

## TECHNICAL COOPERATION PROFILE

### PERU

#### I. GENERAL INFORMATION

<b>Project Name:</b>	Development of the Rural Economy in the Sierra of Peru		
<b>Project Number:</b>	PE-T1012		
<b>Team Leader:</b>	Francisco Basilio Souza (RE3/EN3)		
<b>Team Members:</b>	Geoffrey Cannock, (RE3/EN3); Juan Pablo Severi (COF/CPE); Cesar Falconi (SDS/RUR); Geronimo Frigerio (LEG/OPR); and Giovanna Mahfouz (RE3/EN3).		
<b>Date of Request:</b>	June 30, 2005		
<b>Beneficiary Country:</b>	The Republic of Peru (GOP)		
<b>Executing Agency:</b>	The Ministry of Economy & Finance (MEF)		
<b>Financing Plan:</b>	IDB (JSF):	US\$600,000	
	Local:	US\$200,000	
	Other sources:	<u>US\$100,000</u>	
	Total:	US\$900,000 <sup>1</sup>	
<b>Technical Responsibility:</b>	Environment and Natural Resources, Region 3 (RE3/EN3)		
<b>Tentative Dates:</b>	Loan Committee:	October 27, 2005	
	DIR/PRE:	November 23, 2005	

#### II. BACKGROUND AND PROBLEM STATEMENT

- 2.1 The stubborn persistence of rural poverty in the *Sierra* (Mountain Region) and *Selva* (Jungle) is one of Peru's most pressing social, political and economic problems. The country made some progress in poverty reduction in the 1990s, but virtually all of that took place before 1997, and was concentrated in urban areas and on the coast. In 2002, over half the Peruvian population was poor and almost one-fourth was in extreme poverty. This poverty problem is concentrated in the rural areas of the Sierra and Selva where 57% and 43% respectively of their populations are living in extreme poverty and 81% and 71% in poverty altogether.

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<sup>1</sup> An initial phase of the proposed study on the amount of US\$150,000 is under way with resources from the IFPRI administrative budget (See ¶2.5).

- 2.2 Governments, past and actual have spent a significant amount of money to alleviate the poverty problem in the Sierra and Selva (approximately 0.9% of GDP, i.e. US\$460 million per year). Projects with support from both the IDB and JBIC<sup>2</sup> have been or are still in execution, but those programs are either safety nets such as temporary work programs like “*Trabajar*” and nutrition programs such as “*Vaso de Leche*” or loosely targeted like FONCODES. The latter program finances small infrastructure works in education, health, rural roads, etc. that help the poor in the short run, but do little to overcome the structural causes of poverty. That requires making the poor more productive so that they can earn their own way out of poverty. This could be done only through investment programs targeted to the whole spectrum of activities that supports economic growth. The transfer approach is essentially a band-aid approach that uses government revenues from the modern sector on the coast to alleviate poverty in the highlands.
- 2.3 Unfortunately, in spite of the recovery in Peru since 2000, there is no sign that the rural poverty picture in the Sierra and Selva is improving. According to Escobal and Valdivia (2004), rural poverty in the Sierra has risen from 72.5% in 1997 to 78.5% in 2002. Poverty in the rural Selva over the same time period has grown from 55.7% to 71.8%. But what is striking is the difference in poverty trajectory between the Sierra and the urban sector, in particular Lima. Urban poverty is highly sensitive to the rate of economic growth. This has two important implications: First, the poor in the Sierra and the Selva are not well linked into the modern economy of the coast. Second, and as a result of the lack of linkage, it is not reasonable to expect that Peru will be able to solve its rural poverty problem simply by generating a rapid rate of growth. Some sort of intervention or change in the growth strategy will be required to change this situation. This proposal lays out a framework for developing such a strategy.
- 2.4 Smallholder farmers within Peru differ significantly according to where they live, and the assets available to them, particularly: land, climate, education, water, and transportation to local or regional markets. The key constraints that need to be addressed to enhance their development differ among those heterogeneous groups. Given such heterogeneity, it is unlikely that a “one-size-fits-all” development strategy will be successful in overcoming poverty in the Sierra and Selva regions; rather an approach reflecting this heterogeneity is needed.
- 2.5 Recognizing this fact, the MEF, requested the Bank’s support to study the issue of targeting productive investments in the highlands of Peru (Sierra region). The Bank’s initial response was to hire the International Food Policy and Research Institute – IFPRI to study the issue. IFPRI produced a concept paper on the existing programs in Peru. As a follow up IFPRI designed a conceptual framework and a proposal to develop a set of tools, which would allow the Peruvian Government to prioritize investments in the Sierra region. Both documents were presented and discussed at a Seminar in Lima. After this, IFPRI has started the development of the first of a set of development “tools”. The first of the tools being developed is a “Typology of Microregions of the Sierra”. This typology

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<sup>2</sup> JBIC has also financed PRONAMACHS in the Sierra Region. This project is targeted to natural resources management, but will finance small productive investments when they contribute to improve the environment.

takes into account different dimensions: geography, poverty, and inequality, regional ethnic characteristics, production, access to infrastructure, access to markets, nearness to regional urban centers, off farm employment opportunities, population density, and presence of institutions. The full study, using resources of this TC, will build on this knowledge, with the final objective being the preparation of “A Framework for Development of the Rural Economy in Sierra of Peru”.

- 2.6 Specifically, this TC will contribute to the GOP efforts to reduce rural poverty by developing a “Peruvian regional tool box of solutions” for the different bottlenecks faced by the different “types” of microregions”. This tool box will be transferred to each of the regional and local governments, to be incorporated in their strategies for rural development. In addition, this toolbox will be used for the designing and preparation of investment projects in three regions of the Sierra. This strategy will be designed in collaboration with MEF, the Ministry of Agriculture, and the regional and local governments. Finally, capacity building of local institutions will be implemented. This will result in the prioritization of strategies and developing regional rural development plans based on the results identified in the projects. These regional plans will include concrete investment projects and will be done in collaboration with the regional and local governments and the MEF in such a way that the investment projects are in accordance with the national system of public investment.
- 2.7 Another important contribution of the TC is that it will provide the technical and information framework to start the preparation of a potential operation in the rural sector. This new operation will probably use the new approach called Sector Wide Approach Program (SWAP). On different Bank missions the Government of Peru has mentioned their interest in designing an operation in the rural sector coordinating the efforts of the several international organizations involved in the development of the rural sector. The SWAP and this TC can help in providing a long-term strategy in the rural sector and harmonize the agendas of the donor community.

### III. OBJECTIVE AND DESCRIPTION

- 3.1 The objective of this TC is to support the GOP in the implementation of a strategy for rural poverty reduction. The project will develop a knowledge base for prioritizing public and private investments based on the characteristics of different microregions in the rural Sierra as well as their economic potential and the bottlenecks that impede increases in production. With this information the project will develop regional rural development plans for three specific regions in the country.
- 3.2 The project has four components:
  - a. **A regionalized simulation model of the Peruvian economy:** This model will be developed to for use in simulations of alternative development pathways under assumptions about public and private investment and policy reforms in the Sierra. A critical component of the regionalized model is the specification of household demand and the links between the rural sector and regional urban centers. It will be

important to distinguish between products which are traded goods with a national market and other products and activities that are produced and consumed locally but not traded nationally. The working hypothesis is that this latter class of activities will be far larger in the Sierra than is the case for the coastal region because of the transportation barrier.

- b. **Market chain analysis of the activities and products with potential comparative advantage:** Consists of the systematic identification of the bottlenecks that arise in each of the different types of microregions and the design of strategies or experimental pilot solutions to overcome these bottlenecks. The work will concentrate on three major aspects: (i) identifying commodity investment and possible prioritization of commodities; (ii) identifying the main bottlenecks within the market chain generated by market and government failures; and (iii) evaluating possible public investment decisions proposed as solutions to bottlenecks.
  - c. **Database of alternative solutions for the different types of microregions:** This component will concentrate on an exhaustive review of existing best practices both local and in other countries to identify a menu of possible solutions that can be implemented as pilot projects. This effort will be demand-driven, and will involve close consultation with local policy makers, leaders of farmer organizations and technical assistance organizations, and other key stakeholders to identify options that are politically and socially feasible as well as economically advantageous.
  - d. **Preparation of regional rural development plans for three specific regions in the country:** The plans will include specific investment projects; institutional capacity building of the regional and local governments and civil society organizations in the areas of the projects and monitoring and evaluation. The challenge here is to interface the inherent top-down decisions associated with many public investments with the bottom up interests of local people. This reconciliation depends on involving local governments and communities in decisions about what, where, and how to invest. This should lead to regional rural development plans based on the results identified in either the pilot projects or the best practice solutions. These regional plans will be done in collaboration with the regional governments, local governments and the MEF in such a way that the investment projects are in accordance with the *Sistema Nacional de Inversión Pública* (SNIP). The inclusion of both institutional capacity building of local institutions and civil society and an impact evaluation methodology module will increase the ability of local stakeholders to understand why they are prioritizing certain investments and use evaluation results to improve future performance. Results of the previous phases and consultation with stakeholders will determine the selection of the three regions.
- 3.3 The detailed final products of the TC will be listed in the Plan of Operations of the TC. The main ones are: (i) a report summarizing the results of component one, that is the characterization of the main microregions in the Sierra; (ii) a report identifying bottlenecks at the level of the region and microregion; (iii) a report analyzing the complementary policy interventions for eliminating the main bottlenecks in a sample of the different microregions; (iv) a sequenced and prioritized plan to address these

bottlenecks, including a clear role of the public and private sectors, and investment estimates for each intervention; (v) a road map to link these proposed investments to the investment programming matrix for rural areas of the Ministry of Finance; (vi) capacity building for regional and local government; and (vii) support in the preparation of rural development plans for three specific regions off the Sierra.

#### IV. COST AND FINANCING

- 4.1 The estimated total cost of the Project is US\$900,000, of which the Japan Special Fund (JSF) will finance US\$600,000. Counterpart funds of US\$200,000 will be provided by the MEF and US\$100,000 will be provided by CAF. IFPRI is spending a total of US\$150,000 to complete the first phase of the project. This sum is not being considered as counterpart.

TABLE 1: ESTIMATED COST IN US\$

CATEGORY	BID-JSF	CAF	LOCAL	TOTAL
<b>1. Administration &amp; Supervision</b>	<b>50,000</b>	<b>0</b>	<b>50,000</b>	<b>100,000</b>
1.1 Administration	0	0	50,000	50,000
1.2 Supervision & Evaluation	50,000	0	0	50,000
<b>2. Direct Costs</b>	<b>550,000</b>	<b>100,000</b>	<b>150,000</b>	<b>800,000</b>
2.1 Regionalized simulation model of Peru	120,000	0	0	120,000
2.2 Market Chain Analysis	180,000	100,000	0	280,000
2.3 Database of alternative solutions for different types of microregions	100,000	0	50,000	150,000
2.4 Preparation of regional rural development plans for three specific regions in the country	150,000	0	100,000	250,000
<b>Total</b>	<b>600,000</b>	<b>100,000</b>	<b>200,000</b>	<b>900,000</b>
<b>% from sources</b>	<b>66.67%</b>	<b>11.11%</b>	<b>22.22%</b>	<b>100.00%</b>

#### V. EXECUTING AGENCY AND EXECUTION STRUCTURE

- 5.1 Execution will be under the responsibility of the *Dirección General de Programación Multianual* (DGPM) of the Ministry of Economy and Finance (MEF).
- 5.2 The GOP has requested that the Bank directly manage the funds in order to engage the consultancy services as soon as possible. Responsibility for the coordination of the work of the consultants within the Bank will be with the Project Team, supported by COF/CPE. The Project Team, in consultation with the GOP, will review and approve the consultants' reports. Bank's counterpart within the GOP will be the *Dirección General de Programación Multianual* (DGPM) of MEF.

## **VI. ISSUES**

- 6.1 The Project will support one of the main objectives of the Bank's strategy in the Country, which is poverty reduction. Although a new Government is to be elected during 2006, by the nature of the Project, no impact is expected from this change. A series of outputs and publications are expected from the Project. In the case of publications, intellectual ownership will be shared between the Government, Bank and IFPRI

## **VII. ACTION PLAN**

- 7.1 The TC will be developed by IFPRI, acting as a consulting firm. The contract will be done in agreement with MEF following Bank procedures for direct contracting. To complete the TC, national and international consultants in addition to research assistants will be required.
- 7.2 A list of specific reports and outputs has been identified and will be listed on the TORs, as annexes of the Plan of Operations. The presentation of these reports will be the responsibility of the Coordinator/Team Leader, who will also be responsible of ensuring the cohesiveness of individual contributions of each member of his team. TORs for the consultancy have been prepared. It is estimated that one mission will be needed to complete the TC.

## **VIII. ENVIROMENTAL AND SOCIAL STRATEGY**

- 8.1 This operation will have no negative social or environmental impacts. It will generate positive impacts by the involvement on the communities in the prioritization and design of the proposed solutions for each region. Furthermore, component four has a specific subcomponent on local capacity strengthening for local government and civil society organizations. Later on, the preparation of specific investment projects will be in accordance with the requirements of the financial institutions and the SNIP.