobeñas, Director of Debt Management, MEF
- Víctor Quispe, Information Technology Department, FONCODES
- Viviana del Carmen Alva, Project Coordinator, Business Advisory Services component, PROSAAMER
- Walter Paredes Rojas, Manager of Infrastructure Projects
- Walter Zecenarro, Coordinator, Provías Departamental

WASHINGTON

- Alberto Melo, Sr. Country Economist, Country Division 5 (RE3/OD5)
- Alicia Ritchie, Manager, RE3
- Ana María Vidaurre, Private-Sector Specialist
- Antonino Giuffrida, Health Specialist, RE3
- Arnaldo Posadas, Specialist in Modernization of the State
- Claudio Cortellese, Senior MIF Specialist
- Daniela López, Consultant, RE3/OD5
- David Rogers, Sr. Country Coordinator, RE3/OD5
- Eduardo Figueroa, Environment Specialist (consulted)
- Elizabeth Brito, Environment Specialist, PRI
- Fidel Jaramillo, Regional Economic Advisor, RE3
- Flavio Bazan, Deputy Representative, Guatemala
- Francisco De Souza, Senior Infrastructure Specialist
- Geoffrey Cannock, Agriculture Specialist, RE3 (consulted)
- Gianina Nuñez, Private-Sector Specialist, PRI
- Hunt Howell, Consultant, RE3
- Ichiro Toda, Private-Sector Specialist, PRI
- Jaime Pinto, (former) Executive Director for Peru
- Jaime Quijandría, Executive Director for Peru
- Jaime Vargas, Education Specialist, RE3
- John G. Graham, Private-Sector Specialist, PRI
- Jorge Lamas, Social Specialist, RE3

- Juan José Neyra, Counselor for Peru, Office of the Executive Director for Peru and Chile
- Kim Stakin, Pr. Country Economist, RE3/OD5
- Michelle Fryer, Evaluation Officer, OVE
- Pablo Alonso, Specialist in Modernization of the State, RE3
- Pablo Cardinale Pizani, Natural Resources Specialist, PRI
- Robert Montgomery, Environment Specialist, PRI
- Rodolfo Huici, Transport Sector Specialist, RE3
- Susan Kolodin, Sr. Country Coordinator, RE3/OD5
- Vera Lucia Vicentini, Transport Sector Specialist, RE3

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