

PROGRAM IN SUPPORT OF THE FONDO NACIONAL
DE COMPENSACIÓN Y DESARROLLO SOCIAL
(FONCODES II)

(PE-0101)

EXECUTIVE SUMMARY

BORROWER AND: The Republic of Peru
GUARANTOR:

EXECUTING AGENCY: Fondo Nacional de Compensación y Desarrollo Social
[National Fund for Social Compensation and
Development] (FONCODES)

AMOUNT AND SOURCE:	IDB:	US\$150 million (OC)
	IBRD:	US\$150 million
	Local contribution:	<u>US\$130 million</u>
	Total:	US\$430 million

FINANCIAL TERMS AND CONDITIONS:	Amortization period:	25 years
	Commitment period:	3 years
	Disbursement period:	4 years
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%

OBJECTIVES: To continue supporting the improvement of the quality of life of the poorest and most vulnerable segments of the population by financing small projects presented by organized communities.

DESCRIPTION: The evaluations conducted in 1994, the mid-term evaluation conducted in 1995, and the joint supervisory visits by the IDB and the World Bank have led to the conclusion that the staff, organization, and procedures of FONCODES are efficient and that the executing agency is capable of carrying out small infrastructure projects in Peru's poor communities. They also made it possible to identify some areas that needed improvement. Both factors served as a basis for the design of the second stage. The most significant results of the evaluation are set forth in Annex I-1.

The program will have two components: (i) social support and infrastructure projects; and (ii) institutional strengthening and community management.

1. Social support and infrastructure projects

These will focus chiefly on primary education, basic health care services, responsible parenthood, clean water supply, and sewerage and environmental sanitation systems.

2. Economic infrastructure and production development projects

a. Economic infrastructure projects. This subcomponent comprises projects for basic road infrastructure, rural electrification, small irrigation systems, the construction or improvement of artesian wells, land reclamation, afforestation and reforestation, and basic marketing infrastructure.

b. Production development projects. Under this subcomponent, financing will be granted for small production projects both for subsistence farming and to generate income for the beneficiaries.

In view of FONCODES's lack of experience in projects of this type, this subcomponent will be executed on a pilot scale, and not more than US\$12.4 million, or 3% of the program resources earmarked for project financing, may be allocated to finance it.

c. Development project packages (PADs). This is a special line designed for the financing in a single locality of a package of mutually complementary projects - based on the priorities established by the beneficiary community - that can optimize the use of the natural resources in the locality. The projects will be treated as a unit and must focus on one or more production development projects. The socioeconomic evaluation will take into account the package of projects as a whole, which should have a rate of return at least equal to 12%.

3. Institutional strengthening and community management

The institutional development component comprises support for three interconnected activities: decentralization of FONCODES, equipment for the central office and the branch offices, and a training plan for FONCODES personnel and the beneficiary

communities. The total cost of the component is US\$6.8 million.

**ENVIRONMENTAL
CLASSIFICATION:**

At its meeting of January 17, 1996, the Environment Committee classified this as a Category III operation.

BENEFITS:

- A principal benefit of the program will be an improvement in the standard of living, productivity, and incomes of the most disadvantaged segments of the population brought about by the decentralized execution of some 9,000 small projects for basic social and economic infrastructure and production that are of high priority for the target communities. The projects will not only contribute to the generation of immediate benefits in the form of employment and income for the beneficiaries during execution of the works, but will satisfy some of their most urgent and long unmet basic needs.
- The investments made by FONCODES, which account for about 15% of total yearly public investment, give the government an instrument of proven effectiveness for the expeditious, efficient, and highly targeted channeling of a sizable volume of resources to the poorest segments of the population, and have become one of the government's principal mechanisms for social action.
- In addition, FONCODES's operations have made an important contribution to generating conditions for peace and social stability in the country, particularly in rural areas that have been enduring serious violence and insecurity.
- A high level of community approval of the works carried out is achieved by working through the executing units and using a demand-driven approach in project selection, thereby contributing to developing in the communities the capacity to organize themselves and work together to supplement government initiatives.
- The success of this arrangement for the execution of small projects to meet the basic needs of the poorest and most vulnerable segments of the population, the still limited institutional capacity of the line ministries and municipal governments, and the continuing need for an effective, transparent mechanism to channel resources to needy communities have prompted the

government's decision to keep FONCODES in operation and request the support of the Bank and the World Bank for a second stage of the program.

- By implementing production development projects on a pilot scale in this new stage of the production development component, lessons can be drawn to guide the government's future strategy and activities for the financing of this type of projects.
- Lastly, the decentralized operation of FONCODES through its 24 branch offices in the departments has helped develop an ability to work closely with the poorest communities in the country at the regional level to identify, formulate, execute, and supervise social and economic infrastructure and production projects.

RISKS:

- During execution of the first stage, communities in a state of extreme poverty were able to benefit from the participation and technical assistance of NGOs, church groups, and municipal governments, which support is expected to continue in this new stage. Now, however, the emphasis will be on targeting even poorer and more remote groups. Accordingly, since the program is driven by community demand, there is a risk that the weakest and most remote communities will be left out because of their limited ability to formulate and submit projects eligible for FONCODES financing. To minimize this risk, FONCODES has incorporated into the new project cycle a simplified mechanism for project submittal and greater support for preinvestment financing.
- Another risk of the present operation is the long-term sustainability of the investments, for which proper operation and maintenance of the works is required. In the proposed new stage, this risk is being addressed by specific measures such as (i) strengthening the training of communities in the operation and maintenance of their works as part of each project; (ii) making explicit reference during the promotional stage to the financial contributions and commitments that the beneficiaries will have to make in that connection; (iii) involving the beneficiaries directly in construction of the works by requiring them to make a contribution to the project; and (iv) involving the municipal

government and local and regional enterprises in FONCODES projects.

- A risk that usually arises is insufficient coordination with the line ministries and central government agencies and with the municipal governments. Though the mid-term evaluation of the first stage detected certain problems in this area, FONCODES has been completing and updating its coordination agreements with the line ministries and other agencies, with good results in terms of compliance with technical standards and commitments for the operation and maintenance of works. In addition, standing offices for interagency coordination are being set up and new strategies are being examined for working closer with local authorities.
- Finally, a risk common to all social investment funds is the possibility that the executing agency may become politicized and bureaucratized. During the first stage, FONCODES's operations were found to be based on eminently technical criteria, in accordance with FONCODES's specific objectives and purposes. This experience suggests that such a risk should not be significant in the second stage, especially considering that FONCODES operated normally and autonomously, even through the political campaigns that preceded the presidential and congressional elections of April 1995 and the municipal elections in November the same year. In addition, despite a relatively high turnover of executive staff, in recent years FONCODES has maintained a highly professional technical staff with a keen sense of commitment to and identification with FONCODES's main purposes.

**THE BANK'S
COUNTRY AND
SECTOR STRATEGY:**

The Bank's strategy for Peru comprises three major components, the objectives of which are to: (i) support the economic stabilization program and the implementation of structural changes for the purpose of accelerating economic growth and employment generation; (ii) improve the transportation and energy infrastructure and social services for health, sanitation, and education, the impact of which will be seen in the middle and long terms; and (iii) support the government's efforts to reduce poverty by implementing programs such as the proposed operation.

The project presented in this proposal has been designed in keeping with that strategy.

Moreover, the primary purposes of the Bank's strategy in the agricultural sector are to promote private investment, reduce poverty in rural areas, and preserve renewable resources. In accordance with these purposes, the Bank has supported the government's efforts to: (i) improve the land tenure situation of small farmers; (ii) rehabilitate small and middle-scale irrigation projects; and (iii) contribute to the introduction of technological improvements that improve productivity. Since FONCODES's operations will focus on rural areas, the conception and design of the proposed program is consistent with and complementary to this strategy.

**POVERTY
TARGETING:**

The program furthers the goals of social reform and poverty reduction established in the Eighth General Increase in the Resources of the Bank in that the investments are geographically targeted to rural communities in the poorest parts of the country and a significant majority of the direct beneficiaries (more than 60% of them) are low-income groups.

**SPECIAL
CONTRACTUAL
CONDITIONS:**

The borrower, acting through FONCODES, must submit the following as a condition precedent to the first disbursement of the loan:

1. the loan contract with the IBRD and the transfer agreement with FONCODES (see paragraph 3.2);
2. evidence that the independent accounts have been opened (see paragraph 3.28);
3. the operating regulations for the program (see paragraph 3.23);
4. the training plan for the program (see paragraph 2.23); and
5. the evaluation methodology to be used at the annual meetings for the monitoring and mid-term evaluation of the program (see paragraph 3.41).
6. The borrower must submit evidence that the operating manuals for the program have been put into effect (see paragraph 3.23).

Other contractual conditions

1. Up to US\$6.5 million may be recognized as a contribution to the program by the beneficiaries (see paragraph 2.36).

2. Up to US\$12.4 million may be used to finance pilot production development projects (see paragraph 2.9).
3. Up to US\$5 million may be recognized as part of the local counterpart contribution and up to US\$15 million in previous expenditures may be reimbursed from the loan proceeds (see paragraph 3.35).
4. The mechanism for disbursement of the resources of the loan proceeds must be authorized (see paragraph 3.29).
5. The borrower must agree to report any changes in the organic structure or executive staffing of FONCODES (see paragraph 3.3).
6. Annual meetings for program monitoring and evaluation must be held (see paragraph 3.38) and a mid-term evaluation of the program carried out (see paragraph 3.39).

**STANDARD
CONDITIONS:**

The loan contract will contain the Bank's standard clauses on rates, progress reports, bidding and procurement, supervision, maintenance, evaluation, and presentation of financial statements.

**STANDARD
PROCEDURE:**

Pursuant to Section 2(a), Part III, of the Regulations of the Board of Executive Directors, this operation must be presented to the Committee of the Whole for consideration.

I. FRAME OF REFERENCE

A. Introduction

- 1.1 The Fondo Nacional de Compensación y Desarrollo Social [National Fund for Social Compensation and Development] (FONCODES) was created by the Government of Peru in August 1991 in response to the institutional and operational weakness of the line ministries and the limited coverage attained by specialized government programs, which resulted in little or no attention being given to the poorest segments of the population, especially in the small communities remote from urban centers. The principal responsibility assigned to FONCODES was to channel the transfers of funds targeting those segments.

B. The macroeconomic context and economic policy of the government

- 1.2 In 1990, the government adopted macroeconomic adjustment policies and structural reforms to stabilize the economy and lay the foundations for sustainable growth in the long term. Over the last five years, this economic program has wrought a change in the economy, reducing distortions in relative prices and maintaining a tight fiscal policy based on increased tax revenues and caps on government spending in keeping with a monetary policy designed to achieve price stability. It also sought a more efficient allocation of production resources based as the country's comparative advantages and elimination of the barriers that were hindering foreign trade, private investment, and economic growth.
- 1.3 The reforms significantly reduced and redirected the role and activities of the public sector and put the country back on the road to economic growth. This process included implementation of the program for the privatization of government enterprises, the liberalization of foreign trade and the financial market, and the establishment of clear, stable, nondiscriminatory rules for foreign investment. In addition, the labor market was made substantially more flexible.
- 1.4 Encouraging as these developments are, economic recovery has not yet been fully consolidated. Despite the substantial growth over the last few years, per capita GDP is barely at the level of the 1960s. Moreover, only 17% of the economically active population is fully employed, while 74% is underemployed, and the remaining 9% is unemployed. And although income distribution has improved in recent years, it still compares unfavorably with the Latin American average.
- 1.5 To address this situation, the government has decided to focus public spending and social investment on higher-yield and more cost-efficient projects and better target the more vulnerable groups through an orderly, gradual process of functional and

financial decentralization. One of the most important challenges facing the country today is to move from the rapid economic recovery of recent years to a stage of sustainable growth with a reduction in poverty and an improvement in the education, health, and nutrition of the most disadvantaged population.

- 1.6 Since the second half of 1995, new fiscal adjustment measures have been adopted to moderate the pace of economic activity and bring down the high balance-of-payments deficit on current account, which in 1995 was 7.5% of GDP. Thus, though in the period 1993-1995 the economy grew an average of 8.3%, the highest rate in Latin America, this rate is expected to decline to 3%-4% in 1996. Some of the main economic policy objectives of the present administration for the term that began in July 1995 are to: reduce inflation to international levels; develop human capital and increase productivity; complete normalization of relations with all its creditors, with an effort to arrange a comprehensive, final solution to the problem of its foreign debt; achieve sustainable growth of the economy; and redress the balance of payments in the medium term.
- 1.7 As the structural reforms are consolidated and investment and domestic savings rise, the economy is expected to grow at a sustained rate of 5-6% a year. The present conservative management of public finances and strict control of the monetary base, intensification and institutionalization of the economic and social reforms, and the government's commitment to assigning top priority to social investments targeting the most vulnerable segments of the population are the foundations of a process that will generate greater opportunities for the neediest and contribute to a significant reduction of extreme poverty – the cornerstone of the current administration's policies.

C. The government's social strategy

1. Poverty in Peru

- 1.8 Since 1991, Peru has made important strides in its fight against poverty. In the areas of the country for which there are comparable data obtained from surveys conducted in 1991 and 1994, the poverty level has declined from 54% to 46% of the total population, and extreme poverty from 21.5% to 17.7%. However, unmet basic needs remain at high levels: 53% of dwellings have no drinking water, 60% have no sewerage, and 60% no electricity. In the rural areas, where extreme poverty is concentrated, needs are even greater: 90% of dwellings have no drinking water, and 95% of them have no sewerage or electricity.
- 1.9 Although economic growth is expected to gradually resolve the problem of poverty in the medium term, recent experience in Peru shows that economic growth, when it occurs, is concentrated in the coastal areas and certain regions in the center. This is why there has been so much more poverty reduction in Lima than elsewhere in

the country. In Lima, poverty contracted more than 30%, from 49% to 33%, between 1991 and 1994, and by similar proportions in the other coastal areas. In the sierra, on the other hand, urban poverty declined only 1% (from 47% to 46%), and rural poverty only 2% (from 68% to 66%). Almost the same gap can be observed in the growth of per capita consumption, which has been very fast in Lima and very slow in the sierra.

- 1.10 To summarize, economic growth has significantly benefited the poor along the coast, and had considerably less impact on the regions in the sierra and jungle, where most of the poor and extremely poor live. 1/ The challenge facing Peru in its fight against poverty is therefore to formulate and implement a strategy that will bring more government support and more growth to the sierra and jungle regions, especially in rural areas.

2. The government's social action

- 1.11 According to government plans, FONCODES operations are part of a medium-term strategy for the reduction of poverty, which must be grounded in gradual change in the line government agencies operating in the social sectors. This requires, at the central level, the establishment of policies, standards, and procedures for the delivery of social services, and a proper system for the monitoring, evaluation, and regulation of those activities to ensure that they are coherent, of good quality, and cover the most vulnerable population. Moreover, local governments are expected to take on an increasingly active role in the planning and execution of investments in social services through a combination of public financing and, when appropriate, cost recovery.
- 1.12 One of the problems that the current government had to face was the collapse of social spending at the end of the 1980s. In 1990, total spending on education was a mere 2.1% of GDP, and per capita expenditure on health was less than half the figure attained in 1985. One of the principal goals of the government has been to reverse this situation. The restructuring of the tax and customs systems, supported by successive technical-cooperation projects financed by the Bank, led to a significant recovery of fiscal revenue, the increase being largely channeled into social investments. Thanks to this effort, spending on health and education went up from 3.2% to 6.7% of GDP between 1990 and 1995.
- 1.13 In addition to increased outlays in the social sectors, the government has assigned priority to selective intervention targeting the neediest population segments. In 1995, 22% of the entire national budget was allocated to social programs such as FONCODES, the Municipal Compensation Fund [Fondo de Compensación Municipal], and

1/ According to the 1994 survey, 74% of the extremely poor are in the sierra and jungle (59% are in rural and 15% in urban areas).

the National Food Program [Programa Nacional de Alimentación] (PRONAA), which target the poor, and programs for the improvement of health and basic education.

- 1.14 To extend the benefits of the economic adjustment and stabilization program to the poorest segments of the population, in 1994 the government proposed the implementation of a social stabilization plan [Plan de Estabilización Social] (PES) to include a package of policies and programs to promote the assimilation of those segments into employment in production and more equitable and efficient delivery of public goods and services for a sustainable improvement in the situation of the poorest strata of the population.
- 1.15 In response to that request, the Bank approved technical-cooperation project ATN/SF-4627-PE in the amount of US\$1.4 million for a poverty analysis, a review of the public and private institutions providing services to the poor, and the compilation of a natural resources map identifying the localities that promised the best results as targets for poverty-reduction projects. In addition, a pilot project was to be designed and implemented for application of the findings of the studies, from which lessons would be drawn for implementation of the project on a larger scale.
- 1.16 The government and the Bank have agreed that there would be more emphasis on the pilot plan, through which projects would be developed for the sustainable reduction of poverty. The pilot projects are called development project packages [Proyectos Articulados de Desarrollo] (PADs), 2/ and will be organized around one or more of the production development projects to be financed by FONCODES under the proposed program. The PES will provide general coordination for the PADs, and must assign US\$800,000, about one third of its budget, for the selection and development of the pilot projects.

D. Experience of the Bank with social funds

- 1.17 From the time that structural adjustment programs began to be implemented in the countries of the region, the Bank has been consistently supporting the measures they have been taking to alleviate the impact of adjustment on the poor. The Bank has supported with approximately US\$1.1 billion in financing the creation of social investment funds in most countries in the region, and in some cases has funded second and third stages of those programs.
- 1.18 In the 10 years that it has been engaging in operations of this kind, the Bank has built up an important body of experience on the strengths and weaknesses of the funds, which has enabled it to improve their design and efficiency. Among their main achievements, the funds have demonstrated the feasibility of:

2/ See paragraph 2.12.

- a. responsive mechanisms for the approval and execution of small projects for social and economic infrastructure and for the generation of temporary employment in poor localities, directly benefiting those communities;
 - b. mechanisms for coordination with the line institutions and ministries for carrying out complementary operations, especially for education, health, and environmental sanitation, with the rehabilitation or replacement of schools and primary health care facilities;
 - c. transparent project-approval systems and a project cycle with clear and simple mechanisms for project targeting, promotion, evaluation, management, control, and monitoring;
 - d. direct community participation in the selection and formulation of small projects, base on a demand-driven approach; and
 - e. proper targeting of the poorest segments of the population on which government activities have had little or no impact.
- 1.19 However, there are some risks which, though measures have been taken to reduce them, have not been entirely eliminated. These include:
- a. **Maintenance.** This has been a problem in almost all the funds. It stems from lack of training and shortages of funds in the beneficiary communities and from the budgetary and technical limitations of the municipal governments and other institutions responsible for the operation and maintenance of the works. The problem is being alleviated by education and training of maintenance committees in the communities.
 - b. **Politization.** Though this has not occurred frequently, it is important to take steps that will minimize this risk, as there have been isolated cases of funds that have been almost paralyzed by the dismissal *en masse* of their technical personnel.
 - c. **Project diversification.** The funds have been very successful with infrastructure projects, but they have not developed projects of the same quality in other areas of activity that promised qualitative improvements, such as the distribution of teaching materials, training, and child care.
 - d. **Participation by women.** There have been some successes, but no satisfactory level of equity has been attained for participation by women in the stages of project formulation and selection. Nor has it been possible to make women the majority beneficiaries of the temporary jobs generated during execution of the projects.

e. **Temporary nature of the funds.** The social funds justified their creation as a temporary solution in social emergencies. They are all still in operation, however, and several countries have been considering the possibility of granting them permanent status.

- 1.20 As can be seen from the results of the evaluations conducted during execution of the first stage of FONCODES, which are summarized in section F below, the accomplishments and strengths that characterize such programs were present in the Peruvian case. While the risks enumerated above existed, their impact was slighter than in other social funds, except for project maintenance.
- 1.21 To obtain a clearer idea of the yield of the funds and of their future role in a long-term strategy for poverty reduction, the Bank is currently performing a comparative study of those operating in eight countries of the region, including Peru. This study, based on field work done in each country, will answer questions such as the following: What impact do these funds have on poverty and unemployment? How successful are funds that target the poor? How do they relate to the various levels of government and to project sustainability? The study will provide key elements for a report on social development funds being prepared by SDS.

E. Execution and results of the first stage

- 1.22 As a result of implementation of the government's structural reform program, in 1992 the Bank approved technical-cooperation project ATN/JF-3810-PE for US\$4 million equivalent to launch FONCODES and draw up the social program it would implement.
- 1.23 Once its structure had been set up and its managerial and technical staff assigned, FONCODES began to operate with local funds, financing small social support and infrastructure projects. In July 1993, the government requested a Bank loan for US\$100 million equivalent to finance social and economic support and infrastructure projects presented by poor communities, which was approved at the end of that year and put into execution in March 1994.
- 1.24 The World Bank also participated in the financing of FONCODES projects by granting a US\$100-million loan. The two banks participated in parallel operations, each with its own standards and procedures, which obliged FONCODES to maintain dual administrative procedures. 3/

3/ In addition, different countries and agencies, including the European Community, Switzerland, Finland, Japan, The Netherlands, and Germany have cooperated with FONCODES in the financing of pilot projects, most of which target specific geographic areas.

- 1.25 The menu of projects offered by FONCODES as eligible for financing included more than 25 types of projects in support of social and economic infrastructures and production development. Out of this range of projects, the IDB participated in the financing of projects for water supply and sewerage, small irrigation systems, and health and education infrastructure.
- 1.26 At its inception FONCODES targeted the rural and marginal urban poor, financing some 17,000 projects totaling close to US\$650 million, with a significant impact on the poorest regions of the country (80% of investments during the period 1991-1995 targeted provinces classed as poor or very poor – see table I-1). As a result, its operations have reached all 188 provinces in the country; 19,000 classrooms, 750 health posts, 58 health centers and 420 community centers have been built or renovated; water supply and sewerage systems have been installed for 260,000 families and electricity for 57,500 families; and 31,600 hectares of cropland have been reclaimed.

TABLE I-1: TARGETING BY FONCODES
1991-1995

	VERY POOR	POOR	NORMAL	ACCEPTABLE
Population by district	24.3%	24.2%	41.2%	103.0%
FONCODES spending by district	31.1%	49.0%	19.0%	0.9%

Source: FONCODES

- 1.27 Though the original contractual term for disbursements was four years, by December 1995, after only two years of execution, the loan was almost entirely disbursed. The reason for this was that the projects were simple and well targeted, the executing unit system worked well, and FONCODES's administration was efficient.

F. Evaluation of the results of the first stage

- 1.28 FONCODES is probably one of the most evaluated funds in the region. In 1994 two independent consulting firms, CUANTO and SASE, evaluated a total of 101 FONCODES projects and, in 1995, a firm called APOYO conducted an ex post evaluation of 300 additional projects as part of the mid-term evaluation of the first stage and of the process of preparing the loan proposal for a possible second stage. These 300 projects, financed in 1994, were distributed around various regions of the country and covered different types of projects. A large number of direct beneficiaries, members of the executing unit, project operators, local authorities, etc., were interviewed. Annex I-1 includes a more detailed summary of the evaluation conducted by APOYO as well as a selection of the most significant statistical data it contained.

- 1.29 The mid-term evaluation confirmed both the results of the other two evaluations conducted in 1994 and the findings of the numerous joint supervisory visits by the two Banks, leading to the conclusion that FONCODES is a social fund with efficient staff, organization, and procedures that has established an effective, nationwide system to carry out small infrastructure projects in Peru's poor communities.
- 1.30 The large majority of the projects financed were selected and strongly supported by the beneficiary population itself and the works have been providing the services for which they were constructed. Although there were some problems connected with the additional equipment and staff needed for both health posts and schools, almost all the projects were operational and the additional costs, where applicable, were being covered from contributions by users or other sources of local funds. The community participation and executing unit system developed by FONCODES for project execution seems to be a particularly successful method to ensure that the projects reflect local needs and that the communities feel they own the work once it has been completed. The evaluations conducted did not make it possible to measure the direct impact of FONCODES projects on income and employment. However, by reestablishing a positive government presence in areas dominated by violence and the Shining Path, FONCODES has played a significant role in bringing peace to large areas of the country, particularly in the sierra and jungle regions.

1. Institutional issues

- 1.31 While the institutional organization of FONCODES has made it possible to carry out a large number of small projects in the remotest parts of the country and its personnel showed high motivation and a capacity for self-criticism, the evaluation revealed certain issues that required attention. These concerned the need to: (i) streamline and improve the efficiency of the mechanisms for coordination among the departments involved in project evaluation, approval, and monitoring; and (ii) further decentralize the activities carried out at headquarters in Lima to the branch offices, including greater delegation of authority to those offices, especially in regard to project approval. FONCODES has been gradually recognizing these issues, and is taking steps to address them in this second stage.

2. Project cycle

- 1.32 The project cycle was one of the points considered most important during preparation of the first stage because the objectives of the operation could only be attained if there was an orderly system for the execution and monitoring of FONCODES's operations.

- 1.33 The evaluation examined the effectiveness of the project cycle, with generally positive results. Nevertheless, certain elements still required strengthening or adjustment: (i) promotion must be more active and consistent with FONCODES's benchmark annual budget allocations and, in particular, must include information on the obligations assumed by the community when projects under which rates must be charged are assigned priority; (ii) the requirement to present fully completed designs in order to apply for financing limits participation by the poorest communities; (iii) headquarters needs to monitor more completely the branch offices that are authorized to approve projects; and (iv) in some cases, the second disbursement is subject to delays that hinder project execution. Moreover, though project operation has not been directly affected, delays have been detected in entering the works on the public registers.

3. Targeting

- 1.34 FONCODES has made significant progress in the design and implementation of a poverty map and a mechanism for project execution with poor communities. The basic targeting strategy used in the first stage was to allocate resources to provinces in the same proportion as the percentage of the country's poor population living in them. A poverty map at the provincial level was compiled using 11 indicators of unmet basic needs. The poverty index of each province was then weighted by the population to obtain the coefficient for resource allocation. As constructed, the coefficient represents the fraction of the total poor population living in the province and not the province's poverty index.
- 1.35 Since the FONCODES system is based essentially on demand, the resource allocation coefficient is only a benchmark goal. The volume of projects assigned to a province corresponds to the number of applications submitted and approved. Accordingly, to determine the success of the targeting, the scheduled allocation of resources can simply be compared with the actual allocation. For the last three years, a high correlation has been found between the allocations scheduled and actually carried out: 0.83 in 1993, 0.85 in 1994, and 0.84 in 1995. Moreover, 80% of the projects were concentrated in the geographic areas and socioeconomic strata identified on the poverty map as poor or very poor.

4. Community participation in priority-setting

- 1.36 Direct community participation in the priority-setting for projects is one of the most important aspects of FONCODES's *modus operandi*. The evaluation showed that 90% of those surveyed indicated that the project executed was the one that the community needed the most, and 66% indicated that the community itself had directly established it as a priority.

5. Representativity of the executing unit

- 1.37 Of those surveyed, 68% stated that the executing unit had been elected by decision of a majority of the community, 3% indicated that it had elected itself or had been appointed by the mayor, and only 1% referred to the participation of a promoter or project designer in the election. In regard to the procedure for designation of the executing unit, 68% of those interviewed said there had been no problem in its election and 9% said there had been some problem.

6. Supervision during execution

- 1.38 Of the interviewees ^{4/}, 75% indicated that the works had been carried out with adequate supervision and advisory services by FONCODES during their execution, and 72% said that the supervisor's observations had contributed to significant improvements in the execution of the works.

7. Sustainability

- 1.39 More than 80% of the projects are considered sustainable. In the areas of education and health, the projects are operating in accordance with the agreements with the ministries to cover recurrent personnel, equipment, and input costs. Operation and maintenance problems are most common in the water supply and sewerage projects because the commitment by the local government is not always backed up by the necessary technical capability or budgetary resources. In 80% of the jungle projects, 54% of the sierra projects, and 46% of the coast projects, the community participates in operation and maintenance. However, this effort on the part of the communities has not been accompanied by appropriate training or instruction by FONCODES or the local governments.

8. Environmental impact

- 1.40 The evaluation revealed a weakness of FONCODES in the area of environmental protection. An environmental assessment manual and field forms for the review and classification of the environmental impact of projects were prepared, but are being inadequately used. The manual places projects in category A when no special measures are required, in category B when some measures are required to mitigate negative impact, and in category C when special studies or activities are required.
- 1.41 According to the evaluation, these procedures have been applied erratically, primarily because of the following factors: (i) the lack of a permanent environmental specialist at headquarters in

^{4/} The beneficiary community, the executing unit, and the local authorities.

Lima; (ii) the practice of eventually placing virtually all projects in category A, because projects rated B and C are returned to the executing units for documentation to be added demonstrating that the necessary mitigating measures will be taken, on which basis the projects are then upgraded to category A; (iii) insufficient training of branch office staff in environmental protection; (iv) a lack of effective indicators with which to monitor the implementation of environmental procedures; (v) the lack of environmental protection criteria for the supervision phase of the project cycle; and (vi) failure to include the environmental impact of projects in ex post evaluations. All these factors are being carefully reviewed by FONCODES to ensure that environmental criteria will be properly applied in the second stage.

9. Participation by women

- 1.42 The evaluation showed that participation by women was satisfactory in the first stage. Of the women interviewed ^{5/} 92% rated the project executed as top priority in their community. Of the women interviewed who participated in meetings for project selection 60% were of the opinion that a majority of the participants were women, and 32% felt that women were in the minority. Women participated the most in the construction of classrooms, health care posts, programs for the provision of equipment and medical supplies, and literacy programs. In regard to employment generation, however, the data showed that most of the executing unit members interviewed said that the project had not generated any significant number of jobs for women during its execution.

10. Participation by indigenous communities

- 1.43 Although there are no direct data with which to estimate the indigenous population that has benefited from FONCODES, an estimation has been made by superimposing the ethnolinguistic map on the map showing the locations of financed projects. Since 80% of the investments were made in localities rated as poor or extremely poor, and most of the indigenous population lives in these areas, it could be estimated that about 43% of the projects had been executed in areas populated by indigenous peoples.

G. Continuity of FONCODES

- 1.44 The success of this arrangement for the execution of small projects that meet the basic needs of the poorest and most vulnerable population in the country, the still limited institutional capacity of the line ministries and municipal governments, and the continuing need for an effective, transparent mechanism for channeling

^{5/} The women interviewed in the sample represented 41% of a total of 1,463 participants, and this proportion was significantly higher on the coast (53%).

resources in disadvantaged communities, are the reasons for the government's decision to keep FONCODES in operation and request support from the Bank and the World Bank for another stage of the program. In any case, the activities undertaken by FONCODES will become more specialized and gradually be concentrated in localities that have never been served by any government agency and which, because of their small size and remoteness, are not included in such agencies' medium-term expansion plans.

H. The Bank's country strategy

- 1.45 The Bank's strategy for Peru has three major components, the objectives of which are to: (i) support the economic stabilization program and the implementation of structural changes to accelerate economic growth and employment generation; (ii) improve the transportation and energy infrastructure and social services for health, sanitation, and education, which will produce results in the medium and long terms; and (iii) support the government's efforts to reduce poverty through the implementation of programs such as the proposed operation.
- 1.46 In the agricultural sector, the main goals of the Bank's strategy are to promote private investment, lower rural poverty rates, and preserve renewable resources. In keeping with those aims, the Bank has supported the government's efforts to: (i) improve the land tenure situation of small farmers; (ii) rehabilitate small and medium-scale irrigation projects; and (iii) contribute to the introduction of technological improvements to increase productivity. Since FONCODES operations will focus on rural areas, the conception and design of the proposed program are consistent with and complementary to this strategy.

II. THE PROGRAM

- 2.1 The program design is based on the findings of the evaluation conducted on the first stage and is consistent with the government's social strategy. In addition, in view of the government's request that the program be cofinanced by the IDB and the World Bank, both the evaluation of the previous stage and the analysis of this new operation were carried out jointly with the IBRD, with the two banks establishing a single project team together. The program described below has thus been agreed upon by the two institutions and the country.

A. Purpose

- 2.2 The purpose of the program is to continue supporting improvement of the quality of life of the poorest and most vulnerable population by financing small projects for social and economic infrastructure and production submitted by organized communities.

B. Description

- 2.3 Under the previously described strategy it has been decided that FONCODES's project portfolio is to gradually shift towards projects for economic and production infrastructure. This means that FONCODES will place greater emphasis on stimulating the demand for such projects.
- 2.4 On this basis, the program will have two components: (i) social support and infrastructure projects, and (ii) institutional strengthening and community management. The details of each of these components are presented in Annex III-2 (Clause Five, Operating Regulations).

1. Social support and infrastructure projects

- 2.5 This component is for projects to meet basic needs and improve the satisfaction of needs for which only precarious solutions exist. These projects will target chiefly primary education, basic health care services, responsible parenthood, clean water supply, sewerage systems, and environmental sanitation.

2. Economic infrastructure and production development projects

a. Economic infrastructure projects

- 2.6 This subcomponent comprises projects for basic road infrastructure, rural electrification, irrigation systems, the sinking or improvement of artesian wells, land reclamation, afforestation and

reforestation, and basic marketing infrastructure. It will also include training in the use and maintenance of works, where necessary.

- 2.7 Projects involving small irrigation systems, land reclamation, afforestation, and reforestation have been initiated by various NGOs and by the National Watershed Management and Soil Conservation Program [Programa Nacional de Manejo de Cuencas Hidrográficas y Conservación de Suelos] (PRONAMACHCS), with various methods of recognizing the unskilled labor provided by the beneficiaries. In the case of the NGOs, this labor is compensated through wages based on rural sector values, while PRONAMACHCS considers the labor a contribution from the beneficiaries and is therefore unpaid. In view of the fact that this situation causes distortions affecting in particular the poorest members of the population, who need jobs for their livelihood, the government has undertaken to agree with the Bank, within three months of the signature of the loan contract, on a method to compensate unskilled labor for this type of project when eligible for financing with program resources.

b. Production development projects

- 2.8 This subcomponent is for the financing of small production projects both for subsistence farming and to generate income for the beneficiaries. They could include projects in agriculture, handicrafts, mills, and storehouses, among other areas. The menu of projects will be flexible to allow genuine community participation in the identification of projects are best suited to local characteristics, pursuant to the program objectives.
- 2.9 Because of FONCODES's limited experience in projects of this kind, which accounted for only 1% of investments in the first stage, this subcomponent will be executed on a pilot scale, and not more than US\$12.4 million, or 3% of the program resources allocated to project financing, may be used for this subcomponent.
- 2.10 In keeping with their purpose, production projects may be of two types: (i) those essentially for the subsistence of the families in the community, and targeting only extremely poor communities, and (ii) those for the production of goods to be marketed outside the community, such as handicrafts, mills and storehouses, or agricultural projects such as small animal farming, llama breeding, bee-keeping, and fish farming. Projects of this latter type will require careful analysis of the market conditions in which they will be operating.
- 2.11 The parameters for placing them in one category or another will be the type of good to be produced and the expected production volume.
- 2.12 Each production project will include specific mechanisms and resources for monitoring, which must afford FONCODES a detailed understanding of the associated problems and benefits.

- 2.13 In this new stage, FONCODES will not include among the options the financing of projects for credit to microenterprises, which is being provided by other government agencies.

c. Development project packages (PADs)

- 2.14 This is a special line designed to finance a series of mutually complementary small projects in a single locality - based on priorities established by the beneficiary community - so as to optimize use of the local natural resources. The projects will be treated as a unit and must be centered around one or more production development projects. The socioeconomic evaluation will take into account the package of projects as a whole, which should have a rate of return at least equal to 12%.

3. Institutional strengthening and community management

- 2.15 In designing the component for the strengthening of FONCODES and the outfitting of its branch offices, the experience acquired by the latter was deemed sufficient to allow them to become the source of technical support for local governments. In addition, the training to be provided to the communities will improve their participation in ensuring the sustainability of the projects and increase their awareness of the environment and the need for participation by women.
- 2.16 The institutional development component comprises support for three interconnected activities: (i) the FONCODES decentralization process, (ii) the outfitting of the central and branch offices, and (iii) a plan for the training of FONCODES staff and for the target communities in project management. The total cost of the component is US\$7.8 million.

a. Decentralization

- 2.17 This subcomponent will support consolidation of the decentralization begun in 1994. The purpose of the plan is to improve the effectiveness of FONCODES operations by reducing project processing time, so that community needs can be promptly addressed. In addition to the headquarters in Lima, there are currently 24 branch offices, six of which have been granted delegation of authority on a trial basis to afford them some degree of autonomy in project approval (three can approve projects of up to US\$20,000 and three can approve projects of up to US\$40,000). Of the FONCODES's project portfolio, 15% has been delegated to the branch office level. Based on the analysis at headquarters of branch offices operation a plan has been designed to complete decentralization of the 24 branch offices within two years. In 1996, 50% of the projects in FONCODES's portfolio will be conducted by the branch offices, and this proportion will rise to 90% by 1997. This decentralization process is consistent and coordinated with both the

training plan and the program for the outfitting of the offices. The cost of this activity is estimated at US\$1 million.

b. Outfitting

- 2.18 The outfitting program will be completed in three years at an estimated cost of US\$3.9 million. It includes the purchase of new vehicles and repair of those already on hand, the provision of equipment, furniture, and fixtures for the offices, and the installation of telephone lines and radio communications equipment. Regarding computer software and hardware, in the first stage a system was designed that afforded adequate control of operations. In view of the large number of projects, however, their diversity, and FONCODES's decentralization plans, this system has had to be redesigned and adjusted to the new situation.

c. Training

(i) FONCODES personnel

- 2.19 This subcomponent will support the training plan, which has been designed for the personnel at FONCODES's headquarters and in its branch offices. Approximately 300 staff members at all levels will be trained through two programs. Each program will be subdivided into courses, the sizes of which will vary depending on the subjects. The first program, on institutional management and techniques and instruments for operations management, will be 40 hours long and will target executives, professionals at headquarters and the branch offices, and outside evaluators and supervisors. About 150 persons will attend, of whom 70 (47%) will be selected in the branch offices as part of the institutional strengthening of decentralization. The courses will include training modules to increase the awareness of FONCODES staff of the importance and benefits of gender analysis, and the changes made in the operations manuals concerning participation in projects by poor farming and indigenous communities and by women.
- 2.20 The second program will be on administrative techniques and data processing, with a duration of 50 hours, and will target the technical and support personnel, to facilitate FONCODES's implementation of the new project cycle and streamline application processing. It will be attended by 150 persons, of whom 90 (60%) will be chosen in the branch offices. The two programs will have a combined cost of approximately US\$600,000.

(ii) Community management

- 2.21 Altogether about 828 workshops will be held to train some 41,000 beneficiaries and municipal government and NGO staff. The workshops will be organized by the 24 branch offices, with an average of 12 events a year, and will focus especially on promoting community organization to encourage project management, participation by

women, and environmental protection. The cost of this phase has been estimated at US\$1.8 million.

- 2.22 As a condition precedent to the first disbursement, FONCODES will submit a training plan itemizing all the activities to be carried out over the three-year period and the respective timetable.

C. Sizing

- 2.23 At present FONCODES has a pipeline of over 3,700 projects totaling about US\$240 million, which have already been favorably evaluated. Another 9,000 projects totaling about US\$460 million are in process of evaluation. Based on past experience, if 25% of the projects pending evaluation are rejected, there would be an inventory available for this second phase of more than US\$580 million (Annex II-1). Of these, the economic infrastructure projects to be assigned priority in this stage represent about 40% (US\$230 million), almost twice as much in value as those financed under the first program. In addition, based on recent experience, some 3,500 new eligible projects totaling some US\$200 million are expected to be added to the FONCODES portfolio every year.
- 2.24 As the agencies and ministries of education and health have gradually been strengthening their operating capacity, and in view of the large number of projects in the FONCODES pipeline, new applications for the financing of infrastructure projects in these areas will be taken on by the line agencies and ministries. Accordingly, for this new stage FONCODES has decided to finance only projects for infrastructures in education and health that are already in its pipeline. The capacity of these institutions to take on new projects will be reviewed at the annual followup meetings.
- 2.25 The Government of Peru has asked the Bank for a US\$150 million loan, and the IBRD for a similar, concurrent loan for a four-year program totaling US\$430 million, including US\$130 million in local counterpart funding, for the execution of some 9,000 small projects in poor communities.
- 2.26 In view of the experience and operating capacity of FONCODES demonstrated in the first stage, the sizable pipeline of projects, and the government's commitment to give assign priority to social investments targeting the poorest population, the amount of the proposed program is considered appropriate.

D. Cost and financing plan

1. Financing

- 2.27 The proposed Bank loan, for the equivalent of US\$150 million, would be from the ordinary capital and would finance about 35% of the total cost of the project. This percentage is consistent with document AB-1704 on the Eighth General Increase in the Resources of

the Bank, as the maximum percentage to be financed with foreign exchange for Group B countries, since the program geographically targets the poorest areas of the country and low-income groups constitute a significant majority of the direct beneficiaries.

- 2.28 The financing plan would be as follows, broken down by investment category and source of funds:

TOTAL COST OF THE PROJECT
(US\$ thousands)

CATEGORY	IBRD	IDB	LOCAL CONTRIB.	TOTAL	%
I. Projects	146,100	146,100	128,500	420,700	97.8
1.1 Investment projects	141,800	141,800	124,700	408,300	94.9
1.2 Production projects	4,300	4,300	3,800	12,400	2.9
II. Institutional strengthening	3,900	2,400	1,500	7,800	1.8
2.1 Equipment and refurbishing of buildings	2,100	600	1,200	3,900	0.9
2.2 Training, followup and evaluation, consulting services and audits	1,800	1,800	300	3,900	0.9
III. Inspection and supervision	0	1,500	0	1,500	0.4
TOTAL	150,000	150,000	130,000	430,000	100.0

- 2.29 Regarding interest accruing during the program execution period, it was agreed with the country that it would not be included in the loan.
- 2.30 To simplify project administration, the government asked for cofinancing from the two Banks instead of two parallel projects. This would be feasible because: (i) both Banks would be financing the same types of projects throughout the country; (ii) the equipment required for the project has been divided into two groups so that each Bank may use its own procurement procedures, with the IBRD financing the information processing, office, and communications equipment and the refurbishing of the offices, and the IDB financing the procurement of the vehicles for the branch offices; and (iii) there should be no problems in the hiring of services to carry out the institutional strengthening activities, since it has also been divided between the two Banks, with the IDB in charge of training FONCODES staff and the IBRD in charge of the program for training the staff of the executing units, NGOs, and municipal governments, and the community leaders.

2. Local counterpart contribution

- 2.31 The amount of the local counterpart contribution, the equivalent of US\$130 million over the three years, is proportioned to the amounts invested by FONCODES from treasury resources in the last two years (about US\$56 million in 1994 and US\$46 million in 1995). Consequently, no problems are foreseen in its timely allocation by the government. The following items will be recognized as part of the local contribution: (i) part of the additional operating costs of FONCODES, and (ii) the resources to be channeled from other sources through the project cycle agreed upon for the same types of works.
- 2.32 Moreover, while in the first stage the government delivered to FONCODES resources that far exceeded the amount agreed upon as the counterpart contribution to that project, in this new operation fiscal restrictions would prevent such a situation from occurring and the resources provided would be limited to the program requirements.

3. Beneficiary contribution

- 2.33 In the first stage, beneficiaries could contribute to projects either by donating land or materials, making contributions in cash, or providing labor. However, there was no standard procedure for setting the level of beneficiary contributions, nor was there any mechanism for their ex post measurement.
- 2.34 For the second stage, it has been agreed that, to regulate the level of contribution that FONCODES requires of beneficiaries, the community will be asked to contribute at least 10% of the unskilled labor required for execution of the project, free of charge. Contributions of unpaid labor instead of payment of wages below market, as was done in the first stage, will avert distortions in the labor markets and, to ensure transparency and clarity, will be required for all types of FONCODES investment.
- 2.35 Similarly, to regularize the levels of beneficiary contributions, it has been agreed that the community's contribution will be established in the project budget and considered part of the project cost for purposes of evaluation. Up to the equivalent of US\$6.5 million in such contributions (5% of the local counterpart contribution), not to exceed 10% per project, may be recognized as part of the local counterpart contribution. In addition, they will be monitored during project execution to determine the differences between the contributions in labor estimated in the budget and the contributions actually made by the community.

4. Cost breakdown

- 2.36 The amount of category I, for the financing of about 9,000 projects, is US\$421.7 million. The average cost of each individual project is estimated at the equivalent of US\$47,000, which is

considered consistent with the average cost per type of project in the first stage and the expected restructuring of FONCODES's portfolio.

- 2.37 The resources earmarked for category II, for the institutional strengthening component, are the equivalent of US\$6.8 million, of which US\$3.9 million will be allocated to the equipment and refurbishing of offices needed to complete the decentralization of FONCODES. The balance of US\$2.9 million equivalent will be used to finance: (i) training for the managerial, technical, and administrative personnel of FONCODES and the outside evaluators and supervisors of the branch offices; (ii) the training workshops for the communities, municipal governments, and civil society; (iii) the consultants working, among other areas, on the decentralization program; (iv) the socioeconomic impact and followup evaluations; and (v) the external audits of FONCODES and the project. The estimated cost of each item is considered reasonable, having been calculated on the basis of past FONCODES experience during the first stage and the specific queries by FONCODES to different domestic suppliers.

**BREAKDOWN OF THE INSTITUTIONAL STRENGTHENING COMPONENT
BY SOURCES OF FINANCING
(US\$)**

CATEGORY	IBRD	IDB	LOCAL CONTRIB.	TOTAL
II. Institutional strengthening	3,900,000	2,400,000	1,500,000	7,800,000
2.1 Equipment and refurbishing	2,100,000	600,000	1,200,000	3,900,000
- Equipment	1,800,000	600,000	900,000	3,300,000
- Refurbishing of offices	300,000		300,000	600,000
2.2 Training, followup and evaluation, consultations and audits	1,800,000	1,800,000	300,000	3,900,000
- Training of FONCODES personnel		600,000		600,000
- Training workshops for communities, municipal governments, and civil society	1,800,000			1,800,000
- Consulting services		200,000		200,000
- Followup and evaluations		1,000,000		1,000,000
- External audits			300,000	300,000

5. The Bank loan

2.38 The terms and conditions of the Bank loan would be:

Source of funds	Ordinary capital
Amount	US\$150 million
Terms:	
Amortization period:	25 years
Grace period:	4 years
Commitment period:	3 years
Disbursement period:	4 years
Interest rate	variable
Credit fee	0.75% p.a. on undisbursed balances
Inspection and supervision	1% of the loan amount

III. EXECUTION

- 3.1 The operation has been conceived as a project cofinanced by the IDB and the IBRD, and its execution has been designed accordingly. The two Banks have agreed with the country on the procedures, organization, and timetables so that they will meet the requirements of both institutions. Consequently, for the program to be executed in its entirety, it has to be processed completely by both Banks.

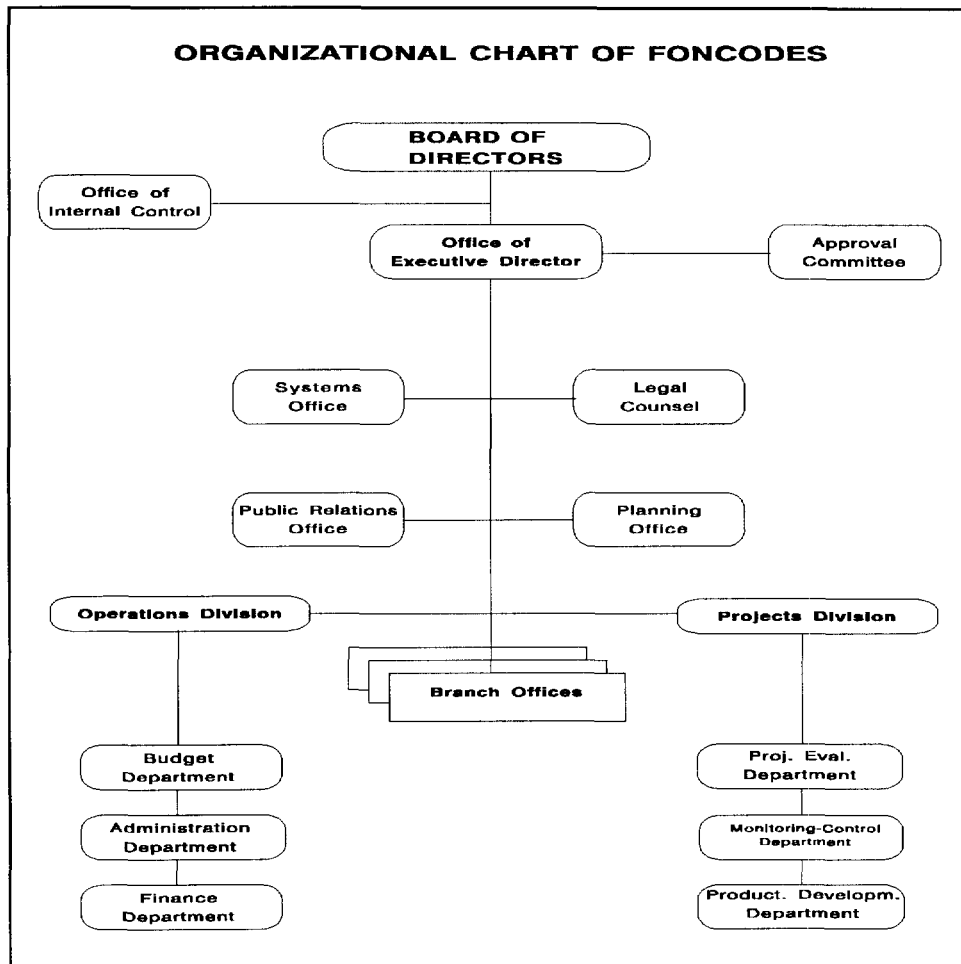
A. Execution of the program

- 3.2 The proposed financing would be granted to the Government of Peru and its execution would be entrusted to FONCODES, to which the proceeds of the loan and the counterpart contribution would be transferred as the program is executed. As a condition precedent to the first disbursement, the following documents must be presented to the Bank: (i) the signed contract between the government and the IBRD, and (ii) the signed agreement between the government and FONCODES for transfer to the latter, in the form of a grant, of the proceeds of the loans and the local counterpart contribution. The agreement will stipulate that FONCODES agrees to fulfill all of its obligations as the executing agency for the program set forth in the loan contracts.

B. FONCODES

- 3.3 FONCODES has a simple organic structure and reports to the Office of the President of the Republic. Its operations are determined by a board of five directors, which is chaired by the Minister of the Presidency. The board sets general policies, regulates and supervises the institution's general operations, and approves projects above US\$100,000. One of the members of the board is appointed as executive director to act as the legal representative of FONCODES and to implement the board's decisions. Until 1995 there was a general manager in charge of three divisions: project evaluation, monitoring and control, and operations. In March 1996, the board changed that structure, eliminating the position of general manager and reducing the number of divisions to two: projects and operations. FONCODES thus sought to eliminate duplications, improve communication and coordination among the divisions and, above all, make the organic structure of its Lima headquarters consistent with the decentralization program. This new organic structure, which is considered adequate in principle, will undergo specific evaluation in the annual followup meetings. The present organizational chart is presented in figure 1.
- 3.4 The FONCODES has a headquarters staff of 283, of whom 203 are professionals with higher education; the branch offices employ 138 outside evaluators and 379 supervisors who provide support in the

field, and are hired for specific projects as needed and for the duration of the respective works.



C. New project cycle

- 3.5 In view of the findings and recommendations of the evaluations on the first stage and the institutional changes and adjustments that will be made in the structure of FONCODES for this second stage, the project cycle has been modified mainly in regard to targeting, promotion, project processing, evaluation, and sustainability.

1. Targeting

- 3.6 For the second stage, FONCODES has revised its targeting mechanism to allocate more resources to communities in extreme poverty. It has defined as its main target population 13,500 localities classified as rural which have between 40 and 300 families each. A questionnaire has been used to obtain information for a more

accurate, up-to-date measurement of the unmet needs in the localities. The information will be used to allocate resources to extremely poor rural areas. FONCODES will continue to accept applications from other areas of the country, though it will assign lower priority to them.

- 3.7 Since the poorest districts have neither the technical nor the financial capacity to prepare good projects, FONCODES will assign a larger amount of resources for promotion and training in the areas of greatest poverty so that more projects will be approved.

2. Promotion

- 3.8 At the district level, there are areas of extreme poverty in the jungle and high Andean regions with inadequate routes of communication, few factors of production, and no knowledge of new and easily accessible production practices and techniques, which have not applied for support from FONCODES or have presented few or unsatisfactory applications.
- 3.9 Because FONCODES's project promotion work to date has not been very active in the more remote areas, institutional reorientation should be associated with an aggressive promotional campaign that will help increase the number and improve the quality of the projects generated by the priority demand of the poorest localities.
- 3.10 FONCODES's promotional work will have the following features: (i) it will target the districts of extreme poverty (poverty map) and the areas in which projects have not yet been financed; (ii) it will be carried out in the branch offices by their staff professionals, outside evaluators and supervisors, and consultants and/or consulting firms; and (iii) it will develop the capacity of communities to identify, prioritize, and operate projects.

3. Project processing

- 3.11 The project cycle includes the presentation of a project profile by applicants before an application is filed. Once the profile has been approved, it is returned to the executing unit so that the project can be prepared. This procedure favors the poorer communities and at the same time spares the applicant populations needless expense and unwarranted expectations.
- 3.12 Environmental protection procedures have been added to and modified in the methodology and operating manuals to provide elements for the ex ante and ex post measurement of proposed measures to mitigate any adverse environmental impact.

4. Sustainability

- 3.13 For new projects, an evaluation of their sustainability is required in the project preparation guide. Furthermore, to address some of

the sustainability problems encountered in the past, training in operation and maintenance and cost recovery will be mandatory for certain projects. FONCODES is working with the municipal governments and beneficiaries to identify appropriate ways for them to take on more responsibility for the operation and maintenance of their projects.

- 3.14 Moreover, FONCODES and the line ministries are coordinating their activities. The ministries will review the projects in their respective areas, identify the operating and maintenance costs, and participate in project monitoring. They will thus be able to plan the project completion dates and budget in good time the required personnel and equipment so as to minimize any delay in setting the projects into operation.

D. Project eligibility criteria

- 3.15 The following general eligibility criteria must be met by all projects financed with resources of the program, regardless of the type of project: (i) the cost of each project may not exceed the equivalent of US\$250,000; (ii) at least 50% of the direct beneficiaries must be members of low-income groups and have incomes below the poverty line established by the Bank and the country; (iii) each project must include, when necessary, proof of possession of legal title, rights of way, and other rights to the land, and where appropriate the waters, on which the works are to be executed; (iv) projects must have all components (financial and institutional) needed to guarantee the operation and, if applicable, the maintenance of the works; (v) a project must not have any negative environmental impact, or, if it does, the latter must be mitigable at reasonable cost; and (vi) projects must fit into the areas of activity of the program.
- 3.16 In addition to the general eligibility criteria, for each type of project a set of specific criteria have been established which must be met for a project to qualify for financing under the program.

E. Project evaluation

- 3.17 To ensure that the lowest-income sectors are targeted, projects must be small and simple to qualify for financing from program resources. In keeping with this requirement, the evaluation systems must also be simple and easy to use.
- 3.18 In this context, every project proposed must meet the cost-efficiency criteria (cut-off points) established for each region and type of project. For projects in the agricultural sector (small-scale irrigation, land reclamation, artesian wells, afforestation and reforestation, basic marketing infrastructures) that exceed US\$60,000, a cost-benefit analysis will continue to be required and must show a rate of return above 12% at market prices.

Cost-benefit analysis will also be required for all market-oriented production projects (type B projects), regardless of their cost.

- 3.19 Projects will be properly supported by technical evaluations based on information obtained from visits to the field by outside specialized personnel hired by the regional offices. As part of the project evaluation process, FONCODES will compare the unit costs of the proposed works to the benchmark prices in a computer data base. This data base contains information on costs at the regional level for some 3,000 inputs; the 250-300 of them that are of greatest importance are closely monitored and updated every two to three months with information collected from more than 60 supply centers nationwide.
- 3.20 The cut-off points established for the first stage gave satisfactory results, affording simple and rapid evaluation of the projects. For this second stage, the cut-off points will be updated and completed on a regional basis and new cost-efficiency criteria defined for the new types of projects to be covered by the program, such as community centers, land reclamation, road infrastructures, basic marketing infrastructure, afforestation and reforestation, and rural secondary electrification. Annex III-1 presents a summary of the cut-off points that FONCODES will use for the different types of eligible projects.
- 3.21 The Bank has been monitoring execution of the first stage of the project through visits to the field and supervision missions, most of them carried out jointly with the IBRD. These regular supervisory visits by the two Banks have confirmed that the regional standard unit price system and the cut-off points and cost-efficiency indicators established for the types of projects are actually used and applied. The analysis of the operation established that the methodology of cost-benefit analysis for agricultural projects and the cut-off points established for the different types of eligible projects were being applied.

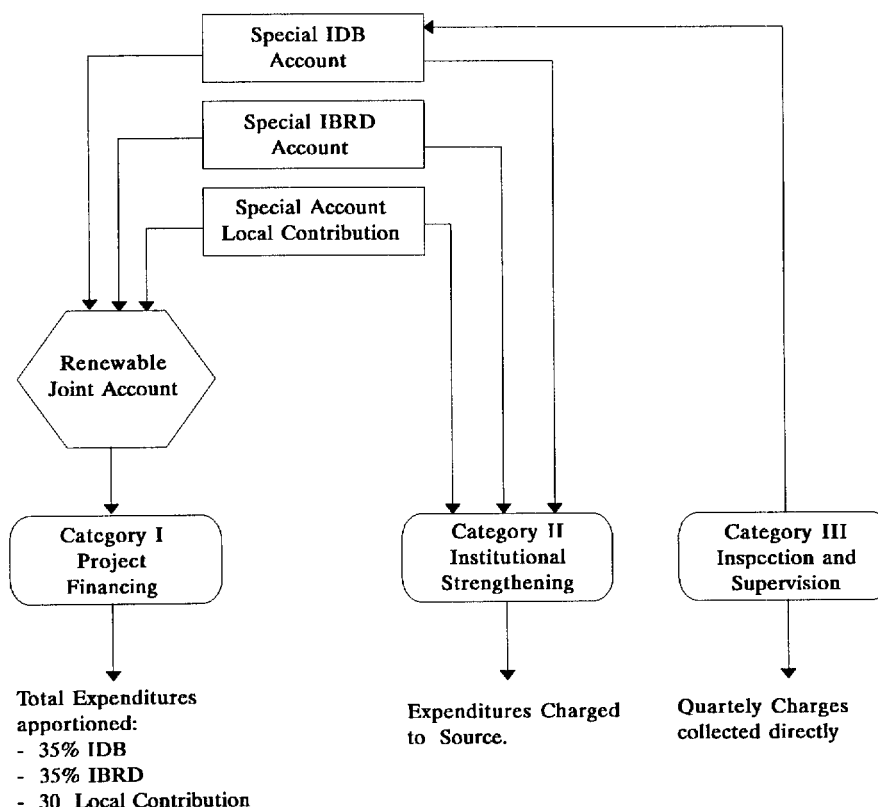
F. Interagency coordination

- 3.22 Since program resources will be used to finance projects for which other agencies are responsible, close coordination between FONCODES and the ministries and institutions of the respective sectors will be necessary. Interagency agreements have been signed or ratified to ensure, at least, that: (i) the projects conform to the policies, standards, and guidelines for the sector; (ii) there is no duplication of effort; and (iii) there are sufficient guarantees that the projects will be properly operated and maintained. The agreements required are itemized in Annex III-2, all of which have been signed. Only the one with PRONAMACHCS still needs to be adjusted.

G. Financial administration

- 3.23 Use of all the program resources will be subject to the standards and policies of the two Banks and to the procedures and guidelines set out in FONCODES's operating manuals and the Operating Regulations of the program (Annex III-2). The entry into force of the manuals and Operating Regulations will be a condition precedent to the first disbursement.
- 3.24 Owing to the large number of projects and small executing units, this program calls for a different strategy for portfolio and disbursement management. A procedure has therefore been devised under which the "project" category is to be financed as follows: 35% from the IDB, another 35% from the IBRD, and the remaining 30% from the local counterpart contribution.

CASH FLOW BY INVESTMENT CATEGORY



H. Project financing

- 3.25 FONCODES's disbursements begin with payment of per diems for the project designers who will participate in preparation of the profile. Later, if the project is approved, the following payments are made: (i) cost of project preparation, (ii) cost of external evaluation, and (iii) the first disbursement or advance of funds, which may amount to as much as 60% of the total cost. In addition, a record is made of the actual contribution by the beneficiaries.
- 3.26 Once project execution has progressed and the outside supervisor has conducted his visit, financing is provided for (i) the second disbursement for the project, and (ii) the fees of the outside supervisor.

I. Financial control

- 3.27 Detailed accounts of all costs and recognized expenditures will be kept for each project and also in the aggregate for the program as a whole, without predetermining the sources of financing. The records will be kept separate for the rendering of accounts and justification of advances of funds, with a single table being drawn up detailing the payments made in each period, which must accompany requests for reimbursement of expenses incurred and justification of advances of funds from both Banks.
- 3.28 As a condition precedent to the processing of the first disbursement, FONCODES must have opened the special accounts for each of the Banks and for the treasury resources, and a renewable joint account through which transfers or payments will be made to finance operations in the "projects" category. All transfers from the special accounts to the joint account will be made in FONCODES, and semiannual reports will be prepared for each Bank.
- 3.29 In view of the large number of projects and of the cofinancing with the IBRD, it is recommended that, for purposes of disbursements, the respective supporting documents be reviewed by sampling in FONCODES offices. Advances of funds from the Bank for projects will be justified by a list showing all charges and amounts recognized during the justification period, which list must be presented to both Banks and must indicate the percentages of financing and the cumulative amounts for each one. FONCODES will keep records and complete files for each operation that has generated an expenditure. All supporting documentation, such as the project evaluation, the summary sheet, receipts, reports, supervision documents, etc., will be duly filed by FONCODES to the satisfaction of the Banks, and remain at their disposal and at that of the external auditors for any reviews that may be required.

J. Financing of the institutional strengthening

- 3.30 To make the payments against the financing for activities in the category of investment for institutional strengthening, the current procedures and policies of each of the Banks will be followed for the procurement of goods and services, as broken down among the items that each institution is financing. No difficulties are foreseen in the use by FONCODES of different procedures for the financing of each item.

K. Execution timetable

- 3.31 The program resources will be committed within a period of three years from the effective date of the loan contract, and are expected to be disbursed within four years from that same date. Commitment of resources is defined as the signing of the agreement to finance a project by FONCODES and the executing unit. The gap between the periods for the commitment and disbursement of resources is appropriate to allow for the completion of projects contracted for six months before end of the life of the program.

L. Procurement procedures

- 3.32 In the procurement of goods and service and the awarding of construction contracts under the program, the Bank's standard procedures will be followed. It is recommended that international competitive bidding procedures be followed for the procurement of goods or services in amounts of US\$350,000 equivalent or more, and in the case of works, for contracts over US\$1 million. When the amount of a construction contract is less than the equivalent of US\$60,000, the executing unit will carry it out on force account. In the case of works ranging between US\$60,000 and US\$250,000, the price competition system will be used. Both cases are provided for in Peruvian legislation, and the applicable procedures are detailed in the respective FONCODES manuals. In any event, it is recommended that the local procedures be followed for the awarding of construction contracts, provided they do not conflict with Bank policies. Consulting services will be hired following the Bank's procedures, as described in Annex C.
- 3.33 The following execution timetable has been projected on the basis of current demand, the executing capability of FONCODES, and the availability of counterpart resources.

ESTIMATED DISBURSEMENT TIMETABLE

YEAR 1	YEAR 2	YEAR 3	YEAR 4	TOTAL
25%	30%	30%	15%	100%

M. Advances of funds and recognition of previous expenditures

- 3.34 In view of the pace of execution achieved in the previous stage, it is recommended that an advance of funds be granted in the amount of 10% of the total amount of the proposed loan (US\$15 million).
- 3.35 FONCODES's evaluation of the projects in its pipeline indicates that in 1996 a large percentage of them will meet the requirements established in the program's Operating Regulations. Accordingly, to continue the present flow of FONCODES's investments, it is recommended that expenditures incurred since January 1, 1996, totaling up to US\$15 million, both for the projects it is financing and for the institutional strengthening, be retroactively recognized. In addition, up to US\$5 million in investments made since that date may be recognized as part of the local counterpart contribution. Any such expenditures must have been made for projects to be financed under this second stage which comply with the requirements and Operating Regulations of the program.

N. Inspection and supervision

- 3.36 The Bank will establish the inspection procedures it deems necessary for proper execution of the program, and FONCODES must provide all cooperation required for the accomplishment of this purpose. The amount of US\$1.5 million will be deducted from the loan for deposit in the accounts of the Bank for general inspection and supervision.

O. External auditing

- 3.37 The financial statements of the program and those of FONCODES must be certified by a firm of independent auditors acceptable to the Bank and the IBRD. The statements must be presented within 120 days following the close of the government's fiscal year (December 31) throughout the program execution period, beginning with the audit for calendar 1996, in accordance with terms of reference acceptable to both Banks. The auditors will supervise, among other things, the expenditures of the project, the special accounts, and the project accounts, and the statements of expenditure and internal control.

P. Followup, evaluation, and progress reports

1. Followup meetings and evaluations

- 3.38 Every year FONCODES and the Banks will hold followup meetings to review program execution, in terms of both institutional development and operations. They will also examine the results of an ex post evaluation of a representative sample of the projects financed during the year with resources of the program. These evaluations must be conducted by an independent specialized firm following a methodology agreed upon by FONCODES and the Banks. At these

meetings, should the findings of the review so warrant, such measures as may be required for the proper execution of the program will be adopted.

2. Mid-term evaluation

- 3.39 FONCODES and the Banks will conduct a mid-term evaluation of the program 18 months after the effective dates of the loan contracts or once 40% of the resources of the Banks' loans have been committed, whichever happens first.
- 3.40 This evaluation will include at least an analysis of the institutional development of FONCODES, its operating systems, the project cycle, and the targeting and socioeconomic impact of the investments. It will also include an ex post evaluation of a representative sample of the projects financed under the program. If that evaluation should find any significant deficiencies in the execution of the program, the Banks may refuse to authorize the commitment of further program resources until FONCODES has taken the necessary corrective measures to enable it to continue executing the program properly.
- 3.41 The methodologies for the evaluations to be examined in the annual followup meetings and for the mid-term evaluation are being developed by FONCODES and must be agreed upon with the Bank as a condition precedent to the first disbursement. The methodologies make special reference to the types of projects that the Bank did not finance in the first stage.

3. Progress reports

- 3.42 Throughout the program execution period, FONCODES will present to the Bank suitably detailed semiannual progress reports on the works financed, the beneficiaries served, and the procedures followed in use of the loan proceeds, and the reports and recommendations presented by the independent firm that will periodically evaluate a representative group of completed projects.

Q. Ex post evaluation of the program

- 3.43 Since the projects are for small amounts and will be rapidly completed, an ex post evaluation of the program is to be conducted. However, the evaluation methodologies for both the yearly followup meetings and the mid-term evaluation will include indicators and parameters that can be analyzed if the Bank decides to carry out an ex post evaluation of the program.

R. Benchmarks

- 3.44 Projects completed and in operation. At the end of the first year, it will be determined whether 1,200 projects have been completed and are in operation and 1,800 are under construction. In the

second and third years, 6,000 additional projects will be completed and put into operation, and at the end of the third year, 1,800 projects will be under construction.

- 3.45 Targeting. In the first year, it will be determined whether at least 85% of the resources allocated for each province have been approved. In the second year, that proportion will be at least 87%, and in the third year, at least 89%.
- 3.46 Decentralization. In the first year, 70% of FONCODES's projects should be approved by the branch offices. Starting in the second year, that proportion should be 90%.
- 3.47 Training. (i) FONCODES personnel: 60% should be trained in the first year and the remaining 40% in the second, and (ii) communities: 25% of the activities should be completed in the first year, 40% in the second, and the remaining 35% in the third.
- 3.48 Project management indicators. Based on the average project processing times in the second half of 1995, in the first year these times will be reduced by at least 10%, 20% in the second, and 30% in the third. The following indicators will be evaluated: average times between (i) submittal and evaluation, (ii) between evaluation and approval, (iii) between approval and the first disbursement, (iv) between approval and completion of the works, (v) between completion of the works and final settlement, and (vi) between the scheduled and the actual execution period.
- 3.49 Participation by women. Based on the findings of the mid-term evaluation broken down by region, the participation by women will be determined in: (i) project selection, (ii) the executing unit, (iii) project execution, and (iv) project preparation. Also to be determined is the extent of women's participation as recipients of jobs generated during project execution and of training for maintenance programs, and as beneficiaries of production development projects. In addition, the following indicators will be determined in FONCODES's training plan: (i) number of courses including a module to increase awareness of the importance of participation by women; (ii) number of FONCODES technical staff members who have attended courses that included that module, broken down by sex; and (iii) number of community members who have attended courses with a gender approach, broken down by sex (Annex III-4).
- 3.50 Operation and maintenance. In the first year, it will be determined whether at least 85% of the completed projects are being operated and maintained properly. This proportion must be at least 90% in the second year and 95% in the third.

IV. LESSONS LEARNED, FEASIBILITY, BENEFITS, AND RISKS

A. Lessons learned and program feasibility

- 4.1 The purpose of the proposed program is to help improve the quality of life of the poorest and most vulnerable segments of Peruvian society through small social and economic, infrastructure and production projects assigned top priority by the poorest rural communities in the country. Since this is a demand-driven program, the population participates directly in project identification, execution, and monitoring through executing units consisting of elected members of the community, and in the operation and maintenance of the investments. The high degree of community participation in decision-making at the different levels in the project cycle is one of the primary factors in the success scored by FONCODES, which has financed more than 17,000 small economic and social infrastructure projects that are meeting the most pressing needs of remote and poor communities in Peru.
- 4.2 The various external evaluations conducted in the course of the first stage, the principal findings of which are described in chapter I above, and the supervision missions sent out by the Bank and the World Bank, which included visits to different localities where FONCODES-financed projects were being executed, have consistently demonstrated the high degree of community participation in and commitment to the prioritization, monitoring, operation, and maintenance of the projects and the importance of that participation for achievement of the expected benefits. It is also important to highlight the proper targeting of the program resources, more than 80% of which have benefited poor and extremely poor districts in the country.
- 4.3 The successful targeting and impact of the projects being carried out by FONCODES have been largely due to inclusion in the project design of project of: (i) a high degree of community participation in project prioritization, execution, and management; (ii) regular outside supervision of the works by qualified professionals expressly hired for that purpose by the branch offices; (iii) geographic targeting at the lowest administrative level in the country (districts and localities) and the inclusion of mechanisms for self-targeting by beneficiaries, including the types of projects that may be financed, the levels of remuneration for unskilled labor, and community contributions; (iv) proper promotion of the program in potential beneficiary communities; (v) community participation in the operation and maintenance of the works; (vi) clear criteria and cost-efficiency standards for each type of project; (vii) optimal use of existing infrastructure; (viii) preparation of the project designs and construction of works of any magnitude by the private sector; and (ix) implementation of simple, expeditious procedures for project approval and execution.

- 4.4 The lessons drawn during execution of the first stage and those being learned from similar IDB and World Bank programs in different countries of the region are being incorporated into the operations manuals to be approved for each line of investment. Those manuals, now being revised and updated by FONCODES, include simple methodologies for the identification, preparation, and evaluation of each type of project from the technical, socioeconomic, environmental, institutional, financial, and gender standpoints, which were agreed upon with the Bank during execution of the first stage, have been developed on the basis of the operating experience of the previous stage, and/or are used by other national institutions in charge of similar projects.
- 4.5 The feasibility of the projects is enhanced by FONCODES's possession of a computer database, which under FONCODES's decentralization and equipment plan will be interconnected between headquarters and the 24 branch offices to permit rapid determination of, among other variables, the benchmark costs for each type of works to be financed in each region of the country. This database was set up during execution of the first stage; its systems are being modernized with the support of the Banks for this new stage, and it receives daily feedback of information on new projects being financed by FONCODES.
- 4.6 To ensure compatibility between its investments and the respective sector plans, compliance with the technical regulations and criteria established by each sector authority, and proper operation and maintenance of the completed projects, FONCODES has entered into a series of agreements with the line institutions and ministries in the sectors of education, health, transportation, energy, sanitation, and agriculture.
- 4.7 Moreover, FONCODES has been optimizing the design of each type of project to take into account the need to maximize the likelihood that the investments will remain sustainable in the long run. Similarly, all infrastructure works require an agreement by the responsible community, ministry, municipal government, and/or enterprise to operate and maintain them properly as a condition precedent to FONCODES's approval of the financing for the works. To ensure fulfillment of the community's obligations, it has been agreed that, as part of its promotion of the program, FONCODES must ensure that the eligible communities are well informed of the contributions and/or rates for operation and maintenance involved in the different types of projects before they start to prioritize them. Moreover, to strengthen the communities in their operation and maintenance work, it has been agreed that henceforth FONCODES will finance, in the cases where required, community training in the operation and maintenance of executed projects.
- 4.8 Lastly, the administrative decentralization and strengthening of the project analysis and followup capabilities of the regional offices now in progress will enable FONCODES to evaluate and

respond more promptly and efficiently to project applications submitted by communities and facilitate their closer monitoring and evaluation throughout the project cycle.

B. Impact on low-income groups

- 4.9 The program is consistent with the goals of social reform and poverty reduction established in the Eighth General Increase in the Resources of the Bank in that its investments geographically target rural communities in the poorest parts of the country and because a significant majority of the direct beneficiaries (more than 60%) will be low-income groups.

C. Participation by women

- 4.10 Women have been fairly active participants in FONCODES projects. However, since the proposed program includes measures to improve the promotion, targeting, and prioritization of projects, and new areas of action on the project menu, special measures have been taken to increase their participation as beneficiaries in the project selection and execution. Agreement has therefore been reached with FONCODES that: (i) training modules for all technical personnel at headquarters and the branch offices will be instituted in order to increase awareness among staff of the importance of and benefits from the use of analysis with the gender approach, and the necessary steps will be taken to include the subject in the training courses to be offered to communities; (ii) the participation of women will be included in the operating manuals on FONCODES's project cycle, and especially with regard to project promotion, preparation, evaluation, supervision, and maintenance; and (iii) in the pilot production development projects, the generation of projects in which women are direct participants will be widely promoted, so that women may benefit from employment and/or income generation.

D. Participation by indigenous communities

- 4.11 The following measures will be taken for poor farming and indigenous communities during execution of the new stage: (i) representative projects will be designed which allow for the characteristics of these target populations; (ii) there will be coordination with other institutions with responsibilities for or experienced in work with poor farming and indigenous communities and in the types of projects to be promoted in them; (iii) the personnel in charge of promotion, evaluation, and supervision in the branch offices servicing that population will be required to speak the local languages; and (iv) if necessary, qualified staff will be hired to work directly with poor farming and indigenous communities.
- 4.12 Moreover, the diversity and number of indigenous communities implies a range of problems so wide as hardly to be encompassed by

any single project. Accordingly, the Bank and the Government of Peru are to develop a program of diverse measures for the benefit of those communities. Those measures are (i) the FONCODES II program, which will benefit a sizable number of poor farming and indigenous communities, (ii) a project for the institutional strengthening of the Peruvian Indigenous Institute [Instituto Indigenista Peruano], the government agency for indigenous affairs; (iii) a project of training and technology transfer to the Asociación Nacional de Empresas Comunes y Multicomunes [National Association of Community and Multicomunity Enterprises], which services mainly Andean communities; and (iv) a project of technical assistance and training for grassroots organizations of indigenous peoples in the jungle.

E. Environmental protection

4.13 The evaluations show that during execution of the first stage the environment was one of the weakest areas, and will therefore have to be strengthened. The principal measures adopted to improve it are as follows:

- a. The following environmental features will be introduced into the project cycle: (i) a new environmental protection manual will establish categories for projects based on their environmental impact; (ii) projects will be categorized from the onset on the basis of their expected environmental impact (I, II, III, or IV), and that category will be maintained until project completion, regardless of any mitigating measures that may have to be taken; (iii) an environmental impact assessment will be conducted, including the quality of the mitigating measures, during the visits of the evaluators and supervisors; (iv) compliance with the environmental protection guidebooks and manuals developed by FONCODES will be monitored; and (v) the environmental impact will be included in the ex post evaluation of projects.
- b. For project execution, the environmental protection guidelines will be incorporated into all construction contracts and financing agreements, and compliance monitoring will be a contractual condition.
- c. The training for both FONCODES personnel and the communities will include modules on the environment, particularly in connection with the operation and maintenance of works.
- d. All environmental information on the projects and on the activities to be carried out in this respect will be added to the project database.
- e. Visiting supervisors will review compliance with the environmental protection requirements in each case and the

results thereof, which information will be entered in the databases as background material for the ex post evaluations.

- 4.14 To monitor all these activities, FONCODES has hired an environmental specialist who will work at its Lima headquarters. The duties of this specialist are set out in detail in Annex IV-1.

F. Benefits and risks

1. Benefits

- 4.15 One of the principal benefits of the program will be improvement of the standards of living, productivity and income of the most disadvantaged population groups through the decentralized execution of some 9,000 small projects for basic social and economic infrastructure and production assigned high priority by the beneficiary communities. The projects will not only help generate immediate benefits in terms of employment and income for the beneficiaries during execution of the works to be financed, but will satisfy some of their more pressing basic needs, which have long been unmet. According to information from the 1994 National Standard of Living Survey, more than 40% of the infrastructure investments in poor rural areas have been financed through FONCODES in recent years, and this proportion should be significantly higher today since in the last two years FONCODES's range of activities has widened and the volume of projects financed by it has increased.
- 4.16 In the investments made by FONCODES, which amount to about 15% of total annual public investment, the government has an instrument of proven effectiveness for responsively and efficiently channeling a highly targeted, sizable volume of resources to the poorest segments of the population, which has made it one of the principal mechanisms of government social action.
- 4.17 In addition, FONCODES operations have contributed significantly to the creation of conditions for peace, social stability, and growth of the country, particularly in rural areas where serious violence and insecurity reigned for many years. The salutary impact on the living conditions of a broad segment of the population that had never before benefited from government activities or participated in the allocation of budgetary resources has been an important factor in the attainment of this basic objective of the government.
- 4.18 The prioritization of projects by the beneficiary communities and the execution of works by the executing units elected from among the members of those communities were key elements in the success scored by FONCODES in the previous stage. The demand-driven approach to project selection and the arrangement of execution through executing units are not only the reasons for the high degree of community approval of the works executed, but have helped generate in the communities a capacity to organize and work in unity of purpose to supplement government action to meet to their

most pressing needs. Confirmation of the effectiveness of this community participation and the knowledge and skills acquired in the process of project approval and execution can generate enduring benefits in the generation of fresh initiatives for community cooperation in the search for solutions to their problems.

- 4.19 Implementation in this new stage of the component for production development projects on a pilot basis will teach lessons to guide the future strategy and action of the government in the financing of this type of projects.
- 4.20 FONCODES's increasingly decentralized management through its 24 branch offices has helped develop a regional and local capacity to work closely with the private sector and the poorest communities in the country in the identification, preparation, execution, and supervision of social and economic infrastructure and production projects. In the medium term, given FONCODES's demonstrated capacity to adapt its structure and operation to the country's changing needs, the development of this ability at the local level can help lay the foundations for future decentralization.

2. Risks

- 4.21 During execution of the first stage, extremely poor communities were found to be able to benefit from the participation and technical assistance of NGOs, church groups, and municipal governments, and this support is expected to continue in the new stage. In this second stage, however, the emphasis will be on targeting of groups that are even poorer and more remote. Since this is a community demand-driven program, there is thus a risk that the most isolated and weakest localities will be left out because of their inability to prepare and submit projects that are eligible for FONCODES financing. To minimize this risk, FONCODES has incorporated into the new project cycle a simplified mechanism for project processing and increased support for preinvestment financing. In addition, the mechanisms for promotion are being strengthened and developed to bring the latter more into line with the yearly benchmark budget allocation, which reflects the investment targeting priorities.
- 4.22 Another risk of the proposed operation concerns the long-term sustainability of the investments, which requires proper operation and maintenance of the works. For the education and health infrastructure projects, which accounted for much of FONCODES's financing in the first stage, this risk was minimized by the approval only of projects to which the responsible ministries had committed enough funds for their operation and maintenance. However, since water supply, sewerage, and economic infrastructure projects are expected to become gradually a larger proportion of the portfolio of projects financed by FONCODES, in this new stage specific measures are being taken to minimize this risk: (i) strengthening the capacity of communities to operate and maintain their works as part of each project; (ii) making explicit reference, during the

promotion stage and before a community selects its priority project, to the contributions and financial commitments the beneficiaries would have to take on for the operation and maintenance of each type of project to be financed; (iii) involving the beneficiaries directly in construction of the works; (iv) requiring the communities to make a contribution to their project; and (v) to the extent possible, involving the municipal governments and local and regional enterprises in FONCODES projects. Moreover, as in the first stage, the Bank, jointly with the World Bank, will continue its constant monitoring and followup of the investments, and an effort will be made to strengthen the mechanisms for their ex post evaluation.

- 4.23 One risk that often arises is that of insufficient coordination with the line ministries and central agencies and with the municipal governments. Though during the mid-term evaluation of the first stage some problems were detected in this area, FONCODES has been completing and updating its coordination agreements with the line ministries and other agencies with positive results in terms of compliance with procedures, technical standards and commitments for the operation and maintenance of works. In addition, standing offices for institutional coordination are being set up and new strategies examined for working more closely with local authorities.
- 4.24 Finally, one risk common to all social investment funds is that of possible politization and bureaucratization of the executing agency. During the first phase FONCODES operations were based on eminently technical criteria consistent with its objectives and purposes. This experience suggests that in the second stage, this risk will not be significant, especially considering that the fund operated normally and autonomously, even through the campaigns leading up to the presidential and congressional elections of April 1995 and the municipal elections in November that year. In addition, despite a relatively high turnover of executive staff, FONCODES has in recent years maintained a technical staff of very good professional quality, with a high sense of commitment and identification with the institution's main purposes. All of these factors demonstrate the will of the government to keep FONCODES mostly free of political interference and devoted to the fight against poverty and to improving the quality of life of the most disadvantaged segments of the population.

**SUMMARY OF THE RESULTS OF THE MID-TERM EVALUATION
OF THE FIRST STAGE OF THE PROGRAM IN SUPPORT OF
THE FONDO DE COMPENSACIÓN Y DESARROLLO SOCIAL (FONCODES I)**

1. The most extensive evaluation of the first stage of FONCODES was carried out in 1995 by the local research and consulting firm, Apoyo, S.A. This study, which included the ex post evaluation of 300 projects, was conducted as part of the midterm evaluation of the first stage of the process of preparing the loan proposal with a view to a possible second stage. These 300 projects, financed in 1994, were distributed around various regions of the country, covered the different types of projects, and included a large number of interviews with direct beneficiaries, members of the executing unit, project operators, local authorities, etc.
2. This evaluation confirmed both the results of the other two partial evaluations conducted in 1994, and of the numerous joint supervisory visits by the IDB and the World Bank, leading to the conclusion that FONCODES is a social fund with efficient staff, organization and procedures, and that it has established an effective, nationwide system to carry out small infrastructure projects in Peru's poor communities.
3. The great majority of the projects financed were selected and strongly supported by the beneficiary population itself, and the works have been providing the services for which they were constructed. Although there were some problems connected with the additional equipment and staff needed for both health posts and schools, almost all of the projects were operational and the additional costs, where applicable, were being covered from contributions by users or other sources of local funds. The community participation and executing unit system developed by FONCODES for project execution has proven to be a particularly successful method of ensuring that the projects reflect local needs, and that the communities come to feel they own the work once it has been completed. The evaluations conducted did not make it possible to measure the direct impact of FONCODES projects on income and employment. However, by reestablishing a positive government presence in areas dominated by violence and the Shining Path, FONCODES is playing a significant role in bringing peace to large areas of the country, particularly in the sierra and jungle regions.
4. For purposes of this summary, a selection has been made of the information deemed most relevant in terms of the principal lessons to be drawn from the midterm evaluation of this operation, including that which served as the basis for designing its second stage. These results are presented below, grouped under five main headings: (i) determining priorities among projects; (ii) project legitimacy; (iii) operation and sustainability of the investments; (iv) project management; and (v) impact of the investments:

- a. Determining priorities among projects. Of the beneficiaries interviewed, 90 percent felt that the work being carried out by FONCODES was what the community needed most (Table I-1), and 95 percent saw this work as benefitting the neediest groups in the community. As well, 80 percent thought that priority among projects was determined either directly by the community, or by representatives chosen by the community in direct elections (Table I-2).
- b. Project legitimacy. The projects carried out by FONCODES enjoy a satisfactory level of legitimacy among their beneficiaries. Thus, for example, over 88 percent of beneficiaries indicating how the project's executing unit was appointed responded that its members had been elected directly by majority vote of the population, and nearly two-thirds of those interviewed reported having participated in the community assembly called to choose the project carried out. In addition, some 98 percent of those that attended the assembly stated that the project had been chosen by majority agreement, and that a large number of women had taken part in the assembly (Tables II-1 through II-4). Moreover, the greater part (83 percent) of beneficiaries interviewed reported having participated in the execution of the project, with a particularly high participation rate in the jungle region (95 percent). This cooperation was primarily in the form of labor provided by workers in the project zone (Tables II-5 through II-7). A major indicator of the legitimacy of the project carried out is the fact that some 97 percent of beneficiaries indicated that they would be willing to help carry out another project in their area (Table II-8).
- c. operation and sustainability of the investments. The great majority of those benefitting from completed projects (84 percent) indicated that the project infrastructure was being used either for the purpose intended or for other purposes, and this percentage rose to around 95 percent in the case of projects carried out in the jungle region. The principal problems relating to the operation of project infrastructure had to do with sewers and storm drains (although the size of the sample was not statistically significant), and health posts. These problems were caused by the lack of equipment and sufficient financing to complete the project or cover works not foreseen in the original project, in the first case, and because the staff responsible for operation of the facilities had yet to be appointed, in the second case (Tables III-1 and III-2). With respect to the operation and maintenance of the works, only 3 percent of the beneficiaries interviewed stated that no one had assumed responsibility for these. However, 41 percent of those interviewed did not indicate who was covering the costs involved, and some 44 percent reported

that the community had not received any training in the care and maintenance of the project (Tables III-3 and III-4). Of those indicating that the project required regular personnel to operate, 51 percent felt that the personnel assigned to the project were qualified for the task, while another 28 percent considered them partially qualified (Tables III-5 and III-6). On the other hand, 32 percent indicated that the staff available for operation of the project service is insufficient, and some 47 percent of beneficiaries stated that the project did not have sufficient equipment and furniture for proper operation.

- d. Project management. The image that the management of FONCODES has among beneficiary communities appears satisfactory since 85 percent of all beneficiaries interviewed felt that the entity was fulfilling its mandate either fully or in part, whereas only 5 percent stated that it was failing to do so (Table IV-1). Some 27 percent stated that there were problems with the execution of the work – notably late disbursements – and 42 percent indicated that it was necessary to extend the period allotted for execution of the project (Tables IV-2 through IV-4). It should be noted that FONCODES provided very close monitoring of the execution of projects evaluated, with the frequent presence of an inspector at the works and a high proportion of projects with their own supervisor (Tables IV-5 and IV-6).
- e. Impact of the investments. Some 72 percent of all beneficiaries of completed projects rated the services provided by the project financed by FONCODES as either good or very good, and deemed the operation of the work adequate (Tables V-1 and V-2). As well, 77 percent of the beneficiaries indicated that the works were of either good or very good quality (Table V-3). Almost 70 percent of those interviewed believed that the proportion of women benefitting from the project carried out in their community was equal to or greater than that of male beneficiaries (Table V-4). From the point of view of potential applicant beneficiaries, the usefulness of the selection of projects offered by FONCODES can be seen in the high percentage of those interviewed who would be willing to pay to obtain better services, especially in water supply, electricity and health (Table V-5). In terms of the principal lines of investment evaluated, 70 percent of the beneficiaries under completed projects in education felt that the project helped to raise the level of education in the area, and the degree of utilization of classrooms constructed or rehabilitated appears to be adequate – 32.4 students per classroom, on average (Tables V-6 and V-7). As well, some 76 percent of those interviewed who were beneficiaries of completed health projects indicated that the project had helped improve

health levels in the area, a figure which was significantly higher in the sierra and jungle regions, and lower in the coastal zone. The majority of the beneficiaries under these projects are adult women or children. Again, in the case of health projects, the degree of utilization of health posts appears to be adequate, with some 29 percent of project operators indicating monthly attendance by between 41 and 60 individuals, and another 48 percent of operators estimating that they serve over 60 persons per month (Tables V-8 and V-10). Finally, 62 percent of those interviewed felt that a project financed by FONCODES had helped to raise the level of economic infrastructure in the area. For example, according to interviews with the operators of irrigation projects, agricultural production will be up an average 60 percent in the region thanks to the irrigation project carried out in their area (Tables V-11 and V-12).

PROJECT RANKING
TABLE I-1

WAS THE PROJECT EXECUTED THE ONE YOUR COMMUNITY NEEDED THE MOST?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes	90	91	89	100
No	9	9	10	0
No answer	1	0	1	0
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

PROJECT RANKING
TABLE I-2

WHO DECIDED THAT THIS PROJECT WAS A PRIORITY?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
The population	66	63	70	48
Executing unit	8	7	7	20
District mayor	7	8	6	18
Promoter or project designer	6	6	5	3
Inspector	1	1	2	2
Other	4	5	3	3
No answer	8	10	7	6
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

PROJECT LEGITIMACY
TABLE II-1

HOW WAS THE EXECUTING UNIT APPOINTED?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
By decision of the majority of the population	68	64	71	72
They appointed themselves	3	4	3	0
Chosen by the mayor	3	2	3	6
Appointed by the promoter/project designer	1	1	2	0
Other	2	3	1	8
No answer	23	26	20	14
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

PROJECT LEGITIMACY
TABLE II-2

DID YOU PARTICIPATE IN MEETINGS TO CHOOSE THIS PROJECT?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes	64	57	69	63
No	32	40	27	32
No answer	4	3	4	5
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

**PROJECT LEGITIMACY
TABLE II-3**

DID THE MAJORITY AGREE ON THE SELECTION OF THE PROJECT?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes	98	97	98	100
No	1	1	1	0
No answer	1	2	1	0
Total: 100% (# responses)	933	352	540	41

Base: Total of beneficiaries interviewed

**PROJECT LEGITIMACY
TABLE II-4**

DID WOMEN PARTICIPATE IN THE SELECTION OF THE PROJECT SUBMITTED TO FONCODES?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes, a majority were women	40	35	42	44
Yes, women were a minority	51	51	52	44
No	5	8	3	10
Doesn't know/no answer	4	6	3	2
Total: 100% (# responses)	933	352	540	41

Base: Total of beneficiaries interviewed

PROJECT LEGITIMACY
TABLE II-5

DOES/DID THE POPULATION PARTICIPATE IN PROJECT EXECUTION?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes	83	84	81	95
No	11	10	13	3
No answer	6	6	6	2
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

PROJECT LEGITIMACY
TABLE II-6

WERE MOST OF THE PEOPLE WHO PARTICIPATED IN THE EXECUTION OF THE PROJECTS FROM THE AREA?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes	81	79	84	80
No	11	10	11	15
No answer	8	11	5	5
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

**PROJECT LEGITIMACY
TABLE II-7**

HOW DID THEY PARTICIPATE?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Labor	89	87	89	96
Money	11	11	12	9
Materials	8	6	9	11
Land	2	2	2	0
Equipment/vehicle	2	1	2	0
Other	5	5	5	0
No answer	1	1	1	0
Total: 100% (# responses)	978	373	558	47

Base: Total of beneficiaries interviewed who participated in the execution of the projects

**PROJECT LEGITIMACY
TABLE II-8**

WOULD YOU BE WILLING TO PARTICIPATE IN THE EXECUTION OF ANOTHER PROJECT IN YOUR AREA?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes	97	97	97	100
No	1	2	1	0
No answer	2	1	2	0
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

OPERATION AND SUSTAINABILITY OF THE INVESTMENTS
TABLE III-1
WAS (IS) THE PROJECT (BEING) USED FOR THE PURPOSES ENVISAGED?

TYPES OF INVESTMENTS	RESPONSES					
	Used only for purposes envisaged (%)	Used for other purposes as well (%)	Not used (%)	Not used for purposes envisaged but used for other purposes (%)	No answer (%)	Total (# responses)
Total	79	5	4	0	12	1099
Classrooms	87	2	1	0	10	261
Health posts	77	1	13	0	9	85
Irrigation channels	82	7	0	0	11	81
Reforestation	83	4	3	0	10	71
Family planning	90	0	0	0	10	10*
Training in mechanics	84	5	0	0	11	19*
Stabilization ponds	0	0	0	0	0	0*
Sewerage	0	0	100	0	0	10*
Medicine and	98	0	0	0	2	44
Community centers	100	0	0	0	0	5*
Water supply	77	11	5	0	7	197
Secondary network	100	0	0	0	0	12*
Electrification	71	0	14	0	15	48
Roads	70	0	0	0	30	20*
Drainage	58	4	17	0	21	24*
Wawa-Wasi	0	0	0	0	0	0*
Literacy	64	8	1	0	27	126
PRONOEI	0	0	0	0	0	0*
Bridge	96	0	4	0	0	25*
Other	80	1	2	2	15	61

Base: Total of beneficiaries interviewed for completed projects

(*) Small sample size does not make statistical reliability tests possible

OPERATION AND SUSTAINABILITY OF THE INVESTMENTS
TABLE III-2

WHY IS ADDITIONAL FINANCING NEEDED?

TYPES OF INVESTMENTS	RESPONSES							Total (# responses)
	For equipment (%)	For maintenance (%)	To cover projects not envisaged in the program (%)	To complete the project (%)	To hire staff (%)	Other (%)	No answer (%)	
Total	31	30	24	21	13	20	2	987
Classrooms	49	32	26	25	10	16	1	270
Health posts	70	26	12	5	45	8	0	74
Irrigation channels	8	13	37	44	9	17	4	100
Reforestation	15	63	13	3	13	18	3	62
Family planning	38	63	25	0	75	25	0	8*
Training in mechanics	23	23	8	0	0	54	8	13*
Stabilization ponds	0	0	0	0	0	0	0	0*
Sewerage	0	0	90	10	10	0	0	10*
Medicine and equipment	72	32	6	11	38	19	0	47
Community centers	40	80	0	0	0	0	0	5*
Water supply	23	50	19	11	12	20	2	146
Secondary network	60	20	10	60	0	0	0	10*
Electrification	15	23	31	23	5	21	5	39
Roads	0	28	6	67	0	28	0	18*
Drainage	4	4	26	52	0	30	0	23*
Wawa-Wasi	0	0	0	0	0	0	0	0*
Literacy	13	6	18	8	9	58	2	85
PRONOEI	0	0	0	0	0	0	0	0*
Bridge	0	42	26	32	0	5	0	19*
Other	10	24	52	24	5	5	5	58

Base: Total of beneficiaries interviewed who say that the project needs additional financing to work properly

(*) Small sample size does not make statistical reliability tests possible

OPERATION AND SUSTAINABILITY OF THE INVESTMENTS
TABLE III-3

THE OPERATION AND MAINTENANCE COSTS OF THE PROJECT ARE COVERED BY:

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Each user	28	25	30	38
Community authorities	7	6	7	26
Mayor's office	6	6	5	29
Public agencies	6	5	6	14
Private agencies/NGOs	1	2	1	0
Other	14	11	16	9
Nobody	3	5	2	0
No answer	41	46	39	15
Total: Multiple (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

OPERATION AND SUSTAINABILITY OF THE INVESTMENTS
TABLE III-4

DID THE COMMUNITY RECEIVE TRAINING FOR CARE AND MAINTENANCE OF THE PROJECT?

TYPES OF INVESTMENTS	RESPONSES			
	Yes (%)	No (%)	No answer (%)	Total (# responses)
Total	34	44	22	1463
Classrooms	36	52	12	357
Health posts	25	51	24	105
Irrigation channels	40	37	23	141
Reforestation	57	37	6	81
Family planning	30	15	55	20*
Training in mechanics	31	37	32	19*
Stabilization ponds	0	100	0	5*
Sewerage	27	19	54	26*
Medicine and equipment	25	55	20	64
Community centers	60	20	20	5*
Water supply	43	42	15	217
Secondary network	27	64	9	22*
Electrification	34	48	18	68
Roads	13	35	52	40
Drainage	0	77	23	44
Wawa-Wasi	0	0	0	0*
Literacy	15	25	60	136
PRONOEI	0	0	0	0*
Bridge	0	65	35	34
Other	63	33	4	79

Base: Total of beneficiaries interviewed

(*) Small sample size does not make statistical reliability tests possible

OPERATION AND SUSTAINABILITY OF THE INVESTMENTS
TABLE III-5

THE STAFF AVAILABLE TO OPERATE THE PROJECT IS:

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Qualified	51	44	51	71
Partly qualified	28	29	32	13
Not qualified	3	4	3	3
No answer	18	23	14	13
Total: 100% (# responses)	467	205	207	55

Base: Total of beneficiaries interviewed who say that the project requires staff to operate

OPERATION AND SUSTAINABILITY OF THE INVESTMENTS
TABLE III-6

THE NUMBER OF STAFF FOR PROJECT OPERATION IS:

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Sufficient	45	41	48	51
Excessive	6	8	2	9
Insufficient	32	26	40	27
No answer	17	25	10	13
Total: 100% (# responses)	467	205	207	55

Base: Total of beneficiaries interviewed who say that the project needs staff to operate

PROJECT MANAGEMENT
TABLE IV-1

DO YOU THINK THAT FONCODES IS FULFILLING ITS ROLE OF FINANCING PROJECTS IN YOUR LOCALITY COMPLETELY, PARTIALLY, OR NOT AT ALL?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes, completely	41	36	44	51
Yes, partially	44	45	42	43
No	5	9	3	0
No answer	10	10	11	6
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

PROJECT MANAGEMENT
TABLE IV-2

WERE THERE PROBLEMS IN THE EXECUTION OF THE PROJECT?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes	27	27	27	19
No	63	62	64	72
No answer	10	11	9	9
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

**PROJECT MANAGEMENT
TABLE IV-3**

WHAT TYPES OF PROBLEMS EMERGED DURING PROJECT EXECUTION?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Late disbursements	34	40	29	33
Lack of construction materials	19	18	18	42
Problems in the executing unit	16	14	17	33
Lack of labor	9	8	10	8
Other	39	42	37	17
No answer	9	5	12	8
Total: Multiple (# responses)	390	167	211	12

Base: Total of beneficiaries interviewed who said there were problems in project execution

**PROJECT MANAGEMENT
TABLE IV-4**

WAS THE TIME FRAME SPECIFIED FOR PROJECT EXECUTION CHANGED?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
It was expanded	42	38	45	37
It was shortened	4	4	4	0
Did not vary	37	39	35	37
No answer	17	19	16	26
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

PROJECT MANAGEMENT
TABLE IV-5

HOW FREQUENTLY DID THE INSPECTOR VISIT THE LOCALITY?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Each week	35	41	30	48
Every two weeks	28	23	31	29
Once a month	19	15	22	9
Other	10	11	10	11
No answer	8	10	7	3
Total: 100% (# responses)	884	340	509	35

Base: Total of beneficiaries interviewed who know the project inspector

PROJECT MANAGEMENT
TABLE IV-6

WAS THE PROJECT SUPERVISED?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes	75	74	75	94
No	6	6	5	1
No answer	19	20	20	5
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

**IMPACT OF THE INVESTMENTS
TABLE V-1**

IN GENERAL, DO YOU THINK THE SERVICES DELIVERED BY THE PROJECT ARE ...?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Very good (5)	22	22	23	13
Good (4)	50	46	52	60
Average (3)	16	16	15	25
Bad (2)	1	2	1	2
Very bad (1)	1	1	0	0
No answer	10	13	9	0
AVERAGE:	4.0	4.0	4.1	3.8
Total: 100% (# responses)	1099	443	616	40

Base: Total of beneficiaries interviewed for completed projects

**IMPACT OF THE INVESTMENTS
TABLE V-2**

WHAT IS YOUR OPINION ABOUT THE PROJECT'S CURRENT OPERATION?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Adequate	72	63	77	88
Inadequate	10	9	12	10
Does not operate	6	9	4	0
No answer	12	19	7	2
Total: 100% (# responses)	1099	443	616	40

Base: Total of beneficiaries interviewed for completed projects

IMPACT OF THE INVESTMENTS
TABLE V-3

IN GENERAL, HOW WOULD YOU QUALIFY FONCODES'S PROJECTS?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Very good (5)	21	20	21	31
Good (4)	56	55	57	51
Average (3)	18	21	17	18
Bad (2)	1	1	1	0
Very bad (1)	0	0	0	0
No answer	4	3	4	0
AVERAGE:	4.0	4.0	4.0	4.1
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

IMPACT OF THE INVESTMENTS
TABLE V-4

WHAT IS THE BREAKDOWN BY SEX OF THE POPULATION THAT USES THE PROJECT?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Equal number of men and women	42	47	38	25
More women than men	27	20	33	20
More men than women	16	15	15	40
No answer	15	18	14	15
Total: 100% (# responses)	1099	443	616	40

Base: Total of beneficiaries interviewed for completed projects

IMPACT OF THE INVESTMENTS
TABLE V-5

WOULD YOU BE WILLING TO PAY TO HAVE BETTER SERVICES IN ...?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Water supply				
Yes	75	81	69	91
No	18	13	23	6
No answer	7	6	8	3
Electricity				
Yes	72	80	66	86
No	18	13	23	8
No answer	9	7	11	6
Education				
Yes	56	67	47	69
No	30	20	39	15
No answer	14	13	14	15
Roads				
Yes	49	60	39	68
No	35	25	45	14
No answer	15	15	16	18
Health posts				
Yes	66	75	57	86
No	21	13	29	3
No answer	13	12	13	11
Irrigation channels				
Yes	46	54	39	45
No	37	29	43	40
No answer	17	17	17	15
Bulking centers				
Yes	31	34	27	52
No	42	37	48	32
No answer	27	30	25	15
Total: 100% (# responses)	1463	620	778	65

Base: Total of beneficiaries interviewed

IMPACT OF THE INVESTMENTS
TABLE V-6

DO YOU THINK THAT THE PROJECT HAS CONTRIBUTED TO IMPROVING EDUCATION LEVELS IN THE AREA?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes	70	68	76	53
No	9	11	8	7
No answer	21	21	16	40
Total: 100% (# responses)	261	130	101	30

Base: Total of beneficiaries interviewed for completed education projects

IMPACT OF THE INVESTMENTS
TABLE V-7

HOW MANY STUDENTS ARE THERE PER CLASSROOM NOW?

RESPONSES	TOTAL %
None	2
From 11 to 20	1
From 21 to 30	10
From 31 to 40	38
From 41 to 50	36
From 51 to 60	8
From 61 to 70	3
From 71 to 80	1
No answer	1
AVERAGE:	32.4
TOTAL: 100% (# responses)	72

Base: Total of operators of classroom construction and reconditioning projects interviewed

IMPACT OF THE INVESTMENTS
TABLE V-8

DO YOU THINK THAT THE PROJECT HAS CONTRIBUTED TO IMPROVING HEALTH IN THE AREA?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes	76	40	86	100
No	6	17	3	0
No answer	18	43	11	0
Total: 100% (# responses)	129	30	94	5

Base: Total of beneficiaries interviewed for completed health projects

IMPACT OF THE INVESTMENTS
TABLE V-9

WHO IS SERVED BY THE PROJECT PRIMARILY?

RESPONSES	TOTAL %
Adult women	57
Boys and girls	52
Senior citizens	14
Adult men	5
No answer	14
TOTAL: Multiple (# responses)	21

Base: Total of project operators interviewed — health posts, medication, and medical equipment projects

IMPACT OF THE INVESTMENTS
TABLE V-10

HOW MANY PEOPLE COME TO THE POST MONTHLY?

RESPONSES	TOTAL %
From 21 to 40 people	9
From 41 to 60 people	29
Over 60 people	48
No answer	14
TOTAL: 100% (# responses)	21

Base: Total of project operators interviewed — health posts, medication, and medical equipment projects

IMPACT OF THE INVESTMENTS
TABLE V-11

DO YOU THINK THAT THE PROJECT HAS CONTRIBUTED TO IMPROVING THE AREA'S ECONOMIC STRUCTURE?

RESPONSES	TOTAL %	GEOGRAPHIC REGION		
		COAST %	SIERRA %	JUNGLE %
Yes	62	69	58	60
No	7	11	4	0
No answer	31	20	38	40
Total: 100% (# responses)	507	201	301	5

Base: Total of beneficiaries interviewed

IMPACT OF THE INVESTMENTS
TABLE V-12

HOW MUCH HAS THE PRODUCTION VOLUME INCREASED?

RESPONSES	TOTAL %
No increase	7
From 1% to 25%	4
From 26% to 50%	24
From 76% to 100%	24
No answer	41
AVERAGE:	60.6
TOTAL: 100% (# responses)	29

Base: Total of irrigation channel project operators interviewed

OPERATING REGULATIONS

PROGRAM IN SUPPORT OF THE
FONDO NACIONAL DE COMPENSACIÓN Y DESARROLLO SOCIAL
(FONCODES II)
(PE-0101)

CLAUSE ONE: Purpose

The purpose of these Regulations is to establish the terms and conditions on which the Program in Support of the Fondo Nacional de Compensación y Desarrollo Social, stage two, hereinafter referred to as "the program," financed in part by the proceeds of loan __/OC-PE from the Inter-American Development Bank and of loan ____ from the International Bank for Reconstruction and Development to the Republic of Peru.

CLAUSE TWO: Basic definitions

For purposes of these regulations, the following definitions are adopted:

REPUBLIC:	the Republic of Peru
IDB:	the Inter-American Development Bank
IBRD:	the International Bank for Reconstruction and Development
BANKS:	the IDB and the IBRD
FONCODES:	Fondo Nacional de Compensación y Desarrollo Social [National Fund for Social Compensation and Development]
PROGRAM:	the Program in Support of FONCODES, stage two
PROJECT:	the work to be financed with program resources
BENEFICIARY COMMUNITY:	the population receiving the direct benefits of a project financed with program resources, in which at least 50% of the members do not earn incomes above the poverty line agreed upon with the Banks
EXECUTING UNIT:	the representatives elected by the beneficiary community for execution of a project financed with program resources

- TECHNICAL ADVISOR:** a individual or legal entity chosen by the beneficiary community to support the executing unit in the execution of a project financed with program resources
- SUPERVISOR:** an individual or legal entity hired by FONCODES to inspect, on its behalf and as its representative, the execution of a project financed under the program
- PAD:** a development project package
- INTERAGENCY COORDINATION AGREEMENT:** an agreement entered into by FONCODES and a line agency or ministry establishing the rights and obligations of the parties for the coordination, supervision, maintenance, and operation of the projects financed under the program
- FINANCING AGREEMENT:** an agreement entered into between FONCODES and the executing unit, establishing the rights and obligations of the parties in the execution of a project financed by the program
- LOAN CONTRACT:** the contract of external borrowing entered into by the Republic with the IDB or the IBRD for the partial financing of the program

CLAUSE THREE: Executing units

For an executing unit to be eligible to participate as such in the program, it shall demonstrate to FONCODES that:

1. **Representativity:** it has been elected at a meeting of the beneficiary community applying for financing for a project, and
2. **Priority:** at its meeting, the beneficiary community has assigned first priority to a project for financing under the program.

CLAUSE FOUR: Eligible sectors and projects

The following sectors and types of projects shall be eligible for financing under the program:

1. Support projects
 - A. **Training in responsible parenthood:** courses in family planning at the request of the beneficiary community, to be organized and held by the Ministry of Health.

- B. **Neighborhood dispensaries:** the supply of basic medications in accordance with the guidelines of the Ministry of Health.

2. Social infrastructure projects

- A. **Education:** the provision of equipment and teaching materials and the refurbishing or replacement of schools, with emphasis on preprimary and primary education, including training in their use and maintenance.
- B. **Health:** the provision of equipment for and the refurbishing or replacement of primary health care establishments, with emphasis on health centers and posts.
- C. **Community support:** the construction, refurbishing, or replacement of community centers and day-care centers, including training in their use and maintenance.
- D. **Sanitation**
 - (i) **Water supply and sewerage:** the installation or refurbishing of nonhousehold water supply and sanitary sewerage systems and the provision and installation of latrines in rural and marginal urban areas, including training in their operation and maintenance.
 - (ii) **Basic environmental sanitation:** small projects to improve the environmental situation in the surroundings, such as small drainage works, including training in their maintenance.

3. Economic infrastructure projects

A. **Agricultural infrastructure**

- (i) **Small irrigation systems:** the construction or refurbishing of small irrigation infrastructure works and training in their operation and maintenance.
- (ii) **Land reclamation:** activities for the reclamation of communal lands to restore their production capacity, and in training for the community in how to make optimal use of this resource.
- (iii) **Construction or improvement of artesian wells:** the construction or rehabilitation of artesian wells to improve the water supply, including training in their operation and maintenance.

- B. **Basic marketing infrastructure:** the construction, refurbishing, or expansion of collection and marketing centers, including training in their operation and maintenance.
 - C. **Basic road infrastructure:** the construction and improvement of narrow vehicular trails, third-class local roads, small bridges, and masonry structures, including training in their operation and maintenance.
 - D. **Small rural electrification projects:** the installation or expansion of secondary electric power distribution systems that are operated and maintained by a utility, which shall charge any applicable rates for services provided.
 - E. **Afforestation and reforestation:** activities for the protection of small watersheds from rainwater erosion on slopes, including training in their maintenance.
4. Production development projects

Not more than US\$12.4 million, or 3% of the program resources earmarked for project financing, may be allocated to finance this subcomponent.

Production projects may be of two types: (i) those designed essentially for the subsistence of the families in the community, which shall exclusively target extremely poor localities, and (ii) those for the production of goods to be marketed outside the community. The latter type of project shall require careful analysis of the conditions on the markets in which they would be operating.

Development project packages (PADs). It consists of a special type of project, in which a series of mutually complementary projects are financed in a single locality to optimize the use of its natural resources.

In this new stage, FONCODES will not include among the options the financing of projects for credit to microenterprises, which is being provided by other government agencies.

CLAUSE FIVE: Eligibility criteria

1. General criteria

Following are the general requirements for any project to be eligible for financing with program resources:

- A. No project may cost more than the equivalent of two hundred fifty thousand United States dollars (US\$250,000).
- B. The beneficiaries must be low-income groups in which at least 50% of the members do not earn incomes above the poverty line agreed upon by the Banks and the Republic.
- C. When necessary, a project shall show proof of possession of legal title, rights of way, and other pertinent rights to the land on which the works are to be executed, and, where applicable, water rights.
- D. Every project shall include all the technical, financial, and institutional components needed to guarantee operation and maintenance of the works and its cost must meet the cost-efficiency criteria (cut-off points) established in the manuals for each type of project and region, which will be updated periodically by FONCODES.
- E. No project may generate any negative impact on the environment or, if so, it must be possible to mitigate such impact at reasonable cost.
- F. No project may contain any element that discriminates against the participation by women at any stage.
- G. All projects shall fit into the areas of action of the program described in the present Regulations.

2. Specific eligibility criteria

The following specific conditions must be met by a project, depending on the type, to be eligible for financing with program resources:

- A. Projects in the agricultural sector (small irrigation works, land reclamation, artesian wells, afforestation and reforestation, and basic marketing infrastructure): show a rate of return above 12% at market prices, when their cost exceeds US\$60,000.
- B. Production projects:
 - (i) the parameters for classifying them as either essentially for the subsistence of the family or as market-oriented production projects shall be the types of good to be produced and the expected production volume;
 - (ii) each production project shall include specific mechanisms and resources for monitoring to enable

FONCODES to have detailed knowledge of the problems and benefits associated therewith;

- (iii) cost-benefit analyses shall be required for all market-oriented production projects, regardless of cost.

CLAUSE SIX: Interagency coordination agreements

FONCODES must sign, amend, or ratify the interagency coordination agreements on a case-by-case basis, for all individual projects financed with program resources with the line institutions and ministries responsible for them in order to ensure, at a minimum, that: (i) the project is consistent with the sector policies, standards, and guidelines established by the Republic; (ii) there is no duplication of measures or activities between institutions of the Republic; and (iii) there are sufficient guarantees for the operation and maintenance of the projects financed under the program. Accordingly, FONCODES shall sign, modify, or ratify the following agreements, without prejudice to the need to sign other agreements during execution of the program:

1. FONCODES-Ministry agreements

Listed below are the agreements that FONCODES must enter into with each of the ministries responsible for a sector in which projects are to be financed with program resources. The agreements must establish the sphere of action of FONCODES in the respective sector, how coordination is to be ensured, and how other entities are to participate in the sector, especially in the area of the program:

- A. FONCODES-Ministry of Education agreement.
- B. FONCODES-Ministry of Health agreement.
- C. FONCODES-Ministry of Energy and Mines agreement.
- D. FONCODES-Ministry of Transportation agreement.
- E. FONCODES-Ministry of Agriculture agreement.

2. FONCODES-Ministry of the Interior agreement

This agreement must establish the sphere of action of FONCODES in relation to the local governments and how coordination is to be ensured. This agreement must include other institutions participating in the sector, especially in the area of the program.

3. FONCODES-PRONAMACHCS agreement

This agreement must establish the sphere of action of the National Watershed Management and Soil Conservation Program (PRONAMACHCS) in FONCODES projects, especially in relation to the obligations of the beneficiaries, which must be consistent with FONCODES's general system. It must also establish how this coordination is to be ensured.

4. FONCODES-National Housing Fund agreement

This agreement must establish the sphere of action of FONCODES in the water supply, sewerage and electrification sector and how coordination is to be ensured. The agreement must also include other institutions operating in this sector, especially in the areas of the program.

5. FONCODES-INFES agreement

This agreement must establish the sphere of action of the National Institute for Education and Health Infrastructure (INFES) in FONCODES projects, as well as how coordination is to be ensured.

CLAUSE SEVEN: Execution of the program

1. General arrangement for execution

The program shall be executed by the Republic through FONCODES, by financing eligible projects submitted by beneficiary communities and in which executing units participate. A beneficiary community may have the support of individuals or legal entities, community organizations, nongovernmental organizations, or other public or private institutions.

2. Mechanism for financial execution

The program resources allocated for the financing of eligible projects shall be transferred by FONCODES on a nonreimbursable basis to an executing unit by opening a bank account in a local financial institution once a financial agreement has been signed setting forth in detail the rights and obligations of the parties for execution of the given project. This account may be drawn on only with the authorized signature of the resident works engineer.

CLAUSE EIGHT: Miscellaneous provisions

1. Procurement

The procurement of goods and services and awarding of construction contracts must comply with the respective procedures of the Banks, which are appended to the present Regulations. This requirement shall not apply when the resources used are from sources other than the Banks. When the cost of works amount to less than the equivalent of US\$60,000, the executing unit will carry them out by force account. For works ranging between US\$60,000 and US\$250,000, the price competition system will be used. Both cases are provided for in Peruvian legislation, and the applicable procedures are detailed in the respective FONCODES manuals.

2. Amendments to the Regulations

The present Regulations may be amended only with the prior agreement of FONCODES and the Banks.

3. Inspection and supervision

The Banks reserve the right to inspect any and all projects financed under the program at such time and in such manner as shall seem appropriate to them. To this end, FONCODES shall provide all the cooperation and information they may require for the proper accomplishment of this purpose.

CLAUSE NINE: Operation and maintenance of the projects

The purpose of the maintenance of executed works is to preserve them in essentially the same operational condition as they will be at the time of their completion. Therefore, it shall be an obligation of the beneficiary community to care for the projects and, if necessary, to participate in their operation and maintenance, and FONCODES shall include in the financing agreements a clause stipulating this obligation. In addition, FONCODES shall include, in each case, a program of training for the community in the operation and maintenance of the project financed.

CLAUSE TEN: Prevalence of the loan contracts

The terms and conditions established in contracts for IDB loan ____ /OC-PE and IBRD loan ____ shall prevail over the provisions of the present Regulations.

FINANCIAL MANAGEMENT

- 1.1 Use of all the program resources will be subject to the rules and policies of both Banks and the procedures and guidelines set forth in the operations manuals of FONCODES, the Operating Regulations of the program (Annex III-2), and the respective manuals. These documents must enter into force as a condition precedent to the first disbursement.
- 1.2 The features of this program require a portfolio and disbursement management strategy that differs from conventional multiple-works operations, due to the large number of small executing units, the huge volume of projects, and the relatively small amount of each one. Accordingly, procedures have been designed under which expenditures in the "project" category will be financed as follows: 35% by the IDB, 35% by the World Bank, and the remaining 30% by the local counterpart.
- 1.3 The items that may be recognized as part of the contribution by the beneficiaries must be reported in the cost sheet of each project, subject to prior clearance by the evaluators, outside supervisors, and the chief of the respective branch office.

LOGICAL FRAMEWORK

PROGRAM SUMMARY	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<u>Goal:</u> 1. To help improve access to social services and basic economic infrastructure by the poorest segments of the population.	1.1 Indicators of critical unmet needs among population living in extreme poverty are reduced within 10 years after project completion.	1.1 National Institute of Statistics and Data Processing: Population and Housing Census.	(Goal to Supergoal):
<u>Purpose:</u> 1. Projects financed have a direct impact on the poorest population in the country, are efficiently executed, and receive decentralized approval by FONCODES.	1.1 Projects are executed on schedule and within budget within the four years after the first disbursement of the loan. 1.2 80% or more of the resources are allocated to the poorest population. 1.3 90% of the projects are approved by the branch offices upon program completion. 1.4 85% of the projects are in operation and are sustainable.	1.1 Certification of completion of works. Certification of disbursements. 1.2 Location of the projects compared with the poverty map 1.3 Number of projects approved by each branch office compared with the total number of projects approved 1.4 Reports and evaluations	(Purpose to Goal): 1. Beneficiaries of projects have means and will to maintain works/equipment/systems in operation.
<u>Results:</u> 1. Projects for social support, social and economic infrastructure, and production development financed and executed. 2. Measures for institutional strengthening and community management carried out.	1.1 Approximately 9,000 projects financed in four years. 2.1 Branch offices provided with equipment (30 computers, 23 photocopiers, 27 pickup trucks, 4 motorcycles, and 6 motor boats). 2.2 150 managers and employees of FONCODES trained in institutional management. 150 technical and support staff of FONCODES trained in administrative techniques and data processing. 150 technical and support personnel trained in administrative techniques and information processing. 41,000 beneficiaries, NGOs, and municipal governments trained in project management, women's participation, and environmental protection.	1.1 Project completion report. 2.1 Certification of delivery of equipment. 2.2 Report on number of executive, professional, technical, and support personnel properly trained and approved. Report on number of beneficiaries, NGOs, and municipal governments attending the workshops.	(Result to purpose): 1. Maintenance of infrastructure and works is assured. Efficiency increases with know-how acquired. The beneficiaries apply the techniques learned.

PROGRAM SUMMARY	VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p>3. Participation by women</p>	<p>2.3 number of courses offered with module to increase awareness of importance of participation by women, number of persons, of both sexes, of the technical staff of FONCODES who attended such courses, number of persons, by sex, in the community who attended courses with gender approach.</p> <p>3.1 Agents: numbers of women participating in project selection, the execution unit, and project preparation.</p> <p>Beneficiaries: direct/indirect, execution of project (hours/woman), jobs generated during execution, training for maintenance programs and production projects.</p>	<p>3.1 Semiannual progress reports and followup evaluations.</p>	
<p><u>Activities:</u></p> <p>1.1 Design 1.2 Evaluation 1.3 Supervision 1.4 Annual work plans</p> <p>2.1 Design 2.2 Evaluation 2.3 Supervision 2.4 Annual work plans</p> <p>3.1 Preparation of training plans 3.2 Hiring of training institutions 3.3 Training courses 3.4 Preparation of bidding documents 3.5 Awards 3.6 Distribution</p>	<p>Verification based on semiannual progress reports of FONCODES's monitoring and control office.</p>	<p>1.1 Semiannual progress report 1.2 ditto 1.3 ditto 1.4 ditto</p> <p>2.1 ditto 2.2 ditto 2.3 ditto 2.4 ditto</p> <p>3.1 ditto 3.2 ditto 3.3 ditto 3.4 ditto 3.5 ditto 3.6 ditto</p> <p>4.3 ditto 4.4 ditto 4.5 ditto</p> <p>5.1 ditto 5.2 ditto 5.3 ditto</p>	<p>(Activity to Result):</p> <p>1. There are no delays in the preparation of projects.</p> <p>2. There are no challenges in bidding process.</p> <p>3. There is a sufficient number of trainers.</p> <p>4. Contractors stay within established time and cost limits.</p> <p>5. Counterpart resources are made available in accordance with the execution timetable.</p>

TERMS OF REFERENCE
Environment Specialist

To monitor all of these activities, FONCODES has hired an environment specialist to work at its headquarters in Lima. The specialist's duties will include at least the following:

1. Review, adjust, and update the manuals used by FONCODES and prepare new guidelines to supplement those already in use, including promotional manuals for beneficiaries.
2. Develop a methodology for project classification according to probable environmental impact.
3. Establish management indicators to monitor the consistency the procedures following in the branch offices with the environmental protection standards and impact to assess the environmental impact of the projects.
4. Conduct supervision visits to the branch offices on a regular basis.
5. Supervise the ex ante studies for projects that may have a significant adverse impact on the environment.
6. Conduct periodic ex post evaluations of project environmental impact.
7. Propose adjustments in the data management system to include the environmental background of each project, such as the environmental classification of the projects, the ex ante environmental impact studies, and the ex post environmental impact indicators.
8. Participate in the design of modules on environmental projection to be included in the training plan, particularly with regard to project sustainability.
9. Verify that the environmental protection procedures of FONCODES comply with current national legislation and the respective procedures of the Banks.
10. Coordinate the program with other government agencies, especially the National Environmental Protection Board [Consejo Nacional del Medio Ambiente] (CONAM) and the National Institute for Natural Resources [Instituto Nacional de Recursos Naturales] (INRENA).
11. Incorporate environmental protection procedures into FONCODES bidding documents, contracts, and agreements.

PROPOSED RESOLUTION

PERU. LOAN ____/OC-PE TO THE REPUBLICA DEL PERU
(Program of support for the Fondo Nacional de Compensación
y Desarrollo Social)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republica del Perú, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a Program of support for the Fondo Nacional de Compensación y Desarrollo Social. Such financing will be for the amount of up to US\$150,000,000, or its equivalent in other currencies, except that of the Republica del Perú, which are part of the Ordinary Capital resources of the Bank, and will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.