

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**PERU**

**IDB COUNTRY STRATEGY WITH PERU  
2012-2016**

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5. [Nota Técnica de Agua, Saneamiento, Recursos Hídricos y Residuos Sólidos](#) [Technical Note on Water, Sanitation, Water Resources, and Solid Waste]
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15. Hoja de Ruta – Programa de Gobierno del Presidente Ollanta Humala [Roadmap—Government Program of President Ollanta Humala]
16. [Documento del Acuerdo Nacional 2011-2016](#) [National Agreement 2011-2016]
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19. [Diagnóstico de Crecimiento 2008](#) [Growth Diagnostics 2008]
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21. [Documento de Alineación Estratégica Retos de Desarrollo Perú](#) [Document on Strategic Alignment of Peru Development Challenges]
22. [Marco Macroeconómico Multianual 2012-2014](#) [Multiyear Macroeconomic Framework 2012-2014]
23. [Principios de Política Fiscal 2012-2014](#) [Fiscal Policy Principles 2012-2014]

24. [Temas de Sostenibilidad Macroeconómica de Perú](#) [Peru Macroeconomic Sustainability Issues]
25. [Documento Consejo de Asesores de la Sociedad Civil BID-Perú](#) [Document of IDB-Peru Civil Society Council of Advisors]

## ABBREVIATIONS

APCI	Agencia Peruana de Cooperación Internacional [Peruvian International Cooperation Agency]
BCRP	Banco Central de Reserva del Perú [Central Reserve Bank of Peru]
CGRP	Contraloría General de la República del Perú [Office of the Comptroller General of the Republic of Peru]
CIDA	Canadian International Development Agency
Cosude	Cooperación Suiza de Desarrollo [Swiss Development Cooperation]
CPI	Consumer price index
DAC	Development Assistance Committee
DGCF	Dirección General de Caminos y Ferrocarriles [Directorate General of Roads and Railways]
EAP	Economically active population
ENDES	Encuesta Demográfica y de Salud Familiar [Demographic and Family Health Survey]
ESC	Emerging and Sustainable Cities Initiative
GCI-9	Ninth General Increase in the Resources of the Bank
GHG	Greenhouse gas
GIZ	German Development Corporation
IIC	Inter-American Investment Corporation
ILR	International liquidity ratio
IMF	International Monetary Fund
INEI	Instituto Nacional de Estadística e Informática [National Institute of Statistics and Information Technology]
IRI	International Roughness Index
JICA	Japan International Cooperation Agency
KfW	Kreditanstalt für Wiederaufbau
LPI	Logistics Performance Index
MEF	Ministry of the Economy and Finance
MEM	Ministry of Energy and Mines
MIDIS	Ministry of Development and Social Inclusion
MIF	Multilateral Investment Fund
MINAG	Ministry of Agriculture
MINSA	Ministry of Health
MW	Megawatts
NFPS	Nonfinancial public sector
NSG	Nonsovereign guaranteed
OECD	Organisation for Economic Co-operation and Development
OMJ	Opportunities for the Majority Sector
PEFA	Public Expenditure and Financial Accountability
PNSR	Programa Nacional de Saneamiento Rural [National Rural Sanitation Program]
PPP	Public-private partnership

PROCOES	Programa de Mejoramiento y Ampliación de Servicios de Agua y Saneamiento [Water and Sanitation Services Improvement and Expansion Program]
PROVIAS	Programa de Infraestructura Vial [Road Infrastructure Program]
R&D	Research and development
RICYT	Red de Indicadores de Ciencia y Tecnología [Science and Technology Indicators Network]
SCF	Structured and Corporate Financing Department
SEACE	Sistema Electrónico de Contrataciones del Estado [Online government procurement system]
SG	Sovereign guaranteed
SIAF	Sistema Integrado de Administración Financiera [Integrated financial management system]
SIS	Sistema Integrada de Salud [Integrated health system]
SISFOH	Sistema de focalización de hogares [household targeting system]
SMEs	Small and medium-sized enterprises
TFP	Total factor productivity
UNDP	United Nations Development Programme
UNFCCC	United Nations Framework Convention on Climate Change
USAID	United States Agency for International Development
VMCS	Vice-Ministerio de Construcción y Saneamiento [Vice Ministry of Construction and Sanitation]
VMVU	Vice-Ministerio de Vivienda y Urbanismo [Vice Ministry of Housing and Urban Development]

## EXECUTIVE SUMMARY<sup>1</sup>

<b>Country context:</b>	Peru has shown robust macroeconomic performance during the last few years, in a context of fiscal stability, external equilibrium, and low inflation. Nonetheless, the fact that progress has been geographically uneven has accentuated differences between regions and between urban and rural areas. The country's main development challenges stem from persistent disparities in access to social services, social security, basic infrastructure, and economic opportunities; and the need to create conditions to strengthen productivity growth and maintain geographically and environmentally balanced economic expansion.
<b>The Bank in Peru:</b>	The Bank is Peru's main multilateral lender, accounting for about 28% of the country's external public debt and 41.5% of its multilateral debt. Between 2007 and 2011, it approved loans totaling US\$2.434 billion, with a cumulative debt balance of US\$3.906 billion. The Bank is a front-line partner in Peru's development, and the close relationship it maintains with the country transcends financial issues; it is also the main provider of technical cooperation and advice, knowledge products, and support for the private sector.
<b>2012-2016 strategy:</b>	The strategy will aim to help close the economic and social gaps that exist between urban and rural areas, and support productivity gains as a basis for inclusive, sustainable economic growth. The areas prioritized in the strategy are: <sup>2</sup> (i) social inclusion; (ii) rural development and agriculture; (iii) housing and urban development; (iv) climate change and disaster risk management; (v) water, sanitation, water resources, and solid waste; (vi) energy; (vii) transportation; (viii) public management; and (ix) competitiveness and innovation.
<b>Lending framework:</b>	The demand scenario for Bank financing assumes annual approvals averaging US\$257 million, or a total of US\$1.283 billion for the period 2012-2016. This would entail net positive flows between 2012 and 2016, with the Bank maintaining its share in Peru's multilateral debt. The lending framework for this strategy is consistent with the demand assumptions underlying the government's fiscal financing strategy.

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<sup>1</sup> This country strategy with Peru will be in force from June 2012 to June 2016.

<sup>2</sup> The Bank will intervene in the priority areas using the arsenal of instruments at its disposal including sovereign guaranteed operations, its private sector windows, technical cooperation, and innovative instruments such as 'fee for service' arrangements. In its sovereign guaranteed operations, the Bank will aim to prevent fragmentation and pursue operations on a scale that proves operationally efficient and cost-effective.

<b>Strategy implementation:</b>	The strategy will take a multisector approach, involving articulated interventions or “development combos”. <sup>3</sup> Progress will continue to be made in the use of country management, financial administration, and procurement systems. The Bank will maintain fluid dialogue and close coordination with other development partners, according priority to cooperation and cofinancing arrangements among them.
<b>Risks:</b>	Should external conditions deteriorate or if the Peruvian government alters its financing strategy, the demand for financing might be greater than foreseen in this strategy. Institutional capacity weakness in certain areas of the public sector, particularly at the subnational level, could hinder strategy implementation. The natural complexity of the “combos” approach poses coordination risks that could delay the implementation of that line of action. Mitigation strategies are proposed to address these risks.

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<sup>3</sup> For a more detailed definition of “development combos,” see footnote 54.



## RESULTS MATRIX <sup>4</sup>

Peru – Road map	IDB GCI-9	IDB – Strategic sector	IDB Strategic objectives		Results expected from the strategy	Monitoring indicators				
						Indicator	Baseline 2011	Indicative targets for the country strategy period	Frequency of measurement	Source
Social policies	Social policies to promote equality and productivity	Social inclusion	Early childhood development	Increase the coverage of comprehensive child development services in the country's 600 poorest districts	Expectant mothers and children under 4 covered by the Cuna Más [Cradle Plus] program	% of families served in the country's 531 poorest districts	0	60%	Annual	Ministry of Development and Social Inclusion (MIDIS)
			Health	Increase the coverage and enhance the quality of health services in the country's 600 poorest districts	Increase the number of families receiving an integrated set of health services	Number of people in the Integrated Health System (SIS) in the country's 600 poorest districts	4,798,552	5,356,973	Annual	Ministry of Health (MINSA)
						% health units with an adequate success rate given their regulatory category (NOTE: the rate for each category of health facility is set by Technical Standard 0021 of the Ministry of Health of Peru)	68%	85%	Every four years	MINSA
				Reduce chronic malnutrition in rural areas	Reduce chronic malnutrition in children under 5 in rural areas	% of children under 5 suffering from chronic malnutrition in rural areas (NOTE: this indicator is also part of and applicable to early childhood development interventions; it has been listed under the health category to avoid duplication)	40.3% (2009)	25%	Annual	Demographic and Family Health Survey (ENDES)
				Reduce iron deficiency anemia in rural areas	Lower rates of iron deficiency anemia among children under 5 in rural areas	Rate of iron deficiency anemia among children under 5 (NOTE: this indicator is also part of and applicable to early childhood development interventions; it has been listed under the health category to avoid duplication)	51%	40%	Annual	ENDES
			Social protection	Increase the coverage of conditional cash transfer programs	Greater coverage of the Juntos [Together] program	% of households in extreme poverty included in the program	38% (2010)	60%	Annual	National Household Survey (ENAHU)/

<sup>4</sup> The indicative targets will be reviewed or replaced, as the case may be, through the country programming documents prepared during the country strategy period.

										MIDIS
			Education	Improve the quality of services for children ages 3 to 5 in rural and indigenous areas	Quality improvement in preschools in Ayacucho, Huancavelica, and Huánuco	% preschool teachers in the administrative areas of La Mar, Ayacucho; Pachitea, Huánuco; and Acombamba, Huancavelica who use the pedagogic practices promoted by the Bank program	0%	75%	End period	IDB impact assessment
				Improve learning outcomes in key subjects	Improve learning outcomes among students participating in the pilot science and environment project	Students participating in the pilot science and environment project achieve better results than control group by 0.1 standard deviations	0	0.1 standard deviation (2013)	End period	IDB impact assessment
				Close educational gaps with emphasis on rural children and youth	Improve the secondary school completion rate in rural areas	% of students ages 17 to 18 in rural areas targeted by the Bank program who complete secondary school	36% (2009)	45%	Annual	Ministry of Education (MINEDU)
Macroeconomic policy and inclusive economic growth	Environmental protection, response to climate change, and food safety	Rural development and agriculture	Increase current rural income levels	Improve competitiveness in the agriculture sector	Total agricultural productivity	3.6% annual	4.6%	Triennial	Ministry of Agriculture (MINAG)	
					Average income per hectare (US\$ at constant 2000 prices)	US\$1,545	US\$1,700	End period	World Bank	
				Increase the number of rural dwellers (farmers, producers) with access to improved rural infrastructure, goods, and public services	Difference between the percentage change in the number of dwellers (farmers, producers) with access to improved services and public infrastructure before and after the intervention at the national level	0	10%	Annual	MINAG	
			Promote and set up mechanisms to reduce emissions from deforestation and forest degradation	Increase the coverage of protected natural areas	Percentage of national territory conserved in natural areas protected by the State	17%	18%	End period	Peruvian National Protected Areas Service (SERNANP)	
				Increase the area of protected forest through mechanisms to offset climate services in infrastructure project areas of influence	Surface area (hectares) of the forest protected by mechanisms to offset environmental services in the area of the Madre de Dios interoceanic highway	70,000	80,000	End period	IDB	

For a more secure, efficient, transparent, and decentralized State	Institutions for growth and social welfare	Low-income housing and urban development	Promote low-income housing	Reduce the housing deficit	Number of low-income housing units promoted	32,627 (2010)	64,000	Annual	Vice Ministry of Housing and Urban Development (VMVU)
			Restore the historic downtowns of cities	Increase the number of restored historic downtowns	Number of integrated urban recovery projects, of at least 20 ha, implemented	0 (2010)	5	Annual	VMVU
Macroeconomic policy and inclusive economic growth	Environmental protection, response to climate change	Climate change adaptation and disaster risk management	Reduce the country’s vulnerability to disasters and climate change	Reduce the country’s disaster vulnerability	Disaster risk management index satisfactory at the national level	26.6 (2008)	35	Every four years	IDB
			Strengthen government capacities and institutional coordination to respond to climate change challenges	Incorporate climate change adaptation in local disaster risk management groups	% risk management groups incorporating climate change adaptation	0	20%	Annual	Ministry of the Environment (MINAM)
Social policies, macroeconomic policies, and inclusive economic growth	Infrastructure for competitiveness and social welfare	Water, sanitation, water resources, and solid waste	Adequately value the availability of water resources	Improve the efficiency of water use in irrigation projects	Joint water use efficiency for the three watersheds covered by the program (%) (NOTE: Efficiency is measured at the valley level and is defined as: total efficiency (water use) = conveyance efficiency*distribution efficiency*application efficiency according to the national water strategy of Peru)	35% (2010)	40%	End period	National Water Authority
				Make irrigation systems sustainable	Rate charged for water use (US\$/m³)	US\$0.00030/m³	US\$0.00045/m³	End period	National Water Authority
		Improve water resource management in watersheds	Implement integrated watershed management in the country, incorporating a climate change perspective	Number of water use disputes	20	10	End period	National Water Authority	
				Number of integrated water management plans approved by the watershed water resource councils (CRHC), including the climate change variable	0	5	End period	National Water Authority	
		Universalize access to water and sanitation services	Increase coverage in rural areas	% of homes in rural areas with access to drinking water more than 12 hours per day (areas served by the Water and Sanitation Services Improvement and Expansion Program--PROCOES)	12.30%	66%	End period	Vice Ministry of Construction and Sanitation (VMCS), National Rural Sanitation Program (PNSR)	

					% homes in rural areas with individual solutions or wastewater disposal system (areas served by PROCOES)	10%	64%	End period	VMCS, PNSR
				Increase coverage of the drinking water service in urban areas	% of urban homes with access to drinking water for more than 18 hours a day	89%	92%	End period	VMCS, PNSR
				Increase the coverage of wastewater treatment service in urban areas	% of wastewater treated in urban areas	29%	75%	End period	VMCS, PNSR
			Strengthen solid waste disposal and handling at the municipal level	Increase the number of municipios with final solid waste disposal	Number of provincial municipios with final solid waste disposal projects completed and operating	0	8	End period	VMCS, PNSR
				Increase the number of municipios with formally established municipal waste management units	Tons/day of urban solid waste sent to sanitary landfills or formally established municipal waste management units	0 tons/day	342 tons/day	End period	VMCS, PNSR
			Improve understanding of greenhouse gases (GHGs) and promote climate change mitigation measures (as part of the action plans promoted by the emerging and sustainable cities (ESC) initiative)	Prepare GHG inventory and inventory updating systems, identifying mitigation alternatives	Prepare a GHG inventory with mitigation alternatives identified for the city of Trujillo, under the emerging and sustainable cities initiative	0	1	End period	IDB-ESC Report
			Improve understanding of the risk and vulnerability to climate change impacts and adaptation alternatives (as part of the action plans promoted by the emerging and sustainable cities initiative)	Prepare maps of risk and vulnerability to climate change impacts, identifying adaptation alternatives	Prepare a map of risk and vulnerability with adaptation alternatives identified for the city of Trujillo, under the emerging and sustainable cities initiative	0	1	End period	IDB-ESC Report
Energy policies	for competitiveness and social	Energy	Support the development of a sustainable energy matrix	Improve the penetration of renewable energies in the energy matrix	Generating capacity with renewable energy sources installed under very amended regulatory framework	0 MW	465 MW	Biannual	Osinermin (Supervisory body for energy and mining investment)

				Strengthen the Ministry of Energy and Mines' (MEM) capacity to undertake medium- and long-term energy planning	Energy planning unit operating and adequately staffed to fulfill its function	No	Yes	End period	MEM
			Support improvement in the management and transparency of public enterprises in the energy sector	Contribute to the development of good corporate governance practices in public enterprises in the energy sector	Number of public enterprises in the energy sector with the corporate governance codes implemented	0	3	End period	National Government Business Funding Agency (FONAFE)
Macroeconomic policies and inclusive economic growth	Infrastructure for competitiveness and social welfare	Transportation	Improve transportation infrastructure	Improve accessibility	Km of paved roads/000 km <sup>2</sup> area	9.60	12.50	Biannual	National road infrastructure program (Provías) and Directorate General of Roads and Railways (DGCF)
				Improve the condition of the national road network	% national road network in good condition (International roughness index (IRI), 0 < IRI ≤ 2.8)	35%	50%	Biannual	Provías (National) and DGCF
				Improve the condition of the departmental road network	% departmental road network in good condition (International roughness index, IRI ≤ 6)	16%	23%	Biannual	Provías (Decentralized)
				Improve the condition of the neighborhood road network	% neighborhood road network in good condition (International roughness index, IRI ≤ 6)	7%	18%	Biannual	Provías (Decentralized)
			Improve the logistics sector	Reduce average transportation cost	Average transportation cost (US\$)	2,866	2,500	Annual	Logistics Performance Index. World Bank
				Shorten export time	Time for exports (days)	6.34	5.00	Annual	Logistics Performance Index. World Bank
			Improve the efficiency of border crossings	Improve control systems at border crossings	% border crossings with integrated control systems implemented	0	11%	Annual	Ministry of Foreign Relations

			Improve urban mobility in cities	Increase the number of public transport passengers	Number of passengers carried in mass public transit systems	360,000 passengers/day	500,000 passengers/day	Annual	Passenger validation report - revenue center**
			Improve road safety conditions	Reduce the number of traffic accident victims	Number of traffic accident victims/000,000 vehicles	2,430	2,000	Annual	Ministry of the Interior (MTC)
For a more secure, efficient, transparent, and decentralized State	Institutions for growth and social welfare	Strengthening of public management	Build internal revenue generating capacity	Increase the tax burden	Tax burden, % (including internal taxes, customs, and social security)	18% (2010)	20%	Annual	National Superintendency of Customs and Tax Administration (SUNAT)
			Build results-based budgeting capacity	Expand programmatic budgetary coverage	% of the Initial Institutional Budget (PIA) allocated on the basis of results	12.5% (2011)	80%	Annual	Ministry of the Economy and Finance (MEF)
			Build territorial public investment capacities	Strengthen the quality of local investment	% of regional government feasibility assessments with significant observations	81% (2007)	50%	Annual	MEF
			Build multiyear planning capacity	Increase multiyear budgeting	Public Expenditure and Financial Accountability-PEFA-ID-12 multiyear perspective in fiscal planning, expenditure planning, and budgeting	B (2009)	B+	Every four years	PEFA
			Strengthen short- and medium-term cash management	Strengthen cash management	PEFA-ID-4 balance and monitoring of expenditure payment arrears	C+ (2009)	B	Every four years	PEFA
			Strengthen the oversight capacity of the Office of the Comptroller General (CGRP) at the subnational level	CGRP deconcentrated in its mandate, with responsibilities and resources transferred to the regional oversight and macroregional offices	% processes initiated, managed and completed by regional oversight offices and macroregional offices, with minimal or no intervention from the central headquarters	0	40%	Annual	CGRP
			Improve State human resource planning	Keep consistent information available on positions, personnel, and pay	Civil service efficiency index (Longo 2002 methodology)	25 (2010)	40	Biannual	Bank studies

			Introduce technical and merit criteria in jobs linked to the provision of social services	Maintain the definition of posts linked to the provision of social services based on appropriate competencies	Civil service functional capacity index (Longo 2002 methodology)	29 (2010)	40	Biannual	Bank studies
			Build management capacities particularly in social service areas	Increase the availability of adequately selected and trained public sector managers	Civil service management consistency subindex (Longo 2002 methodology)	50 (2010)	65	Biannual	Bank studies
Macroeconomic policies and inclusive economic growth	Infrastructure for competitiveness and social welfare	Competitiveness and innovation	Deepen reforms to improve the business climate	Reduce transaction costs faced by firms for opening and operating businesses	Ranking of transaction costs faced by firms in opening and operating businesses	Ranked 41st	Ranked 36th	Annual	Doing Business Report
			Develop a comprehensive innovation and development toolkit: support for scientific research and private investment in research and development (R&D)	Increase publications	Number of publications in Science Citation Index (SCI)	841 (2011)	1100	Annual	Science and Technology Indicators Network (RICYT)
				Increase R&D investment	% of expenditure implemented by the private sector (% total R&D expenditure)	29.2% (2004)	35%	Annual	Organization for Economic Cooperation and Development (OECD)
					Public expenditure on R&D as % of GDP	0.08% (2004)	0.11%	Annual	Science and Technology Indicators Network (RICYT)
				Increase the number of patents	Number of patent applications granted	359 (2008)	500	Annual	RICYT
			Encourage innovation and business sophistication in small firms	Increase the percentage of innovative sales	% of innovative sales by firms, as a percentage of total sales (NOTE: indicator defined by the World Bank in the Enterprise Survey)	20.7% (2010)	25%	Annual	Enterprise Survey, World Bank
			Achieve a strengthened and articulated National Quality System, with an internationally recognized accreditation agency	Increase the use of product technical standards	% firms not using product technical standards	86% (2007)	60%	Triannual	Ministry of Production

			and a framework of incentives that facilitates the development of services of compliance assessment agencies	Increase certifications	Number of calibration laboratories accredited	8 (2009)	13	Annual	INDECOPI
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## MATRIX OF COUNTRY SYSTEMS<sup>5</sup>

Strategic objectives	Results expected during the country strategy period	Indicator	Baseline	Indicative targets for the country strategy period	Frequency of measurement	Source
Strengthening of public finance management systems and the country oversight system	Better quality and more efficient management of external auditors for Bank-financed projects	% implementation in Bank projects of the new framework for selection, contracting, monitoring, and quality control applied by the CGRP	0%	100%	End of strategy period	IDB - Bank loan portfolio
	Reduction of fiduciary risk in entities that implement Bank projects	% of entities executing Bank projects that implement the internal control system (COSO)	0%	60%	End of strategy period	IDB - Bank loan portfolio
	Improvement of levels of monitoring and evaluation of public expenditure	% of the national budget prepared on a results basis	20%	100%	End of strategy period	MEF - National budget
Strengthening of the country public procurement system	Larger proportion of public procurement undertaken electronically (transactional procurement portal)	% procurement processes undertaken through the online government procurement system (SEACE v3) portal	4%	50%	Annual	SEACE
	Improved profiles of competencies, management capacities, and handling of new information technologies for procurement operators	% operators accredited	0%	100%	End of strategy period	SEACE
	Modernization of the public procurement system regulatory framework	Value of the pillar I indicator of the Methodology for Assessing Procurement Systems (MAPS)	1.08	1.80	End of strategy period	IDB
Use of country fiduciary systems	Integrated Financial Management System (SIAF) II used for all loan operations financed by the Bank in Peru	% Bank operations using the SIAF II project management module	0%	100%	End of strategy period	IDB - Bank loan portfolio
	Increase the use of the internal audit subsystem in the Bank's SG portfolio	% of the Bank's SG portfolio using the internal audit subsystem	0%	25%	End of strategy period	IDB - Bank loan portfolio
	Increase the use of the information subsystem in the Bank's SG portfolio	% of the Bank's SG portfolio using the SEACE information and dissemination subsystem	10%	100%	End of strategy period	IDB
	Increase the use of the framework agreements and reverse auction subsystems in Bank operations up to US\$50,000	% of Bank operations using framework agreements and reverse auctions up to US\$50,000	0%	100%	End of strategy period	IDB

<sup>5</sup> The indicative targets will be reviewed or replaced, as the case may be, through the country programming documents prepared during the country strategy period.

## **I. COUNTRY CONTEXT**

- 1.1 Peru has shown robust macroeconomic performance during the last few years. The country has been one of Latin America's most dynamic economies in a context of fiscal stability, external equilibrium, and low inflation. After overcoming the adverse effects of the international financial crisis of 2009, it staged a rapid recovery. In the current situation, the short- and medium-term outlook for the Peruvian economy are positive, although it is not immune to the effects of a new international crisis.
- 1.2 Social indicators have improved in line with macroeconomic trends, with significant progress being made in the fight against poverty and extreme poverty. Nonetheless, the pace of progress has been uneven regionally, which has accentuated differences in living conditions between urban and rural inhabitants. The gradual reduction in income inequality generally conceals a widening territorial disparity, such that the rural poverty rate is currently three times the urban rate—the largest gap in Latin America.
- 1.3 Peru's economic performance has consolidated its position as a middle-income economy, with all the challenges and opportunities that this entails. The development level achieved means that continued growth, which is necessary to sustain the progress, increasingly depends on sustained productivity gains. Going forward, the persistence of rural-urban disparities in access to social services, social security, basic infrastructure, and economic opportunities; and the creation of conditions to strengthen productivity growth and thus make economic growth sustainable, will be the main challenges on the road towards higher development levels. Peru must build a model that, supported by a more efficient State, maintains economic growth, helps restore social and territorial balances, and is compatible with environmental sustainability.

## **II. THE BANK IN PERU**

- 2.1 The Bank has traditionally been Peru's main international financier, accounting on average for almost 28% of the country's public external debt and 42% of its multilateral debt over the last five years. Nonetheless, the Bank's status as a front-line partner in Peru's development goes beyond purely financial aspects. It has maintained close policy dialogue with the authorities; it has become the main provider of technical cooperation and advice for public policies; it is a continuous source of knowledge products for the country; and it offers support services for private sector development.

- 2.2 Under the last country strategy (2007-2011), the Bank approved loans amounting to US\$2.434 billion.<sup>6</sup> By the end of 2011, the total outstanding debt in respect of sovereign guaranteed (SG) loans with the Bank stood at US\$3.906 billion, distributed mainly between the following sectors: transportation (41.5%), institutional strengthening (19.5%), water and sanitation (17.6%), science and technology (10.2%), and social sectors (7.2%). The current SG loan portfolio consists of 21 loans for US\$626 million and 61 technical cooperation programs amounting to US\$100 million. The non-sovereign guaranteed (NSG) portfolio grew from US\$60.7 million in 2006 to US\$447 million by the end of 2011, comprising 66 operations and accounting for 35% of the Bank's total portfolio in Peru.<sup>7</sup>

### **III. THE BANK'S STRATEGY WITH PERU 2012-2016**

- 3.1 The present strategy has two lines of action, the first of which aims to help close the urban-rural gaps described earlier. This line of action will focus on interventions to reduce poverty and promote social inclusion, targeting eminently rural areas: the selva (jungle) and sierra (mountain) zones.<sup>8</sup> A second line of action will implement crosscutting actions to improve public expenditure efficiency, promote a better business climate, increase productivity, and improve care for the environment, to stimulate sustainable economic growth as a basis for permanent improvements in the population's living standards. To this end, efforts will be made to promote private-sector participation, encouraging the formation of public-private partnerships (PPPs) and other mechanisms in areas such as transportation

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<sup>6</sup> During the previous country period strategy (2007-2011), the country's needs for Bank financing were affected by the Peruvian government's stronger fiscal position, which allowed for a relative change in the availability of internally generated resources to finance investment projects. The government continued to channel the Bank's technical value added through unrestricted operations. The international crisis of 2008 strengthened this trend. During the period 2007-2011, 73% of all SG operations approved consisted of policy-based loans (PBLs), emergency operations, and contingent credits.

<sup>7</sup> Six Structured and Corporate Financing Department (SCF) operations for US\$229 million; 14 Inter-American Investment Corporation (IIC) loans for a total of US\$174 million, and four operations under the Opportunities for the Majority Sector (OMJ) totaling US\$20 million. In addition, a further 42 nonreimbursable technical cooperation programs for US\$41 million are being implemented through the Multilateral Investment Fund (MIF).

<sup>8</sup> The territorial social inclusion approach implicitly puts the focus on indigenous populations, as it is in those territories where there are the largest concentrations of populations that linguistically belong to native populations, and will be one of the formal targeting criteria for the government's initiatives.

infrastructure, delivery of basic services, access to social services, and development of economic opportunities.<sup>9</sup>

- 3.2 The areas prioritized in this document are the shared priorities of the Peruvian government and the Bank, and have been discussed with civil society and private sector representatives. The strategy for the period 2012-2016 will focus on the following areas: (i) social inclusion; (ii) rural development and agriculture; (iii) water, sanitation, water resources, and solid waste; (iv) housing and urban development; (v) transportation; (vi) climate change adaptation and disaster risk management; (vii) energy; (viii) public management; and (ix) competitiveness and innovation.<sup>10, 11</sup>
- 3.3 The Bank will seek innovative ways to facilitate the transfer of knowledge to the country in areas in which the Bank has proven experience, expertise, and comparative advantages. Technical cooperation will focus on supporting operations in the priority areas.

#### **A. Social inclusion**

- 3.4 Low productivity levels among the very poor, particularly in rural areas, where four out of every five extremely poor Peruvians live,<sup>12</sup> stem from shortcomings in capacities and human capital levels and are one of the country's key development challenges. Overcoming these productivity gaps requires an investment strategy targeted on integrated social spending on human capital development in health,

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<sup>9</sup> During the effective period of this strategy, the Bank will take steps to expand its services to the private sector, through NSG operations aligned with the priority sectors identified in this document. SCF will target the following sectors: energy, transportation, financial services, climate change, health, education, and export competitiveness. The IIC will support small and medium-sized enterprises (SMEs) in the areas of renewable energy, agriculture, and competitiveness of productive chains. The MIF will continue to work on social inclusion issues, by improving access to services and economic opportunities in rural areas. OMJ will target private-sector projects with a high social impact, focusing on the education, health, and housing sectors, and supporting the development of new products and services for the base of the pyramid in Peru.

<sup>10</sup> This strategy aims to delineate the Bank's functions and actions through a two-tiered targeting approach: On the first tier are the nine areas identified as priority. On the second tier, the delimitation of the Bank's work is based on identifying concrete sub-areas within those sectors.

<sup>11</sup> To help close the regional gaps, the Bank will work in the areas of social inclusion, rural development and agriculture; water, sanitation, water resources, and solid waste; housing and urban development; and transportation. In its second line of action—promoting the development of productivity and growth sustainability—the Bank will have specific actions in the areas of housing and urban development, transportation; climate change and disaster risk management; energy; public management; and competitiveness and innovation.

<sup>12</sup> Rural areas in Peru are both complex and heterogeneous. They rely heavily on agriculture for employment and income (in more than 90% of rural households at least one member has their main or secondary job in these activities, and three out of every four households have all of their labor working in these areas). In terms of capacities, the rural area has less human capital, lower productivity, and less access to basic services. According to the 2010 National Household Survey (ENAH0), heads of household in rural areas: (i) have on average 4.5 years less education than their counterparts in urban zones; (ii) living in extreme poverty have a level of schooling equivalent to 68% of that among non-poor people; and (iii) young people have a significantly higher levels of schooling than heads of household in all poverty strata.

early childhood education, and social protection. The government has characterized the human capacity disparities between Peru's various geographic areas in terms of "social inclusion," which is understood as a coordinated effort to ensure that all citizens have the essential capacities needed to take advantage of the opportunities provided by economic growth. The government's social inclusion approach, which supports this strategy, is of a multisector nature targeted on the country's poorest families, and incorporates a territorial vision.

- 3.5 One of the main problems facing the population in the social inclusion process is ineffective public social spending, resulting from insufficient coverage of the main programs to alleviate current and inter-generational poverty, quality shortcomings, leakages, and lack of coordination between the different interventions. Spending on social protection programs grew by almost 2.5 times between 2000 and 2010, and represented about 0.5% of GDP in 2010; it is concentrated in nutrition programs, the JUNTOS conditional cash transfer program, and the Vaso de Leche (Glass of milk) program. The main challenge in the social protection system is the low coverage of most of its programs, which reach no more than 20% of target households.<sup>13</sup> It is estimated that leakage to non-poor families ranges from a minimum of 21.9% in the JUNTOS program to a maximum of 46.8% in the Comedores Populares program. These coverage and targeting failures are associated with weaknesses in the system for monitoring, evaluation, and analysis of social programs<sup>14</sup> and an institutional structure that is poorly harmonized and has a low level of operational consolidation.<sup>15</sup>
- 3.6 Conditions to ensure that the next generation does not inherit the social exclusion of their parents are limited by problems in the coverage and quality of integrated care for the development of children ages 0 to 5, and by the absence of a program to serve populations living in rural areas. Children from rural zones display significant deficits in relation to their cognitive development (vocabulary), scoring 75.6 points compared to the 99.3 points of their peers in urban zones;<sup>16</sup> they also have a higher rate of chronic malnutrition, which affects 47% of children under 5 in rural areas compared to 13% in urban areas; higher incidence of anemia—51% in rural zones compared to 45% in urban areas; and problems of access and quality in health

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<sup>13</sup> Except for the school breakfast, Vaso de Leche, and Juntos programs, which have major targeting and leakage challenges.

<sup>14</sup> In general, social protection programs in Peru lack rigorous impact evaluations, and no provisions have been made for this in their design. In the few evaluations that have been conducted, little evidence has been found that nutritional programs are achieving their objectives.

<sup>15</sup> The government recently created the Ministry of Development and Social Inclusion (MIDIS), which is responsible for strategic planning, management of the targeting system (SISFOH), and implementation of the main social programs.

<sup>16</sup> Standardized score on the Peabody Picture Vocabulary Test (PPVT) for children ages 5 to 6 using data from the "Young Lives" early childhood survey, <http://www.younglives.org.uk/where-we-work/peru>.

- services.<sup>17</sup> The disparities seen in the child development sector reflect the nonexistence of a public program to provide comprehensive care for children ages 0 to 3, and the still incipient process of consolidating the Ministry of Development and Social Inclusion (MIDIS) as the coordinating hub of a comprehensive, intersector child development policy.
- 3.7 The most socially excluded households and locations suffer access and quality gaps in universal services for the formation and maintenance of human capital. In the case of health, significant disparities persist between the different geographic areas of the country. The prevalence of low height-for-age among children under 5 is 40% in rural areas compared to a national average of 20%; and 9.5% of under-fives have low weight for their age in rural areas, compared to a national average of 5.9%. Other health indicators, such as immunization coverage and the child mortality rate, are persistently higher in rural zones than in urban areas. While 35.3% of the total population has no health insurance, just 71.1% of the rural population reported having received some type of health coverage. The government is attempting to expand coverage of health services through the Framework Law on Universal Health Insurance, which sets the goal of universal coverage.<sup>18</sup> The country's epidemiological context reflects a transition from a preponderance of communicable diseases, toward a pattern in which chronic-degenerative diseases are gaining relative importance.
- 3.8 Lastly, in the education sector, the country has made significant progress in education coverage over the last few decades. The net enrollment rate in preschool education today is 66%, with 94% enrollment in primary school and 75% in secondary. Between 1998 and 2009, the number of students completing primary and secondary school increased by 23.2%. Nonetheless, there are still weaknesses in the quality and equity of the education system. National and international education evaluations show that Peruvian students perform relatively poorly,<sup>19</sup> particularly students belonging to poor and rural population groups and those who speak a language other than Spanish. There is also poor teacher quality, which

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<sup>17</sup> According to data from a National Demography and Family Health Survey (ENDES) for 2004-2008, the coverage of institutionally attended childbirth, defined as children who born in the most recent year in an adequate place, reached 48% in rural zones compared to 82% in urban areas. The coverage of enrollment of children ages 3 to 5 in the formal preschool education system was 46% in rural areas, compared to 64% in urban zones.

<sup>18</sup> The Ministry of Health (MINSA) at the national level and the regional health offices are responsible for access, quality, organizational design, and regulation of the delivery of health services. MINSA has delegated the provision of health services to the regional and local levels, but it has responsibility at the national level to rationally and efficiently organize public and private services. Public health financing is of a dual nature, subsidized and semicontributory. The principles of health care financing in the subsidized and semicontributory universal health insurance (AUS) regime accord a role to the different levels of government as well as to health insurance fund management institutions (IAFAS).

<sup>19</sup> For example, of the 65 countries evaluated in the 2009 Program for International Student Assessment (PISA) test, Peru ranked 62nd in reading skills, 60th in mathematics, and 63rd in science.

affects students' educational achievement.<sup>20</sup> The main challenges facing the sector are the low coverage of preschool and secondary education among rural and indigenous children,<sup>21</sup> and the poor quality and unequal learning conditions in the formal education system between rural and urban zones.<sup>22</sup> The factors underlying the coverage problems indicated include budget rigidities, as funds are mostly allocated on historical criteria unrelated to the real cost of providing education services.

- 3.9 The Bank's participation in the social inclusion area will seek to support the country in: (i) redesign of the social protection system to improve its effectiveness, evaluability, and targeting;<sup>23</sup> (ii) support for building the institutional framework in MIDIS,<sup>24</sup> including Cuna Más, the flagship program for comprehensive early childhood care; (iii) support for the consolidation and improvement of transfer mechanisms of the national health system, the integrated health system (SIS), and the management of integrated health networks;<sup>25</sup> (iv) support for improving infrastructure and the quality of education to expand educational opportunities for the low-income population living in rural and indigenous areas;<sup>26</sup> and (v) the introduction of results-based operational management at the decentralized level. The NSG windows will target a reduction in coverage and quality gaps in the health and education sectors, through PPPs, and support for private institutions with socially inclusive business plans.

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<sup>20</sup> According to the results of the latest census evaluation of primary school teachers, nearly half (47%) could not perform basic mathematical operations or reproduce routine, short procedures, and 33% were not able to locate concrete, evident data or identify the main ideas in a text. These findings confirm serious deficiencies in the pre-service training of teachers and of current training programs.

<sup>21</sup> Among other factors, rural and bilingual intercultural education in Peru is just beginning to be developed and has persistent, severe curriculum and standardization problems.

<sup>22</sup> While the net enrollment rate at the preschool level is 66.2% nationally, it is only 42.8% in indigenous/rural areas. Another indicator illustrating the disparity between the countryside and the city is the secondary school completion rate, which is 71.7% in urban zones, compared to 39.3% in rural areas.

<sup>23</sup> In the case of the JUNTOS program, its redesign includes the preannounced expansion to 207 additional districts, and the promotion of a comprehensive approach that links the budgets of the Education and Health Ministries and local governments to the quantity and quality of services supplied in the areas covered by the program. It also includes a component to strengthen the cultural relevance of services, their management information system, the beneficiaries register, and verification of the fulfillment of commitments. In the case of other programs, support will be provided to reform the less efficient ones and help reform the SISFOH to improve the targeting of social programs.

<sup>24</sup> Special emphasis will be placed on the design, evaluation, and results-based management of its programs under the new ministry.

<sup>25</sup> The SIS is the health insurance provided by the Ministry of Health of Peru, for citizens that do not have a health insurance policy; it is targeted on those living in poverty and extreme poverty.

<sup>26</sup> Support will be targeted on early childhood development until the first cycle of primary school, with the aim of reducing the urban-rural gap. In Peru the gap between rural and urban children in school currently starts at the preschool level. By their fifth birthday, nearly all urban children are attending a school, whereas this figure is less than 65% for rural children of the same age.

- 3.10 The risk for the Bank's interventions in this sector are concentrated in a possible weakness in operational, governing, and budgetary capacities of the nascent MIDIS, the Ministry of Health (MINSA), and the Ministry of Education (MINEDU), alongside the traditional weaknesses in the decentralized functions in the social areas. To mitigate these risks, active involvement is proposed in designing the MIDIS structure, and maintaining dialogue and technical support with the different stakeholders at the national and subnational levels, to promote local implementation of schemes that ensure the necessary conditions for this type of investment.

## **B. Rural development and agriculture**

- 3.11 Although it produces 8% of GDP and accounts for 37% of total employment, the agriculture sector has been losing momentum despite an expansion of agroexport activities.<sup>27</sup> Farming provides the main source of income in the rural sector, where 80% of rural poor live off this activity. Peru's main constraints for achieving sustainable rural development are as follows: (i) the low level of public investment in research, agricultural health, and information;<sup>28</sup> (ii) the inefficiency of direct government support to the agriculture sector, particularly incentives to adopt modern technologies among small-scale producers;<sup>29</sup> (iii) the lack of economies of scale and scant exploitation of natural wealth for non-agricultural purposes; and (iv) the presence of extensive areas of the country with problems caused by fragmented property ownership and a lack of clarity in property rights over land that restricts private investment. The low level of development in the particular case of the forestry sector<sup>30</sup> is related to: (i) higher rates of return obtainable from migratory agriculture, livestock breeding, and informal mining, which leads to deforestation; (ii) inefficient zoning and land management; (iii) lack of property rights and forest use rights; (iv) weaknesses in the State's crosscutting, decentralized management capacity; and (v) lack of economic incentives, appropriate technologies, and access to financing. The rural sector generally suffers

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<sup>27</sup> Agricultural GDP has grown more slowly than the economy as a whole, and the sector has the lowest output per agricultural worker in Latin America and the Caribbean.

<sup>28</sup> Public goods expenditure accounts for about 8% of total agricultural support spending in Peru, compared to 42% in advanced countries, and levels above 20% in other countries in the region with similar income levels. Expenditure in the sector has mainly targeted infrastructure (74%) and agricultural colleges (15%), with few resources channeled into research and innovation, agricultural health, and agrifood safety and information.

<sup>29</sup> The structure of public support for the agriculture sector still has a major price support component, instead of more efficient alternatives such as direct support instruments more closely targeting specific population groups. Moreover, public investment in public goods to support agricultural production and other related services, such as training and technical support for peasant communities and associations of small and medium-scale producers, to increase income and productivity and thus boost private investment, is still incipient compared to other countries in the region.

<sup>30</sup> The forestry sector produces between 1% and 4% of national GDP, and forestry production occupies 7.4 million hectares of timber-yielding land under forestry concessions. In terms of the impact on climate change, according to Peru's second national communication to the United Nations Framework Convention on Climate Change (UNFCCC), emissions from land use, land use change, and forestry (mainly deforestation) (the LULUCF sector), generates 63.6% of total emissions.



from a failure to promote forestry, agricultural, livestock, and fishery practices that reduce the sector's vulnerability to the effects of climate change, and lacks infrastructure to effectively help reduce greenhouse gas emissions.

- 3.12 The Bank's participation in rural Peru aims to help raise rural income levels by increasing productivity and diversifying economic activities in those areas, through the following actions: (i) improving the quality of delivery of key agricultural services for the sector's competitiveness; (ii) enhancing public management and promoting financing mechanisms for the maintenance and sustainable use of natural resources, particularly forestry resources; (iii) encouraging the formation of agglomeration economies in the form of clusters and value chains, both agricultural and nonagricultural; (iv) completing processes to regularize land ownership in the sierra and selva zones; and (v) supporting activities that reduce emissions arising from deforestation and the degradation of forest areas as a result of economic activities such as formal and informal mining and extensive ranching. The NSG window will support greater vertical integration and value added in the agriculture sector with industry and the introduction of new technologies, such as automated irrigation in the agribusiness sector. Support will also be provided to promote financial inclusion in remote rural areas.
- 3.13 The main risk facing the Bank's intervention is weak communication and collaboration between the multiple sector agents, including the different levels of government (national, regional, and local), and the private sector; and, particularly, poor communication and collaboration with the rural and/or indigenous population. This could generate inefficiencies, delays, opposition, disputes, and low levels of social inclusion in the sector's interventions. To mitigate this risk, the Bank will support integrated actions that foster and promote dialogue and the consolidation of the sector's interagency mechanisms.

### **C. Low-income housing and urban development**

- 3.14 Despite the progress made in recent years, the housing deficit affected 1.86 million families, representing roughly 29.1% of the nation's households. Of the calculated housing deficit, 79% or 1.46 million homes have deficiencies in terms of the quality of living space and/or access to basic services (qualitative deficit); whereas the remaining 21% corresponds to the number of households that do not have housing (quantitative deficit).<sup>31</sup> The formal housing deficit is estimated to grow by 118,000 households per year. In the case of the country's main historic downtowns, chronic blight problems adversely affect the quality of life. It is estimated that there are 5,772 urban fringe neighborhoods, in which actions have been taken in less than 10%, and only in 44 comprehensively.
- 3.15 The housing deficit is associated with sector deficiencies that range from the high volatility and unpredictability of the fiscal resources provided to the sector,

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<sup>31</sup> Of the total of 1.86 million families making up the housing deficit, an estimated 65% are in urban areas and 35% in rural zones. Nearly all of the rural housing deficit is qualitative.

resulting from the lack of multiyear budgeting; to a lack of suitable tools to promote the low-income housing sector, including failures in inter- and intra-institutional coordination mechanisms, and in monitoring and evaluation. Lack of access to credit is one of the main constraints faced by medium- and low- income households when they attempt to obtain a formal housing solution. Moreover, the lack of developed land in the cities reduces the chances of generating a supply of low-income housing at a price that is affordable to the poorest families. In general, the urban development schemes implemented in Peru do not take into account energy sustainability to reduce the impact on the physical environment and promote greater climate change adaptation.

- 3.16 The Bank's participation in the sector aims to support efforts to close the housing deficit and improve the sustainability of approaches to urban development and housing by: (i) improving sector management, building its capacities in terms of processes, monitoring and evaluation instruments, and training for the Vice Ministry of Construction and Sanitation (VMCS) and the Vice Ministry of Urban Housing (VMVU), which are responsible for housing policies; (ii) support for the consolidation of public instruments to promote low-income housing and neighborhood improvement; and (iii) the development of integrated urban development projects in Peru's main cities. NSG windows will provide support for narrowing the housing gap through financing schemes and guarantees to financial entities to encourage greater mortgage lending, and the development of innovative business models with the base of the pyramid.
- 3.17 The main risk of these interventions stems from potential coordination problems between public institutions and the private sector and subnational governments that could impair the implementation of low-income housing and urban development policy, respectively. To mitigate these risks, the Bank will prioritize dialogue with the Ministry of Economy and Finance (MEF) from the project design phase; and it will promote institutional consolidation among its sector counterparts.

#### **D. Climate change adaptation and disaster risk management**

- 3.18 Peru is one of the countries most vulnerable to natural disasters and climate change. Between 1970 and 2009, it suffered 105 disasters that caused over 74,000 fatalities and affected 18 million people. Official estimates suggest that by 2030 there will be an increase in temperature, greater variability in precipitation levels, loss of significant water reserves such as glaciers, and persistent frequency of extreme events such as El Niño, heavy rains, frosts, and droughts.<sup>32</sup> The value of infrastructure that is exposed to natural phenomena and climate change in Peru is estimated at over US\$450 billion; and the country's public sector does not have the financial capacity to absorb the liabilities that would be generated by losses on this

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<sup>32</sup> The latest climate scenario model produced by the National Meteorology and Hydrology Service of Peru (SENAMHI) predicts the following for Peru in 2030: (i) increases of up to 1.6°C in maximum temperatures and 1.4°C in minimum temperatures; (ii) increases and decreases of up to +/- 20% in average precipitation levels in certain zones; and (iii) the same intensity and frequency of extreme weather events.

- scale. Moreover, it is estimated that the adverse economic effects caused by climate change could be in the range of 1% to 4% of GDP by 2030, and between 3% and 20% by 2050. Such events would have a major repercussion on society and the country's ecosystems. The agenda for risk reduction and climate change adaptation is fundamentally linked to reducing poverty, as can clearly be seen in the agriculture sector.<sup>33</sup>
- 3.19 Disaster risk management and climate change adaptation face numerous challenges: the current regulatory and institutional framework for risk management is only partly implemented; institutional management of adaptation issues needs to be consolidated nationally, regionally, locally, and at the sector level; regional and local governments have limited capacity to assume and prioritize risk management and climate change adaptation in their development, land-use, and watershed management plans; the central government does not have adequate financial mechanisms to retain and transfer risks; public investment instruments do not include a climate change adaptation perspective, and risk management protocols and regulations are not fully defined; there are deficiencies in coordination and dialogue between different actors on issues of risk reduction, climate change adaptation, reduction of vulnerability and monitoring; and national disaster preparedness and post-disaster management capacities need to be adapted to the new regulatory framework.
- 3.20 The Bank's participation in the sector will pursue: (i) development, dissemination, and implementation of the new legal framework governing risk management, and a national integrated risk management plan;<sup>34</sup> (ii) institutional strengthening of the National Disaster Risk Management System, including sectors and subnational entities; (iii) strengthening institutional management, building reporting capacity, and coordination and cooperation among the various stakeholders on climate change adaptation at the national, regional, local levels, to support the mainstreaming of climate change adaptation; (iv) support for the adoption of climate change adaptation measures in environmental services and public investment instruments; and (v) support for activities to increase the resilience of climate-change-vulnerable ecosystems to economic activities that exert pressure on them (such as formal and informal mining). The private sector will support direct financing to boost productivity and reduce emissions of gases and pollutants through new technologies (green credit lines to companies).
- 3.21 In the climate change adaptation and disaster risk management sectors, the main risk is related to the changes that are repeatedly made to sector guidelines and policies, which could obstruct implementation progress in sectors where the process is incipient. The Bank will seek to mitigate this risk by supporting rapid regulation

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<sup>33</sup> Peru's second national communication to the UNFCCC notes that the country has made significant progress in reducing poverty in recent years. Nonetheless, unless adaptation measures are put into practice, the climate impacts on sectors such as agriculture could undermine this effort, since a large proportion of Peruvians live below the poverty line and work in farming activities.

<sup>34</sup> This will include developing a strategy for financial management of risks and post-disaster response.

of the law on disaster risk management, strengthening the existing institutional framework, and promoting mainstreaming of the climate change adaptation approach in priority sectors.

**E. Water, sanitation, water resources, and solid waste**

- 3.22 Peru has large water reserves representing about 4% of the planet's water resources. There are major geographic imbalances in the availability and use of those resources, together with persistent difficulties in managing them on an integrated and environmentally sustainable basis. Access to drinking water services is unequal between rural areas, where coverage is 40%, and urban zones where the figure is 89%.<sup>35</sup> The same is true for sanitation, with rural coverage of 45%, compared to 84% in urban zones. The rate of wastewater treatment is low compared to the rest of the region: only 32.7% of all wastewater is treated, and coverage is particularly low in rural zones.<sup>36</sup> Just 43.5% of urban solid waste is disposed of in sanitary landfills, whereas the rest is mostly discharged into open-air dumps. The regulatory framework for the sector is adequate.<sup>37</sup>
- 3.23 These gaps and disparities essentially reflect the absence of an integrated approach to water resources, which display a growing gap between supply and demand in specific geographic regions, compounded by imbalances between agricultural and nonagricultural use, deterioration of quality and the environment,<sup>38</sup> and rationalization of use. Institutional difficulties also persist among service providers to expand coverage of water and sanitation services, and on the part of the municipios, which are responsible for local management of solid waste.
- 3.24 The Bank's work areas for this strategy are as follows: (i) improve the integrated management of water resources including issues of water rights, climate change, energy efficiency, financial strategy, water culture, and management according to seasonality and quality, and the vulnerability of water resources in relation to climate change challenges; (ii) support implementation of the water and sanitation

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<sup>35</sup> A total of 490 Peruvian districts have less than 2 million inhabitants, representing 9% of the country's total population; another 15% of the population lives in rural communities. Of these 76,891 rural settlements nationwide, 59% do not disinfect water. Only 24.5% of households classified as extremely poor have access, while 62.5% obtain this basic resource from rivers, irrigation ditches or similar sources. Coverage of sewerage systems in rural areas is 2.7% among extremely poor households.

<sup>36</sup> There is no treatment in eight regions (Amazonas, Apurímac, Huancavelica, Huánuco, Loreto, Madre de Dios, Pasco, and Ucayali).

<sup>37</sup> The water and sanitation sector policy for expanding coverage and promoting efficient services is based on the National Sanitation Plan. Services are managed on a decentralized basis, whereas policy formulation, regulation, and oversight functions are undertaken by the central government. Local governments are responsible for providing basic sanitation services; while service providers manage service coverage. The rate scheme is sustainable and tends to recover costs with a number of cross-subsidies.

<sup>38</sup> The country faces a major short and long-term challenge in climate variability and change, which, in conjunction with increased vulnerability owing to inappropriate land use, increases the risk of extreme weather events such as flooding, droughts, frost, and decreased availability of water from a loss of glaciers. Climate change in Peru is expected to affect rainfall, run-off patterns, and levels of water storage in glaciers, reservoirs, and aquifers. These impacts will also be reflected in water quality.

sector policy with the aim of making progress in universalizing access to drinking water service, and thus reduce disparities between urban and rural zones;<sup>39</sup> (iii) support steps to expand the coverage of wastewater collection and treatment services and increase household connections; (iv) increase the efficiency of public utilities in the sector and help municipios create efficient municipal utilities;<sup>40</sup> (v) increase formalization among recycling entities; and (vi) implement the climate change adaptation approach in the national water resource management system, including strengthening its hydro-meteorological information system. The Bank's NSG support will be targeted on financing infrastructure provision and the treatment of drinking water and sanitation, stressing the introduction of new technologies.

- 3.25 The main risk to the Bank's intervention are: lack of experience in the nascent institutions involved in water resource management; and limited execution and monitoring capacity of service providers and municipios in water, sanitation, and solid waste projects, which could delay implementation of the actions envisaged. To mitigate these risks, inter-agency dialogue will be continued, to support the instruments envisaged for the water resource sector policy, and the project monitoring and corporate governance tools provided for in the current regulatory framework will be developed.

## **F. Energy**

- 3.26 The current sector development model prioritizes the government's role as regulator and promoter of private investment. Installed electric power generation capacity has grown at an average annual rate of 7% over the last five years. Nonetheless, the share of hydropower in the generation matrix remains relatively low; and the development of relatively less efficient and geographically concentrated thermal power plants has been encouraged; the energy capacity reserve margin has fallen below the recommended level; and relative deficiencies have persisted in terms of capacity to formulate, manage, monitor, and evaluate projects, and in the transparency of public sector energy firms. Peru's electrification rate is relatively low, ranking 22nd out of the 26 Latin American countries. Although electricity reaches 82% of the population, only 29.5% of rural households are connected to the public grid.<sup>41</sup> While the electricity sector regulatory framework

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<sup>39</sup> Efforts will be mainly targeted on developing a plan for small population groups in the coastal, mountain, and jungle regions, including technical assistance and support for the government in implementing service provision regulations, the regulatory framework, and investments.

<sup>40</sup> Particularly solid waste management firms.

<sup>41</sup> Peru is attempting to close these gaps through the rural electrification program. Dialogue between the government and international cooperation agencies, pursuant to the Paris Declaration and Accra Agenda for Action, has increased the level of harmonization and complementarity among donors, reducing space for multiple multilateral financing agencies in the sector. Thus far, the World Bank has been the Peruvian government's partner of choice on rural electrification issues.

is considered adequate,<sup>42</sup> the shortcomings mentioned stem from the lack of an integrated approach to sector planning and management.

- 3.27 The Bank's participation in the sector will contribute to efficient, sustainable management of energy resources in Peru, through: (i) the development of a long-term integrated sector strategic vision to guide the increase in demand for energy and accompany economic growth; (ii) more efficient and transparent management of public enterprises in the energy sector; and (iii) an increase in hydroelectric power and renewable energy resources in the generating matrix.<sup>43</sup> The Bank's NSG interventions will be focused on the PPP strategy in renewable energy generation, transmission, and distribution, and on the opportunities opened up by government projects to expand with private and mixed capital the production, transportation, and downstream processing of natural gas.
- 3.28 The main risks of the Bank's proposed intervention stem from capacity or institutional resource constraints in adopting an integrated sector agenda. To mitigate this risk, joint support is proposed through investment resources, support for policy reforms, and technical cooperation, to afford coherence and integrity to the Bank's presence in the sector.

## **G. Transportation and logistics**

- 3.29 The overall situation of transportation infrastructure in Peru, as well as the budgets allocated for its development, have trended positively in recent years. Nonetheless, lags remain in several areas compared to other Latin American countries. Just 16% of the total road network is paved, although there are major differences between the national (54%), departmental (8%), and neighborhood networks (3%). Road conditions also vary greatly between the national and subnational levels, with 71% of national roads considered to be in good/fair condition, compared to 51% of departmental roads and just 33% of neighborhood roads. The close correlation between the level of coverage/quality of the roads and level of government is stronger in the more rural departments and districts. Deficiencies in the subnational

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<sup>42</sup> The electricity pricing scheme has been designed to recover the cost of the service in each of the three segments—generation, transmission, and distribution systems. Supply rates and payments by end users and between participants in the wholesale market are based on a system of payment for capacity and payment for energy consumption.

<sup>43</sup> The Bank will support medium- and long-term sector planning to make it possible to meet rapid growth in energy demand and support the country's economic growth, considering technical, economic, environmental, and social aspects, in line with Peru's development objectives. The government's strategy is to support widespread domestic and industrial use of natural gas, thereby expanding existing transportation and distribution systems. This should make it possible to reduce the relative importance of natural gas in thermal electric power generation, in line with the desired changes in the long-term sustainable energy matrix. The objectives regarding increasing hydropower generation will be accompanied by renewed efforts to safeguard affected communities from potential environmental and social effects, and to strengthen medium- and long-term sector environmental planning.

- road network generate high logistics<sup>44</sup> and transportation costs, hurting the country's competitiveness.
- 3.30 The Bank's participation in the transportation sector will be geared toward: (i) supporting an increased flow of investment resources to transportation sectors at the subnational level; (ii) strengthening road management capacity and improving approaches to policies, planning, studies, financing, implementation and maintenance, as well as introducing innovative, efficient mechanisms for contracting, financing, and implementing road projects;<sup>45</sup> and (iii) promoting the design and execution of infrastructure projects for physical integration with other countries. The Bank's NSG support will catalyze the financing of private infrastructure provision in the ground, air, and port transportation areas, through the government's concessions policy and PPPs in the sector.
- 3.31 In addition, road safety conditions are inadequate, and the country has high road accident and mortality rates.<sup>46</sup> Connectivity for regional integration has deficiencies, particularly at border crossings, where infrastructure shortcomings persist, along with problems caused by inefficient processes and the lack of an adequate institutional framework.<sup>47</sup> In terms of freight transportation, there are quality and efficiency problems arising from noncompliance with weight and size regulations, informality, and business fragmentation.<sup>48</sup> Transportation in the country's mid-sized and large cities has inefficiencies owing to the substantial increase in the vehicle fleet, poor road safety conditions, obsolescence, and environmental pollution.<sup>49</sup>

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<sup>44</sup> Logistics costs in Peru are estimated at 30% of GDP, compared to an average of 24% in Latin America and the Caribbean, and 13.4% worldwide.

<sup>45</sup> This includes a review of sector policies, the provision of adequate management tools, the building of capacity to structure concession projects, implementation of efficient contracting and implementation mechanisms (e.g. rehabilitation and maintenance contracts), and the supervision of maintenance contracts based on service level.

<sup>46</sup> According to official data, there were over 3,500 deaths and 55,000 injuries per year in Peru, in more than 82,000 traffic accidents; 25% of fatalities and 10% of injuries were on the national road network. There are stretches of road with accident rates over 500 per 1,000 Mvkm (million vehicle kilometers)—one of the highest rates in Latin America.

<sup>47</sup> Peru currently has 19 border crossings on its borders with Ecuador, Colombia, Brazil, Bolivia, and Chile. Only six of these are clustered, with the presence of the four key control authorities. The rest display shortcomings in the control of transportation of freight or passengers.

<sup>48</sup> Peru is ranked 67th out of 155 countries in the Logistics Performance Index (LPI), published by the World Bank in 2010. The LPI provides a good benchmark for the international competitiveness of a country's logistics systems, but it also includes benchmarks for the cost and time associated with the physical distribution of cargo for export and import procedures nationally.

<sup>49</sup> Urban transportation both in Lima and in Peru's medium and intermediate cities has major shortcomings. Problems of microtransportation, with subsequent excessive journeys, constant stops and irresponsible competition, cause major congestion. The excessive fleet size is aggravated by obsolescence, road safety, and environmental impact problems. The transport sector in Peru contributes 40% of greenhouse gas emissions stemming from the generation and consumption of energy (2010).

- 3.32 In the aforementioned areas, the Bank proposes actions aimed at: (i) the design and implementation of a new national road safety plan for comprehensive improvement of road safety conditions; (ii) support for designing plans, policies, institutional management and activities to improve logistics and cargo services, including a public-private institutional framework that is suitable for sector development; (iii) improved infrastructure and integrated control at border crossings, and development of the corresponding institutional framework; and (iv) the implementation of and assistance for cities in identifying, implementing, and strengthening public transportation and urban mobility, involving better safety conditions and less impact on the environment, including measures to reduce greenhouse gas emissions.
- 3.33 The main risks relate to interagency coordination issues and regulatory voids in certain areas of the sector. To mitigate this risk, the Bank's programs will be accompanied by institutional strengthening and technical assistance components.

## **H. Public management**

- 3.34 Over the last decade, Peru has made progress in modernizing various areas of its public management and administrative systems; nonetheless, significant challenges remain for achieving more efficient, inclusive, transparent, and decentralized public management. These include: expenditure inefficiency, owing to a mismatch between the demand for and supply of public goods and services, and their lack of territorial coordination; failures in planning, budgeting, and oversight, particularly at the subnational level, where little progress has been made in implementing results-based budgeting; weaknesses in tax policy and administration, where tax pressure and progressivity indices are below the regional averages;<sup>50</sup> lack of a professional, merit-based civil service, characterized by poor quality compared to similar economies;<sup>51</sup> shortcomings in administrative and oversight systems, where problems of coverage, operational capacity, and quality of public management persist.
- 3.35 The Bank's participation in the sector pursues the following objectives: (i) help increase public sector efficiency, including public expenditure and fiscal management,<sup>52</sup> country administrative processes, and results-based budgeting and management systems, particularly subnational capacities to provide basic services for social inclusion; (ii) help improve design and implementation capacities in

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<sup>50</sup> The tax burden is 18% of GDP, 2.5 percentage points below the average for Latin America and the Caribbean, and also below the average level prevailing in countries with similar income levels to that of Peru. In the Peruvian tax structure, it tends to be more regressive. Compared to other Latin American and Caribbean countries, the level of revenue obtained from personal income tax and property taxes is low.

<sup>51</sup> Peru has roughly 900,000 employees at the national and regional levels. In 2010, the Longo 2002 index of the overall quality of the civil service was 29 points out of a total of 100.

<sup>52</sup> In this context, support could be provided for measures to increase the tax burden; improvement of instruments to forecast public revenues; support for development of monitoring and evaluation systems, dovetailing with public investment and multiyear programming of public expenditure; technical assistance to improve public investment projects with a territorial approach, etc.



- subnational governments, in the framework of the decentralization process; (iii) support modernization of the Office of the Comptroller General of the Republic (CGRP) and deconcentration of the national oversight system; (iv) support strengthening of the management system of the Peruvian civil service by institutionalizing the State civil service career; and support efforts to implement e-government.
- 3.36 The main risks are a lack of multiyear planning and coordination problems between public institutions and between the different levels of government, which could slow implementation and make interventions less effective. To mitigate this risk, interventions are planned that include institutional strengthening and technical cooperation components.

## **I. Competitiveness and innovation**

- 3.37 Despite the economic growth of recent years, Peru continues to lag behind the rest of the region in terms of productivity. Total factor productivity (TFP) is just 40% that of the United States; and the country has a fragmented productive structure and a few sectors with a high TFP.<sup>53</sup> Most exports continue to be heavily concentrated in commodities (89% of the total), which make only a small contribution to GDP and involve little participation by micro, small, and medium-sized enterprises (MSMEs). Peru does not have development instruments or an adequate institutional framework to support the productive development of companies: existing actions are scattered and discoordinated, with major budgetary and design constraints. Moreover, the sustained economic growth has not been reflected in greater investment in research and development (R&D), with expenditure in this area equivalent to 0.15% of GDP, compared to 0.54% as a Latin American and Caribbean average and 2.3% among OECD countries.<sup>54</sup> Private sector participation remains limited, and the sector has limited scientific capacity; low human capital for generating science, technology, and innovation; a small number of scientists and engineers; and low scientific productivity reflected in few publications and patents.<sup>55</sup>
- 3.38 The Bank's support for the sector will pursue the following key objectives: (i) improve the economy's capacity to incorporate innovation as a key element in productivity growth, by managing tools of business innovation policy, and promoting scientific and technological research; (ii) support the definition of a new institutional arrangement and the implementation of three priority support

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<sup>53</sup> Presentation Vera, R. (2010), *Productividad Total de Factores: América Latina y El Caribe* [Total Factor Productivity: Latin America and the Caribbean]. BCRP, based on data from "The Age of Productivity" IDB (2010) and updated data for Peru.

<sup>54</sup> OECD, 2011. Based on data from the 2005 innovation survey financed by Concytec.

<sup>55</sup> The volume of recognized scientific publications produced by Peru is less than a quarter of what would be expected given the size of its economy and population; it has 0.24 researchers for every 1,000 economically active persons, compared to a regional average of 0.54%. The country registers 0.09 patents for every 100,000 inhabitants, compared to a rate of 2.9 in Chile, 3.7 in Brazil, and 15.2 in Canada.

- instruments (clusters, productive chains, and technical assistance to firms); (iii) support a review of the institutional framework of key agencies in the National Quality System, including strengthening the supply of services, and promoting local demand for quality products.<sup>56</sup> The Bank's NSG operations will continue to support competitiveness in the fastest-growing tradable sectors, by catalyzing finance for external trade by financial entities, financing of creative industries, and support for export sectors, such as mining, in implementing best environmental and social sustainability practices.
- 3.39 The main risk to the proposed intervention stems from the nature of implementing microeconomic reforms, which require consistency over time, are intensive in interagency coordination, and could pose challenges in defining the institutional framework. To mitigate this risk, operations will include a strong interagency dialogue and technical cooperation component, to raise stakeholder awareness of the importance of the proposed reforms and supporting their continuity.

#### **J. Areas of dialogue**

- 3.40 The dialogue and knowledge support areas will include the following sectors: (a) trade and integration, on issues of exploiting trade agreements, trade facilitation and services; (b) access to financial services on issues of supervision, financial inclusion, and green financing; (c) labor markets, on issues of informality, pensions, and job training; (d) environmental and territorial management, on issues relating to the definition and use of protected land areas, and territorial environmental sustainability plans; (e) citizens security, on issues of policy and the national safety system, police and prison reform; and (f) gender and diversity, in relation to the empowerment of women, the gender perspective, the cultural relevance of services, and uncontacted peoples. The present strategy could be updated to give details of the Bank's frame of action in these sectors, once the Bank completes its diagnostic, and its participation in these areas is decided upon by mutual agreement.

### **IV. LENDING FRAMEWORK**

- 4.1 The demand scenario assumes annual approvals of US\$257 million on average, or a cumulative total of US\$1.283 billion for the period 2012-2016. Of total approvals projected, an average of 60% are expected to be investment loans, while the remaining 40% would be policy-based loans (PBLs) to support key areas of public policy reform. This scenario projects a slightly positive net capital flow to the country amounting to US\$56.0 million, which would be consistent with the reduction in the Bank's share in total external debt from 16.4% to 14.9%, while its share of Peru's total multilateral debt would remain around 40%.

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<sup>56</sup> This will include not only the supply of services, but also promoting local demand for quality products by companies, consumers, and the State, through public procurement with training and incentives for implementing standards.

- 4.2 The lending framework for this strategy is consistent with the country's fiscal financing needs, the public debt management strategy, and the aggregate demand and economic growth assumptions implicit in the government's multiyear macroeconomic framework. In particular, the lending scenario assumes that the Peruvian economy will grow by 6% on average during the strategy period; and it projects a reduction in the level of public debt, with a recomposition of the external debt to increase the share of sovereign bonds.<sup>57</sup> The Bank will seek a scale of lending that observes cost-efficiency criteria in terms of amounts and the number of individual operations; and it will maintain principles of flexibility, transparency, and timeliness in its financial relations with the country.

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<sup>57</sup> Ministry of the Economy and Finance (2012): Marco Macroeconómico Multianual 2012-2014 [Multiyear macroeconomic framework 2012-2014].  
[http://www.mef.gob.pe/index.php?option=com\\_content&view=article&id=1116&Itemid=100233&lang=es](http://www.mef.gob.pe/index.php?option=com_content&view=article&id=1116&Itemid=100233&lang=es)

**The Bank's Country Strategy with Peru 2012-2016**  
**Lending Scenario**  
**(in US\$ millions)**

	2012	2013	2014	2015	2016	Average
<b>Approvals</b>	<b>265</b>	<b>255</b>	<b>240</b>	<b>263</b>	<b>260</b>	<b>257</b>
(a) Disbursements	203	222	213	275	265	236
(b) Repayment (principal)	215	224	224	214	233	222
Net capital flow (a - b)	-12	-2	-11	61	32	14
Interest and fees	98	101	93	84	76	90
(c) Total repayment	313	325	317	298	309	313
<b>Net cash flow (a - c)</b>	<b>-110</b>	<b>-103</b>	<b>-104</b>	<b>-23</b>	<b>-44</b>	<b>-77</b>
Total external debt/GDP	10.4%	9.4%	8.4%	7.6%	7.6%	8.7%
Multilateral debt/Total external debt	37.5%	36.2%	35.7%	34.2%	34.7%	35.7%
Balance of debt outstanding with the IDB	3,263	3,239	3,181	3,101	3,384	3,234
IDB debt/GDP	1.6%	1.5%	1.3%	1.2%	1.2%	1.4%
IDB debt/Total external debt	15.4%	16.0%	15.5%	15.8%	15.8%	15.7%
IDB debt/Multilateral debt	41.0%	44.1%	43.3%	46.2%	46.2%	44.2%

## V. STRATEGY IMPLEMENTATION

- 5.1 With the aim of achieving the strategy's objectives, some projects will have a multisector approach and will be presented as articulated interventions or "development combos,"<sup>58</sup> covering several of the development areas described above simultaneously. The Bank will support the Peruvian government in progressively implementing integrated multisector interventions as a preferred means of achieving social inclusion.<sup>59</sup> In response to the reduced fiscal financing

<sup>58</sup> Interventions referred to as "development combos" have been developed as a policy response to a complex problem: social and productive inclusion of population groups living in targeted geographical areas, where the relative lag in human development levels is attributable to the simultaneous confluence of multiple deficits, including infrastructure gaps, problems of access to public services, lack of coverage of social services and the social protection network, and barriers to the development of economic and productive opportunities. This characterization is well suited to extensive rural areas in the Peruvian *sierra* and *selva*. In theory, the multidimensional and crosscutting nature of these deficits will require an approach involving coordinated and simultaneous (big push) interventions to produce a positive shock on various fronts that is powerful enough to achieve sustainable improvements in well-being among the target population groups. Given its nature, this approach is territorial and requires intensive intersector coordination and simultaneous alignment of multiple agencies and multiple agendas within the Bank.

<sup>59</sup> In gradually implementing this approach, the government could start by designing interventions in multiple sectors, separate but in parallel, targeting the same territorial area.

needs expected, there is likely to be a gradual reduction in programmatic operations and an increase in the relative share of investment loans.<sup>60</sup>

- 5.2 To consolidate its role as Peru's development partner, the Bank will diversify the instruments it uses to support the country, potentially through service contracts in priority areas ("fee for services"),<sup>61</sup> which are being analyzed as an option at the country's request; and through greater operations with the private sector and the NSG public sector.<sup>62</sup> The diversification of instruments will make it possible to address the priority areas on a scale that is efficient and cost-effective for SG operations.

**A. Country systems**

- 5.3 The most recent Public Expenditure and Financial Accountability (PEFA) diagnostic of public financial management systems in 2009 showed significant progress towards good practices and international standards, mainly in terms of modernizing the institutional framework, accounting and reporting, the budgetary process, cash management, and adequate monitoring of the public debt—although there is still room for improvement. Moreover, the oversight system needs to be strengthened by implementing an internal control system tailored to international practices, the strengthening of preventive oversight actions, management and results auditing, staff training, and the reorganization of processes for managing private external auditors.
- 5.4 The government has prioritized strengthening the management of public finance and has developed a strategic plan in this regard for the period 2011-2015, which puts special emphasis on strengthening subnational governments. The Bank will support strengthening systems by financing the new integrated financial management system, covering all central, regional, and local government entities, and it will also support CGRP restructuring.
- 5.5 In relation to the public procurement system, the diagnostic assessment performed using the OECD/DAC methodology in 2009, identified the system's integrity as its main strength—particularly the efficiency of the appeal mechanism and access to information. Nonetheless, there is still room to improve the institutional framework and management capacity of system operators. The Bank will support

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<sup>60</sup> This is in line with the recommendations of the Office of Evaluation and Oversight (OVE), as shown in the annex.

<sup>61</sup> The Bank is moving forward on having set of standard rules for delivery of such services. Thus far, dialogue with the Government of Peru has identified four areas for potential use of the 'fee for service' instrument for technical assistance: pension reform, modernization of the tax authority (SUNAT), development of public-private partnerships, and strengthening low-income housing and land-use-management policy.

<sup>62</sup> Charging for technical assistance and knowledge services is expected to become another option in dealings with the country, but would not become the predominant modality. The Bank will prioritize areas where the country needs sophisticated technical responses on a timely basis, without being hampered by a lack financing in that area. With this innovation, the Bank aims to bolster its function of channeling external resources to middle-income countries such as Peru.

implementation of the transactional purchasing portal, standardization of processes and documents, the issuance of government procurement policies, accreditation of procurement operators' skills, technical assistance to expand the scope of framework agreements, and the review, easing and simplification of regulations, up to the threshold amount established (currently US\$50,000).

5.6 At present, the Bank fully uses the budget, treasury, and accounting and reporting subsystems, but only partially uses the information system. At the end of this strategy period, there is expected to be gradual progress in use of the internal auditing, external control, information, framework agreement, and reverse auction subsystems. Full use of the new SAFI module for managing projects with external financing is also expected.

5.7 Country systems for monitoring and evaluating public investments are being consolidated, and there is still ample room for improvement. The Bank will continue its line of work supporting results-based management in the MEF, and could also support efforts being undertaken by CGRP in this regard.

**B. Coordination with other development partners**

5.8 The Peruvian government maintains fluid dialogue and close coordination with various development partners, placing emphasis on cooperation and cofinancing schemes. Coordination and dialogue are maintained through the Donor Forum. In coordination with other multilateral agencies, progress has been made in: (i) cofinancing of projects in the solid waste sector with the Japan International Cooperation Agency (JICA); (ii) cofinancing of projects in the water and education sectors with the German cooperation agency KfW; (iii) cofinancing in the transportation, health, and water resources sectors with the World Bank; (iv) coordination of future operations on social inclusion, agriculture, and climate change with the World Bank; (v) joint research strategy on regional development issues with the Swiss Agency for Development and Cooperation (Cosude) and JICA; (vi) coordination and leadership of the roundtable on statistical good practices with the United Nations Population Fund (UNFPA); and (vii) participation with the European Commission, Belgian Development Cooperation, Cosude, the German agency GIZ, the Spanish Agency for International Development Cooperation, the World Bank, and Andean Development Corporation in the MEF's public finance management study group. These cooperation and coordination mechanisms will remain in force during the new strategy period.

5.9 The Bank will continue to maintain close coordination with other cooperation partners to advance its nonreimbursable technical cooperation program for Peru's public and private sectors. For this strategy period, close collaboration will be maintained with other donors in: (i) cofinancing with the UNDP and GIZ in rural development; (ii) cofinancing with the Canadian International Development Agency (CIDA) in energy; (iii) coordination with the World Bank and International Finance Corporation on the investment plan for the forestry investment program for

Peru; (iv) coordination with the World Bank and KfW to manage Forest Carbon Partnership Facility investments; (v) coordination with the United Nations system on access to the Adaptation Fund in the area of climate impacts in marine and coastal ecosystems; and (vi) cofinancing with the United Kingdom's Department for International Development (DFID) and the Global Environment Facility on environmental issues relating to the city of Lima.

## VI. RISKS

- 6.1 Even though Peru has strengthened its main macroeconomic variables and obtained investment grade from all rating agencies, it remains vulnerable to the volatility of external conditions,<sup>63</sup> which implies risks for the implementation of this strategy.<sup>64</sup> If external conditions improve exceptionally, the country's financial demand for Bank resources could decrease substantially, which would make it difficult to fulfill the program as envisaged. Moreover, an erosion of external conditions could involve a risk of increasing the demand for financing even above that foreseen in the financial flows scenario analyzed in this strategy. As mitigation, the Bank will target its efforts on sectors that are less sensitive to the business cycle, and will shore up a Bank-country relationship that goes beyond financial issues, and is based on contributions with greater value added. The Bank will use its macroeconomic monitoring tools<sup>65</sup> to closely track these risks.<sup>66</sup>
- 6.2 Institutional capacity weakness in some areas of the public sector, particularly at the subnational level, could impair strategy implementation. In particular, there are constraints on public capital expenditure execution, project design and evaluation, financial management, public tendering, and environmental analysis. All of this could mean delays in the preparation, approval, and implementation of the public investment program, affecting strategy implementation. To mitigate this risk, the Bank has included direct interventions to strengthen the management of public investment and the State's financial reporting and management. It will also deploy its fiduciary monitoring and control instruments to monitor progress in the institutional strengthening of its counterparts.

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<sup>63</sup> Peru also has some important external strengths differentiating it from other emerging economies. These include the low refinancing risk, as its short-term borrowing indicators are quite low, and the low exposure to market risks, since most of its debt stock is fixed-rate and denominated in local currency.

<sup>64</sup> This risk is characteristics of middle-income economies, with growing access to and integration with international financial markets.

<sup>65</sup> According to the mandate set forth in the Report on the Ninth General Increase in Resources of the Inter-American Development Bank, macroeconomic sustainability assessments of borrowing countries are prepared every year.

<sup>66</sup> The Bank will constantly monitor conditions of access to international financial markets and Peru's multilateral financing needs. Possible future changes in the bias of economic policy, the potential impact of changes in the external conditions of the economy, and/or potential changes in the government's public financing strategy could trigger changes in the country's current financing strategy. The multiyear macroeconomic framework, published by the MEF, will be the main benchmark for indicating potential changes in financing scenarios.

- 6.3 Implementation of the “development combos” approach could face difficulties given the natural complexity of coordinating multiple actors and agendas within the government and the Bank itself. Hence, delays could arise in implementing such interventions. The proposed mitigation strategy is to implement this intervention approach gradually, with its pace of implementation being determined both by the methodology developed by the government, and by the Bank’s response capacity in providing resources for the design and execution of such operations.



## ANNEX I: MAIN MACROECONOMIC AND SOCIAL INDICATORS

Peru: Main macroeconomic and social indicators						
	2007	2008	2009	2010	2011	2012*
<b>Real sector indicators</b>						
Real GDP (Var. % real)	8.9	9.8	0.9	8.8	6.9	6.0
Nominal GDP (US\$ billion)	107.4	127.1	127.4	153.9	176.7	197.8
GDP per capita (US\$)	3,800	4,425	4,361	5,205	5,614	6,571
GDP per capita (PPP)	7,784	8,603	8,635	9,358	10,001	10,888
<b>Monetary and foreign exchange indicators</b>						
Inflation CPI (% , end period)	3.9	6.7	0.2	2.1	4.7	2.8
Growth of the monetary base (% per year)	26.8	32.4	1.6	45.8	19.2	-
Nominal exchange rate (nuevo sol/US\$)	3.13	2.92	3.01	2.83	2.75	2.67
Variation in the nominal exchange rate (% per year)	-4.5	-6.5	3.0	-6.2	-2.5	-3.2
<b>External sector indicators</b>						
Current account (% GDP)	1.4	-4.2	-0.6	-2.5	-1.9	-2.3
Foreign direct investment (% GDP)	5.1	5.4	4.4	4.8	4.3	4.9
International reserves (US\$ billion)	27.7	31.2	33.1	44.1	48.8	56.9
International reserves (% GDP)	25.8	24.5	26.0	28.7	27.6	29.3
<b>Fiscal indicators</b>						
Economic performance of the NFPS (% GDP)	2.9	2.4	-1.3	-0.3	1.9	1.0
Primary balance of the NFPS (% GDP)	4.7	4.0	0.0	0.9	3.0	2.1
Total public debt (% GDP)	28.5	25.9	26.1	23.3	21.2	19.6
External public debt (% GDP)	17.9	16.3	15.6	12.9	11.2	10.4
<b>Social indicators</b>						
Population (million)	28.5	28.8	29.1	29.5	29.8	30.1
Unemployment rate (% of EAP)	6.3	6.0	5.9	5.3	-	-
Poverty rate (% of population)	42.4	37.3	33.5	30.8	27.8	-
Extreme poverty rate (% of population)	11.2	10.9	9.5	7.6	6.3	-

Source: MEF, BCRP, INEI, IMF.

\* Projection.

## ANNEX II: LENDING FRAMEWORK

**Fiscal situation.** In 2011 there was a further reduction in the nonfinancial public sector (NFPS) fiscal deficit, which ended the year with a surplus of 1.9% of GDP. The economic performance of the NFPS was mainly a consequence of the buoyancy of current income and a fall in public investment expenditure. The medium-term fiscal outlook is positive. For 2012, a fiscal surplus of around 1.0% of GDP is forecast, in line with reduced revenues as a result of a deterioration of the terms of trade, and a recovery of investment expenditure execution capacity among subnational governments. For 2013, the NFPS is expected to post a fiscal surplus of 1.1% of GDP.

**Medium-term financing needs.** In keeping with the gradual fiscal consolidation expected in the medium term, the NFPS faces a baseline scenario of declining financing needs in the relevant future, but subject to changes in external financing conditions that could substantially increase the demand for external resources. The NFPS is expected to achieve gross savings equivalent to roughly 0.2 points of GDP in 2012, and 0.3 points of GDP in 2013. In this context, there is sufficient headroom in the government's regular financing strategy to easily close the fiscal gap in the near future.

Peru: NFPS financing needs (% of GDP)			
	2012	2013	2014
<b>Gross financing needs</b>	<b>(0.2)</b>	<b>(0.3)</b>	<b>(0.6)</b>
Deficit (Surplus)	(1.0)	(1.1)	(1.3)
Amortization	0.8	0.9	0.7
<b>Financing</b>	<b>(0.2)</b>	<b>(0.3)</b>	<b>(0.6)</b>
External	0.7	0.5	0.4
Net internal	(0.9)	(0.8)	(1.0)

Source: IMF, MEF, authors' calculations.

**The IDB lending framework.** In keeping with the analysis of fiscal financing needs for the period, the Bank sees a baseline demand scenario for sovereign guaranteed financing for this strategy involving annual approvals of US\$257 million, or a cumulative US\$1.283 billion. This scenario involves a marginal reduction in the Bank's sovereign exposure to the country, but maintenance of its share in Peru's total multilateral debt.

The baseline scenario assumes a progressive fall in Peru's total external debt and, within this, an even steeper fall in multilateral debt, consistent with the MEF's current medium-term fiscal financing strategy. Both scenarios assume real GDP growth rates of 6.0% on average for the period 2012-2016. The Bank will maintain, as a principle, constant monitoring of the country's financial conditions to respond on a timely basis to any demand for resources over and above the scenario described here.

### ANNEX III: ANALYSIS OF MACROECONOMIC RISKS

**General overview.** Peru has shown robust macroeconomic performance over the last few years. The country has been one of Latin America's most dynamic economies in a context of fiscal stability, external equilibrium, and low inflation. Despite suffering the adverse effects of the international financial crisis of 2009, Peru recovered rapidly in 2010 and 2011. Strong economic fundamentals, a track record of prudent economic policies, and timely countercyclical intervention in its monetary and fiscal policies have played an important role in restoring economic growth.

In 2011, real GDP grew by 6.8%, which, although below the previous year's rate of 8.8%, was still among the highest in the region. GDP growth in 2011 was driven mainly by private investment and external demand. Also last year there were selective price pressures, generating an increase in the consumer price index of 4.7%—above the target range set by monetary policy. As in 2008, the relative surge in inflation in 2011 was affected by changes in the food and beverage subcomponent, particularly imported ones. The Central Reserve Bank of Peru (BCRP) responded to these risks by tightening monetary policy somewhat.

**Price stability.** The monetary policy adopted by the BCRP has paved the way for price stability in Peru. Since 2002, the BCRP's monetary policy has followed a scheme of explicit inflation targets. Under this scheme, the BCRP uses expectations of future inflation as a nominal anchor, and does not pre-announce any commitment for other nominal variables such as monetary aggregates, interest rates, or exchange rates. Starting in 2007, the inflation target was set at 2.0%, with a tolerance band of  $\pm 1$  percentage point. The inflation target, measured as a percentage variation of the Metropolitan Lima Consumer Price Index (CPI) has a 24-month time horizon.

In recent years, Peru's monetary policy framework has helped foster price stability, though there have been temporary deviations due to external shocks. In 2011, there were signs of an upturn in inflation with month-on-month rates of up to 0.8%, the highest since 2008; and by year end the annualized CPI variation was above the target range at 4.73%. Nonetheless the temporary departures from the target were caused by external factors, and there is no evidence of internal demand generating inflationary pressures.

In response to inflationary pressures, the central bank progressively raised its benchmark interest rate, raised rates on its deposit and lending activities with the financial system, and increased the legal reserve requirement for deposits in soles. In the second half of 2011, the BCRP adjusted its monetary policy stance to neutral, leaving the benchmark interest rate and legal reserve requirements unchanged.

Despite the divergence of inflation from the monetary policy target range, the monetary scheme continues to anchor expectations of price changes over a 24-month horizon. The economic expectations survey indicates that economic agents expect inflation to return to the target range of 1% to 3% in 2012 and 2013. The trend of inflationary expectations is consistent with the ending of external pressures on non-core inflation, a slower global growth scenario, and with the output gap and inflationary expectations trending within the bounds expected by the fiscal and monetary authorities.

**Fiscal sustainability and public debt.** Peru's recent fiscal performance is characterized by progressive strengthening of the economic results of the nonfinancial public sector (NFPS). The NFPS has gone from carrying a deficit of 1.8% of GDP on average between 2000 and 2005 to an average surplus of 0.9% of GDP between 2006 and 2010. The progressive fiscal strengthening and accumulated savings enabled the Peruvian government to execute an ambitious countercyclical plan in 2009 that included investment spending on the order of 3.2% of GDP. In 2010, the NFPS reduced its economic deficit to 0.3% of GDP, which was further improved to a surplus of 1.9% of GDP in 2011. The medium-term fiscal outlook is positive, with successive fiscal surpluses expected and a scenario of declining financing needs over the foreseeable future.

Over the last decade, Peru's total public debt has trended downward as a result of gradual fiscal strengthening and strong economic growth. Total public debt fell from 46.7% of GDP in 2002 to 21.2% of GDP by the end of 2011. External public debt declined from 36.5% of GDP to 11.2% of GDP over the same period, while domestic debt held steady at around 10.0%.

The most recent debt sustainability analysis shows that the expected path for the public debt is stable even under the most extreme stress scenarios. According to estimates made, the likelihood that the debt in 2017 will be above 40% of GDP is statistically equal to zero; and the chances of an episode of fiscal unsustainability in the medium term are extremely low.

Furthermore, the progressive fiscal consolidation of the Peruvian NFPS, together with the comfortable public debt situation and savings accumulated in the Fiscal Stabilization Fund (3.3% of GDP), give the fiscal authorities room for maneuver to implement a countercyclical fiscal plan similar to or larger than that deployed in 2008, should external conditions so require.

**External sustainability.** The guidelines followed by Peru's monetary and exchange rate policy have fostered effective means of managing national and international liquidity. The scheme of explicit inflation targets followed by the BCRP in implementing its monetary policy, together with a flexible exchange rate regime with specific interventions designed to mitigate excessive volatility in the exchange rate, has given the BCRP sufficient freedom to use its existing instruments to maintain adequate levels of local and international liquidity.

In an external environment characterized by sustained growth in international prices for the primary goods exported by Peru, along with heavy inflows of long-term capital, the monetary policy framework cited above has made it possible to strengthen the Peruvian economy's international liquidity position. In fact, in recent years, the country's net international reserves have shown a clear upward trend, reaching a balance of US\$49.1 billion as of the end of 2011—an increase of US\$4.9 billion over end-2010.

The international liquidity managed by the BCRP is sufficient to cover the transactional and financial needs of the Peruvian economy in the relevant timeframe. International reserves have been gaining strength in relation to the economy's import needs. The current net international reserves (NIR) balance represents over 16 months of imports, a notable improvement over the less than 13 months of imports at the beginning of the international

financial crisis in 2009. NIR represented over 86% of the banking system's total liquidity, and more than 140% of liquidity in soles.

Peru's international liquidity position is more than adequate to deal with its short-term obligations in foreign currencies. The Guidotti-Greenspan international liquidity ratio (ILR) for Peru was 3.48 as of the end of 2011, demonstrating that, under current conditions, the country could go for three and a half years with no new international financing and still meet all of its foreign currency obligations. The expanded ILR indicator, which also includes the current account deficit, reflects the economy's liquidity position in the event of a sudden stop in capital flows in connection with the balance of payments. As of the end of 2011, the expanded ILR indicator for Peru was 2.61.

**Financial system stability.** The Peruvian financial system is made up primarily of banking institutions, with assets representing over 80% of total system assets. The nonbank sector consists primarily of financial enterprises, municipal savings and loan associations, and institutions providing rural and SME financing. The banks' main balance-sheet accounts for both assets and liabilities show even greater strength than the economy as a whole. Bank credit has grown continuously over the last five years. The trend has been dominated by the commercial (67% of the total) and consumer (20% of the total) lending portfolios, while economic prosperity and growth of the real estate offering have enhanced the relative importance of the mortgage loan portfolio (13% of the total).

The portfolio's quality has increased substantially in recent years, as past-due loans have declined on a sustained basis as a proportion of the total portfolio, dropping from 3.89% in January 2005 to 1.54% in September 2011. The size of the past-due portfolio is not cause for concern, and provisions are 2.4 times the size of the past-due portfolio.

The financial system's levels of liquidity are high. In this regard, liquidity is far above the limits established by Peruvian regulations, due to the legal reserve requirements, and interventions in the money market to maintain the inflation target and exchange rate stability. As of September 2011, the financial system liquidity ratio was 40% in domestic currency and 48% in foreign currency.

The new capital adequacy levels have remained stable and significantly above the level required under banking legislation. The Peruvian banking system has shown improvement in operations management in that its operating expenses fell from 4.30% of assets in December 2006 to 3.30% in 2011, the lowest operating expense ratio in the region.

Lastly, profitability indicators have remained relatively stable, even recently increasing its spreads. Peruvian banks have the best average return on assets (ROA) in the Andean region, with the top average return on equity (ROE) and interest rate spreads next to Venezuela. Profitability is even better for foreign banks, which include two of the largest in the system.

To conclude, Peru's banks, which represent most of the country's financial system, have grown faster than the economy as a whole. This has been accompanied by an improvement in portfolio quality, with strong indicators of liquidity, capital adequacy, operational management, solvency, and profitability. In general, the recent growth of the financial system is not considered to pose relevant stability risks.

## **ANNEX IV: SUMMARY OF COORDINATION ACTIVITIES**

### **GENERAL COORDINATION**

The main mechanism used by the Peruvian government to coordinate with international cooperation is the Peruvian International Cooperation Agency (APCI). This is a public steering agency that manages financial resources and coordinates the various public, private, and civil society actors in line with State policies. The APCI promotes harmonization, fluid dialogue, and close coordination with the various development partners, through the Donor Forum, which is the mechanism that reports the country's thematic and territorial priorities, and distributes the work of the various international agencies in the framework of implementation of the principles of the Paris Declaration and Accra Agenda for Action. The forum encompasses 19 bilateral cooperation agencies, the agencies of the United Nations system, and four multilateral development organizations. The Bank's most recent coordination activities are summarized below:

### **COORDINATION WITH MULTILATERALS**

1. Cofinancing with the World Bank of loan operations in the transportation sector
2. Cofinancing with the World Bank of loan operations in the social inclusion sector
3. Cofinancing with the World Bank of loan operations in the water resources sector
4. Advanced phase of coordination with the World Bank and distribution of work for operations in the agriculture and climate change sectors
5. Leadership with the World Bank of the investment plan in the forestry investment program for Peru
6. Coordination with the World Bank in managing investments of the Forest Carbon Partnership Facility
7. Cofinancing with the UNDP of nonreimbursable technical cooperation in the rural development area
8. Coordination with the United Nations system of the climate change adaptation program in the Humboldt current large marine ecosystem
9. Coordination and leadership with the United Nations Population Fund (UNFPA) in the sector roundtable on good statistical practices

### **COORDINATION WITH BILATERALS**

10. Cofinancing with JICA of loan operations in the solid waste sector
11. Cofinancing with KfW of operations and projects in the water and sanitation sectors
12. Cofinancing with KfW of operations and projects in the education sector
13. Cofinancing with GIZ of nonreimbursable technical cooperation in the rural development area

14. Coordination with KfW of the Forest Carbon Partnership Facility
15. Joint research strategy with Cosude and JICA on regional development issues
16. Cofinancing with DFID and the GEF on environmental issues in the city of Lima
17. Cofinancing with CIDA in the energy field





## ANNEX V: RECOMMENDATIONS FROM THE OVE COUNTRY PROGRAM EVALUATION

Recommendations from the OVE country program evaluation with Peru 2007-2011	Incorporation into the Bank's country strategy with Peru 2012-2016
Include knowledge and technical cooperation as program products, both on a stand-alone basis and integrated with loans, ensuring the availability of resources to finance them.	<b>Agreed.</b> The most recent programming cycle and the design of the Bank's country strategy with Peru for 2012-2016 have actively incorporated this recommendation. Future relations with public and private counterparts in the country will place greater emphasis on knowledge and technical cooperation.
Accelerate the change in the public-private makeup of the portfolio, thus elevating the importance and catalytic effect of the non-sovereign portfolio on economic diversification, coordination of business ventures, and public-private partnerships.	<b>Agreed.</b> In the recent past, the Bank has been an important player in financing flagship non-sovereign guaranteed projects. The 2012-2016 country strategy reaffirms the important role of the private sector in diversifying the economy, the coordination of business ventures and public-private partnerships. This recommendation has been incorporated into the strategic exercise. A larger flow of non-sovereign guaranteed operations is expected for the next few years.
Seek greater balance in the sovereign portfolio between investment and policy reform financing modalities, promoting: (i) recovery of the costs of non-credit-related intangible products; (ii) the use of less transactional, results-based investment instruments (SWApS); and (iii) a lower relative importance for programmatic policy-based loans, enhancing the targeting of policy matrices on the problem's active restrictions and on the evaluation of outcomes.	<b>Partly agreed.</b> On this point, it should be noted that SWAp-type operations face regulatory restrictions, and for that reason they have not been preferred by the government thus far. Nonetheless, the recommendation is well received, and the process of exploring new instruments and innovative dealings is a permanent feature in the case of Peru, and certainly is part of the strategic directions of the 2012-2016 country strategy.
Foster progress in the country execution capacities and systems in line with the transformations in the Bank's monitoring and evaluation systems.	<b>Agreed.</b> This recommendation is being actively incorporated in the new 2012-2016 country strategy with Peru.
Concentrate the program's scope on fewer issues, focusing on sustainable growth and inequality reduction, which are the Bank's areas of excellence.	<b>Agreed.</b> Targeting is an intrinsic part of the process of preparing the 2012-2016 country strategy with Peru. Responding to this recommendation, the new country strategy was not only designed to prioritize those areas of excellence of the Bank, in full accord with the areas identified in the Country Program Evaluation, as development challenges where the program's contribution could be significant. The new country strategy will ensure that its sector and multisector actions are also targeted at the territorial level, thereby responding to the country's regional development disparities.

## ANNEX VI: DEVELOPMENT EFFECTIVENESS MATRIX (DEM)

### COUNTRY STRATEGY: DEVELOPMENT EFFECTIVENESS MATRIX

In August 2008, the Board of Executive Directors approved the Development Effectiveness Framework (document GN-2489) to increase the evaluability of all Bank development products.

The Development Effectiveness Matrix for Country Strategies (DEM-CS) is a checklist of the elements that are necessary to evaluate a country strategy. It is based on the evaluation criteria developed by the Evaluation Cooperation Group of the Multilateral Development Banks in the “Good Practice Standards for Country Strategy and Program Evaluation”.

### COUNTRY STRATEGY: PERU 2012-2016

**STRATEGIC ALIGNMENT.** This measures two dimensions: (i) the extent to which the objectives of the strategy are consistent with the country’s development challenges and with the government’s priorities and plans; and (ii) use of a mix of products (financial, knowledge, technical assistance) to attain the objectives, and identification of other cooperation agencies and their areas of action.

Consistency of strategic objectives: The strategy identifies the following areas of work: (i) social inclusion; (ii) rural development and agriculture; (iii) housing and urban development; (iv) climate change and disaster risk management; (v) water, sanitation, water resources, and solid waste; (vi) energy; (vii) transportation; (viii) public management; and (ix) competitiveness and innovation. 100% of the selected areas respond to development challenges and are consistent with the priorities established by the Peruvian government program. In addition, the selected work areas came out of the Bank-country dialogue.

Product mix and participation by other donors: The strategy proposes to use different Bank instruments: sovereign and non-sovereign guaranteed loans, technical-cooperation projects with a multisector approach, articulated interventions or “combos”. The Bank will also explore using ‘fee for service’ arrangements. The strategy takes into account interventions by other multilateral donors including JICA, KfW, the World Bank, Spanish cooperation, and the UNDP.

**EFFECTIVENESS.** This measures whether the country strategy is likely to achieve its intended objectives, through an examination of four dimensions: (i) the quality of the diagnostics on which Bank action is based in each area of work; (ii) the quality of the results matrix for the strategy; (iii) the use and buildup of country systems; and (iv) the analysis of the lending framework.

Effectiveness dimensions	%
<b>I. Sector diagnostics</b>	
- Identifies the main problems based on empirical evidence	100
- Identifies the main beneficiaries	100
- Identifies and measures the factors that contribute to the problems identified	100
- Presents the policy framework and a sequence for Bank intervention	100
- The diagnostic corresponds to the objectives presented in the strategy	100
<b>II. Results matrix</b>	
- Expected outcomes are clearly defined	100
- Indicators are outcome indicators and are SMART	98
- Indicators have baselines	100

Thirteen sector notes were presented as part of the strategy. All the notes have been validated.

- 100% of the notes clearly identify the main sector problems based on empirical evidence.
- 100% of the notes identify the potential beneficiaries in each area of intervention.
- 100% of the notes identify or measure the factors that contribute to the problems identified.
- 100% of the notes identify the policy framework and a sequence for the Bank's actions.
- In 100% of the notes, the subjects dealt with are consistent with the Bank's strategic objectives.

Results matrix: The results matrix contains 41 strategic objectives for the Bank's action, and 60 indicators to measure progress towards the proposed objectives.

- 100% of the strategic objectives clearly identify the expected outcomes.
- 98% of the indicators used are outcome indicators and are SMART; the other 2% are either unsuitable for measuring expected outcomes or need to be specified more precisely.
- 100% of the indicators have baselines.

Country systems: Diagnostics have been performed for all financial management and procurement subsystems. Nearly all financial management, procurement and competitive bidding subsystems will be strengthened. All country systems will be used during the strategy period.

Lending framework: The strategy contains an analysis of the country's financing requirements, and provides an estimate of the amount of financing that could be provided by the Bank. The lending framework is consistent with the demand assumptions of the country's fiscal financing and debt management strategy.

**RISKS.** This measures three dimensions: (i) identification of factors that affect or might affect attainment of the proposed objectives; (ii) definition of mitigation measures; and (iii) monitoring mechanisms.

The strategy identifies the risks associated with Bank participation in each of the strategic sectors and defines mitigation measures. It also identifies macroeconomic and institutional risks, as well as implementation risks arising from the complexity of the "development combos" approach.