



Country Program Evaluation

Peru
2012-2016

Country Program Evaluation

Peru

2012-2016

Office of Evaluation and Oversight (OVE)



Inter-American Development Bank
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Office of Evaluation and Oversight
1350 New York Avenue, N.W.
Washington, D.C. 20577
www.iadb.org/evaluation

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ACRONYMS AND ABBREVIATIONS

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ACRONYMS AND ABBREVIATIONS

| | |
|----------|---|
| BCRP | Banco Central de Reserva del Perú [Central Reserve Bank of Peru] |
| CAF | Andean Development Corporation |
| CEPLAN | Centro Nacional de Planeamiento Estratégico [National Strategic Planning Center] |
| CGR | Contraloría General de la República [Office of the Comptroller General of the Republic] |
| CPE | Country program evaluation |
| EOM | Early operational maturity |
| FIP | Forest Investment Program |
| FMM | Fiscal and Municipal Management Division |
| INACAL | Instituto Nacional de Calidad [National Quality Institute] |
| ITP | Instituto Tecnológico de la Producción [Technological Production Institute] |
| JUNTOS | Programa Nacional de Apoyo Directo a los más Pobres [National Program of Direct Support to the Poorest of the Poor] |
| MEF | Ministry of Economy and Finance |
| MIDIS | Ministry of Development and Social Inclusion |
| MMF | Multiyear macroeconomic framework |
| NFPS | Nonfinancial public sector |
| NSG | Non-sovereign guaranteed |
| NSEM | New Sustainable Energy Matrix |
| OMJ | Opportunities for the Majority |
| OVE | Office of Evaluation and Oversight |
| PBL | Policy-based loan |
| PBP | Programmatic policy-based loan |
| PBP-DDO | Programmatic policy-based loan with deferred drawdown option |
| PPP | Public-private partnership |
| PROCOES | Programa de Mejoramiento y Ampliación de Agua y Saneamiento en Perú [Programme for the Improvement and Expansion of Water and Sanitation in Peru] |
| REDD | Reducing emissions from deforestation and forest degradation |
| RND | Environment, Rural Development, and Disaster Risk Management Division |
| RVN | Red Vial Nacional [National Road Network] |
| SAJ | Sistema de Administración de Justicia [Justice Administration System] |
| SCF | Structured and Corporate Financing Department |
| SENASA | Servicio Nacional de Sanidad Agraria [National Agricultural Health Service] |
| SG | Sovereign guaranteed |
| SIEA | Sistema de Información de Estadísticas Agrarias [Agricultural Statistics Information System] |
| SINAGERD | Secretaría de Gestión del Riesgo de Desastres [Department of Disaster Risk Management] |
| SNC | Sistema Nacional de Control [National Control System] |
| SNIA | Sistema Nacional de Innovación Agraria [National Agricultural Innovation System] |
| SNIP | Sistema Nacional de Inversión Pública [National Public Investment System] |
| SPH | Social Protection and Health Division |

| | |
|--------|---|
| TC | Technical cooperation operation |
| TSP | Transport Division |
| UNFCCC | United Nations Framework Convention on Climate Change |
| XSR | Expanded supervision report |

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The poverty rate fell from 59% in 2004 to 23% in 2014; income inequality declined, and the coverage of public education and health services expanded significantly.

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Executive Summary

Peru is Latin America's seventh largest economy, with a gross domestic product (GDP) of US\$192 billion in 2015. Between 2002 and 2015, output grew at an average rate of 5.7% per year (the second fastest growth in the region after Panama). This was made possible by a series of structural reforms implemented during the 1990s, and assisted by the rise in the international prices of gold and copper, Peru's main exports. The government has been managing its finances carefully, which has enabled it to maintain one of the lowest inflation rates in the region and keep the public debt at a low level. Growth was accompanied by significant improvements in living standards. The poverty rate fell from 59% in 2004 to 23% in 2014; income inequality declined, and the coverage of public education and health services expanded significantly.

Despite the great strides in recent years, Peru still faces a number of development challenges. Public expenditure remains relatively inefficient and ineffective, particularly at the subnational level. Competitiveness is limited by institutional constraints on commercial activity, compounded by infrastructure deficits and low productivity, which in turn is affected by the high level of informality and low investment in research and development. Urban living standards are well above those in rural areas, as reflected in both income levels and the coverage of basic services. This is part of the social inclusion problem, which requires better functioning and coordination among the social protection programs.

In the period 2012-2016, the Bank sought to help the country meet several of these challenges. The Bank's country strategy with Peru had two lines of action (help close urban and rural gaps, and stimulate sustainable economic growth), as well

as nine priority areas. These were generally aligned with the country's challenges and government priorities, expressed in the multiyear macroeconomic frameworks (MMFs) produced by the Ministry of Economy and Finance (MEF). For work with the private sector, the country strategy was less specific. It proposed encouraging the formation of public-private partnerships and listed more than 10 areas where it expected the IDB Group's four private-sector windows to work.

The approved program of sovereign guaranteed (SG) loans was concentrated in five of the Bank's divisions, while the program of non-sovereign guaranteed (NSG) operations focused on the financial sector. Of the total SG amount approved, 70% was concentrated in the Social Protection and Health (SPH) and Transport (TSP) divisions. In terms of the number of operations, 72% were concentrated in those two divisions plus the Environment, Rural Development, and Disaster Risk Management Division (RND), Competitiveness and Innovation (CTI), and Fiscal and Municipal Management (FMM). Nearly half of the operations concluded by the IDB Group's private-sector windows were with the financial sector, which had not been envisioned in the country strategy.

The Bank's lending space in Peru is shrinking. As of 30 June 2016, SG loan approvals were US\$1.565 billion, 52% above the US\$1.028 billion envisaged as a lending envelope in the country strategy. Nonetheless, this very high level of approvals reflects three atypical operations, each for US\$300 million, two of which are contingent loans. The remainder of the approved SG portfolio amounts to just US\$665 million (with individual operations averaging less than US\$30 million), so it would have been difficult to comply with the lending envelope without those three atypical operations. In addition, the lending envelope projected for the previous strategy period (2007-2011) was 65% larger than in 2012-2016, which shows that the Bank's lending space in Peru is shrinking. Lastly, in 2013 the country prepaid a number of operations for a total of US\$1.348 billion, for a negative net capital flow to that country and a decline in the Bank's share of Peru's multilateral debt from 42.2% in 2012 to 35.1% in 2013.

The Bank's smaller lending space in Peru reflects several factors, including the fact that the Bank has become less competitive. Since 2008, Peru has maintained investment grade credit rating, as a result of which its access to international financial markets has been improving. At the same time, the country has reduced its borrowing level. Moreover, IDB loans have lost competitiveness, because they charge a higher interest rate and higher fees than the World Bank and have higher transaction costs than the Andean Development Corporation (CAF).

In 2012-2016, the pace of execution of the Bank's portfolio in Peru increased, particularly the legacy portfolio; nonetheless, a number of problems persisted which caused delays. In 2012-2016, the disbursement curve of the Peruvian SG portfolio was comparable to the median for the Bank as a whole, which is an improvement on

the previous period. Nonetheless, difficulties persist relating to high staff turnover at ministries, institutional coordination, and the poor design of certain operations (for which the Bank and the government share responsibility). There is a good degree of coordination with other international cooperation agencies.

In general, the Bank's operations were focused on helping to improve public management and the Peruvian institutional framework. This is seen in virtually all areas of work, where much of the Bank's support has been aimed at strengthening the planning and management capabilities of line ministries and other public entities and improving the effectiveness and efficiency of government programs and policies, as well as creating new institutions. Much of this work has been through programmatic series which differ from other Bank operations in that they tend to be longer (three or even four phases), and all phases are completed. Despite these virtues, there is room to deepen the reforms contained in them.

The Bank has made contributions in many areas, but several are worth highlighting. In social inclusion, the Bank was a key partner in setting up the Ministry of Development and Social Inclusion (MIDIS) in 2011. Subsequently, it has continued to support improvements in some of the main social protection programs and the household targeting system, but given up its strong positioning in this area. In **agriculture**, the Bank continued to successfully support the improvement of public animal health services. In coordination with other donors, it also supported the implementation of the Reducing Emissions from Deforestation and Forest Degradation (REDD+) program. In **water and sanitation**, the Bank's support has enabled reforms to improve the governance of the service, as well as its technical, environmental, and financial sustainability. The contribution to increasing coverage has been limited owing to the slow progress of the operations, caused by delays in preparation of engineering designs, among other things. In **transportation**, the operations generally did not meet their infrastructure targets. In terms of subnational roads, however, over 5,000 km underwent rehabilitation and periodic maintenance work (in terms of national highways, the original design of the operations could not meet the needs of the road system in a context of rapid growth). In **climate change** adaptation, the Bank's program laid the foundation for crosscutting work on this front in Peru, but the Bank's additionality, relative to the progress made on this by the country itself is limited, since many of the reforms were already being introduced. The Bank supported the creation of the national **disaster risk management** system, which replaces a purely reactive approach, incorporating prevention and a financial strategy for disaster management. In **Energy**, the Bank supported the formulation of a proposal for the New Sustainable Energy Matrix, but the authorities and technical specialists did not take the necessary ownership of the effort for it to be implemented; nor did it address the sector's short- and medium-term challenges. The Bank continued to support **tax and customs administration**, addressing major needs, but neglecting several important problems that affect revenue intake. In **productivity and competitiveness**, the Bank provided significant support to the

institutionalization of innovation, competitiveness, and quality policies through the creation of several institutions. Lastly, **NSG operations** generally have very low levels of evaluability, so their outcomes are difficult to identify. Some operations are highly relevant for development, but others less so; and the financial additionality of many operations is not demonstrated. The Bank is supporting the construction of Line 2 of the Lima Metro, financing both the government and the private concession holder. Although this dual participation entails both risks and opportunities, the IDB Group lacks a clear policy to guide its actions.

On balance, the IDB Group's work with Peru is positive. The following recommendations are made for the IDB Group to improve its services to the country:

- a. Adopt a strategic approach focused on strengthening public management, encouraging the country to make deeper changes. The Bank should maintain and strengthen the work niche where it has positioned itself, and continue to support the improvement of public management, broadly defined. That support should be given by increasing the depth of the reforms and concentrating on a smaller and more select number of areas based on a sound diagnostic assessment of the capabilities of the Peruvian government, identifying the priority areas lagging most, followed by dialogue with the government authorities.
- b. Building on previous success, increase support for the country in institutional areas of social inclusion and poverty reduction. These areas are still priorities in Peru, even though it has made great strides. The Bank possesses capacity to work on these issues, as demonstrated in 2011 when it became the main partner for addressing them. Yet this relationship has weakened in recent years. The Bank should extend an offer to the government to redouble its efforts to address these areas by helping it strengthen the MIDIS, improve the social protection system, and foster financial inclusion, among other things.
- c. Strengthen work with the private sector, selecting the projects to finance more carefully, making greater efforts to expand its population of potential clients, and improving the evaluability of its operations. The IIC should finance projects that have financial additionality and are relevant for the country's development. For this, the Inter-American Investment Corporation (IIC) needs to make itself more widely known in the Peruvian private sector, and thus expand its portfolio of potential clients to include more firms without a large market share. Lastly, the IIC needs to substantially improve the evaluability its projects, so that it can demonstrate its additionality and effectiveness.

- d. Continue supporting public-private partnership (PPP) projects, but with clear rules on such involvement established before the fact. The IDB Group should set the terms on which it will participate in this type of projects financing the public sector, private sector, or both. It should also have transparent guidelines in place that determine the scope and the time frames of its participation, financial and nonfinancial, in each case. That way, such projects can be supported without adding uncertainty to the concession processes, and avoiding conflicts of interest.

The Bank should redouble efforts to lower its lending charges and become more competitive. This applies to the institution generally, not just its relationship with Peru. Nonetheless, it is mentioned here because the relationship with Peru highlights the difficulties facing the Bank owing to its relatively low financial competitiveness.

1



Peru's population is highly concentrated along the coast and more sparsely distributed in the rest of the country, which poses challenges for the provision of infrastructure and water supply.

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1 Context of the Country Program, 2012-2016

A. OVERVIEW

Peru is an upper-middle-income country with a population of 31.5 million and a GDP of US\$192.1 billion (the seventh largest economy in Latin America). Per capita income, measured on the basis of purchasing power parity, was US\$12,195 in 2015 (eleventh in Latin America), compared with the US\$15,434 average for Latin America and the Caribbean.¹

The country's population is highly concentrated along the coast and more sparsely distributed in the rest of the country, which poses challenges for the provision of infrastructure and water supply. Peru is one of the most highly concentrated countries in the world, with the Lima Metropolitan area and El Callao alone accounting for 32% of the population, 45% of GDP, and 70% of port activity.² More broadly, the Pacific coast is home to 65% of the population and contributes 80% of GDP, but possesses only 1.8% of fresh water, which poses a serious supply challenge for that population. In the mountain and forest zones, by contrast, the population is spread very thin, which raises the per capita cost of infrastructure provision.

Peru is considered the world's tenth most vulnerable country in terms of climate change impacts.³ This reflects a combination of risk factors, including the high level of urbanization along the coast, the retreat of the glaciers in the Andes, and deforestation in the Amazon. The country's total glacial area shrank 43% between 1970 and 2014, putting water availability at risk because glaciers play an important role in the hydrological cycles of the western slope of the country. Peru has the second largest area of natural forest in South America; but about 50% of its greenhouse gas emissions are generated by changes in land use, such as deforestation and the advance of the production frontier.

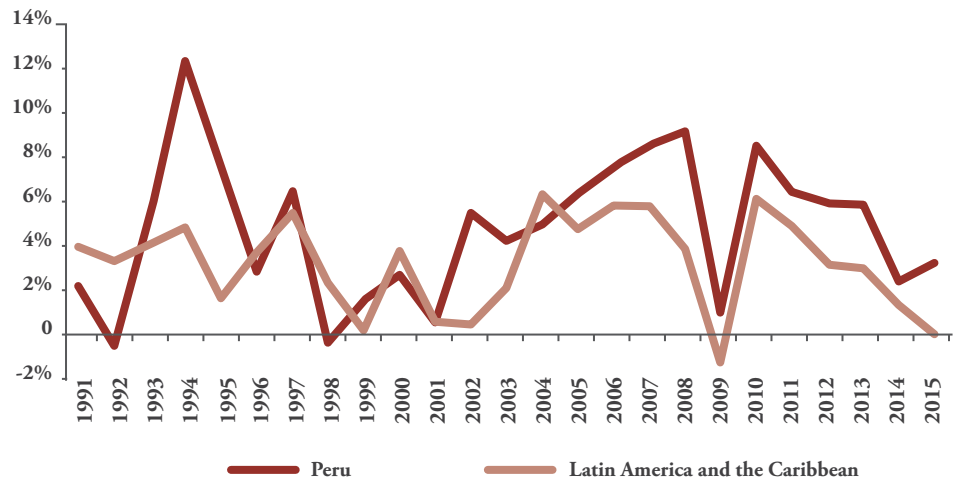
Since the early years of the 2000 decade, the Peruvian economy has been one of Latin America's best performers. Following a contraction phase in the 1980s, the economy began to grow rapidly in the early 1990s, following the implementation of a number of structural reforms. In the period 2002-2015, real GDP grew by an average of 5.7% per year, compared to 3.3% for Latin America and the Caribbean (Figure 1.1). This is the region's second highest growth rate after Panama. At the same time, Peru's gross public debt fell from 41.7% of GDP in 2005 to 23.3% in 2015, is a result of prudent fiscal management. The annual inflation rate averaged 2.9% in that period, the region's lowest.

The Peruvian economy continues to depend on mining, despite the sector's relatively small share. Peru is one of the world's leading producers of copper, lead, silver, tin, and zinc. Driven largely by the prices of these products on the international market, the mining and oil recovery sector's share of GDP (at current prices) rose from 6.3% in 2001 to 14.6% in 2011, then slipped back to 8.0% in 2015. The mining sector generates over half of the country's total exports (two thirds if oil and other hydrocarbons are included) (Figure A.1.1) and contributed an average of around 13% of the central government's current revenue over the last decade, although this proportion fell sharply in 2014-2015. Recent higher tax revenue intake from other sectors (rising from around 13% of GDP in the 2000s to over 15% in 2014) has contributed to lowering the dependence on mining.

The agriculture sector accounts for a small and declining share of GDP but continues to employ a large proportion of the labor force; and nontraditional agroexports have grown significantly. The agriculture sector represented about 5.2% of GDP in 2015, 25% less than in 2000. Its employment share has also fallen but still accounts for 25% of the total (40% if Lima is excluded and 55% in the mountain zone). Meanwhile, the sector's exports over the past 15 years have grown at a rate of 14.2% per year on average, driven by nontraditionals, which grew at an average 17.4% per year (traditional exports have grown at 6.4%).

FIGURE 1.1
Real GDP growth

Source: OVE based on BCRP and IMF data.



There was a sharp slowdown in economic activity in 2012-2015, owing mainly to external factors. The annual GDP growth rate dropped from 6.2% in 2002-2011 to 4.4% in 2012-2015 (with individual rates of 2.4% in 2014 and 3.3% in 2015). The main factors behind the economic slowdown in recent years include the fall in commodity prices (especially gold and copper) and the moderation of growth in the Chinese economy, the main buyer of Peruvian copper. These factors had an adverse impact on mining exports and private investment.

Fiscal policy generally accompanied monetary policy in responding countercyclically to the fluctuations in economic activity. The Peruvian government carefully manages the country's public finances. In mid-2014 it announced a package of fiscal measures to stimulate growth and investment with an estimated impact of two percentage points of GDP. The fiscal balance of the nonfinancial public sector (NFPS) posted a deficit of 0.3% of GDP in 2014, widening to 2.1% of GDP in 2015 (Figure 1.2). But between 2004 and 2014, on average, Peru managed to maintain the region's third highest fiscal surplus (as a percentage of GDP). The NFPS structural deficit is estimated at 1.6% of GDP in 2015, and the public debt is predicted to have risen from 20.1% of GDP in 2014 to 23.3% in 2015 (Figure A.1.2). The net public debt was equivalent to 6.6% of GDP at end-2015, lower than in most other countries in the region.

Inflation edged up slightly between 2012 and 2015, but has since begun to ease. Peru's average inflation rate for the last 10 years (2005-2015) has been the lowest in Latin America. However, the year-on-year rate rose to 4.4% in December 2015, above the upper limit set by the Central Reserve Bank of Peru (BCRP), owing to the effect of a steep depreciation of the Peruvian sol, rate hikes, and domestic supply shocks caused by adverse weather conditions (the El Niño phenomenon). Year-on-year inflation has since fallen back to 2.9% (August 2016) following a reversal of the supply shocks mentioned above and a nominal appreciation of the sol in the three months from March to May 2016. A deterioration of the terms of trade and a reduction in the surplus on the financial account of the balance of payments shrank the central bank's gross international reserves to US\$61.537 billion in late 2015, after reaching a level of US\$65.710 billion at year-end 2013.

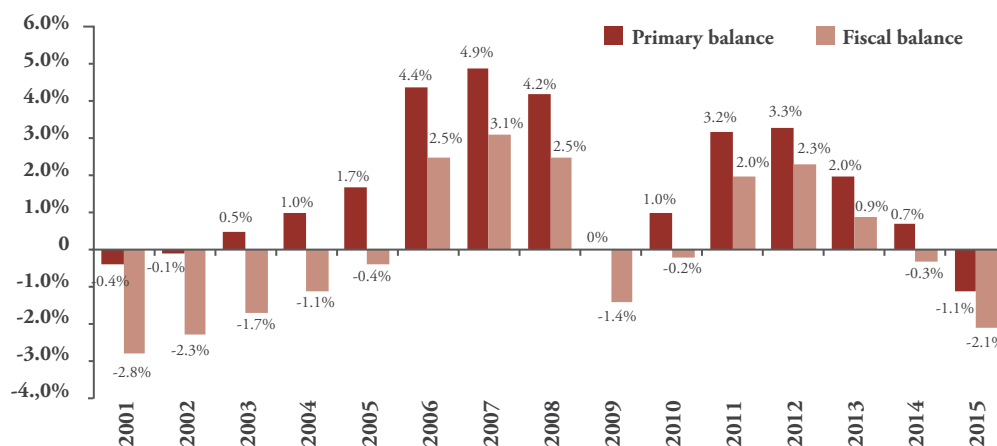


FIGURE 1.2
Primary and fiscal balance of the nonfinancial public sector (% GDP)

Source: OVE based on BCRP data.

B. DEVELOPMENT CHALLENGES

With its rapid economic growth, Peru has made significant gains in many areas. The infrastructure endowment has increased greatly (roads, electric power plants and distribution networks, water and sanitation facilities, schools and hospitals, etc.). The government's capacity to execute public expenditure has improved. The coverage of public education and health services has expanded significantly. Poverty (both moderate and extreme) has declined sharply, as has income inequality. Nonetheless, the country needs to make further improvements on several fronts.

Peruvian public expenditure remains relatively inefficient and ineffective, particularly at the subnational level. The overall tax burden (15.2% of GDP in 2015) is below the average for countries of similar income levels, partly because the tax structure contains numerous deductions, exemptions, and loopholes (worth over 2% of GDP), and evasion rates are high. Despite decentralization (Box A.1.1), the central government collects 98% of all revenue, so the subnational governments depend on the transfers it makes to them. Moreover, public investment displays several deficiencies, particularly at the subnational level, where it is scattered among small-scale interventions, sometimes generating low social returns, and execution well below the budgeted levels. There is also poor capacity for sectoral and territorial coordination, compounded by major disparities in resource transfers. Some regional governments do not have sufficient resources to perform their expenditure functions, while others, located in mining areas, receive very large transfers through the mining royalty. Lastly, the planning function is weak, so the budget bears little relation to the multiyear programming, and it is unclear which is the governing authority on the subject.

The country also faces competitiveness challenges, which have multiple causes. The contribution of total factor productivity to the economy's growth has been less than 2% over the last two decades, below the rates recorded by other benchmark countries in the region such as Chile and Colombia. Investment in research and development is low. In 2010 such investment was just 0.08% of GDP, compared to an average of 0.54% for Latin America and the Caribbean and 2.3% for the Organisation for Economic Co-operation and Development (OECD). Moreover, the excessive time and costs to start and shutter a business, hire labor, and the bureaucracy related to foreign trade and the execution of contracts, combine to form a major obstacle for productive activity. Lastly, informality is very high (roughly 70% of employment). Most jobs in the country are concentrated in small economic units with very low productivity.

The major infrastructure deficits that the country still faces also undermine its competitiveness. Despite recent substantial progress, Peru ranks 89th (out of 138 countries) in the World Economic Forum's infrastructure endowment

ranking. In addition, electric power generating capacity is adequate but service coverage remains low (92%), in comparison with other comparable countries. There are also very large disparities in infrastructure and service delivery between urban and rural areas. For example, in 2014, water and sanitation coverages in urban areas were 85% and 79% respectively, compared to 62% and 14% in rural areas (Table 1.1).

TABLE 1.1. INDICATORS OF THE URBAN-RURAL GAP

| | <i>Urban</i> | <i>Rural</i> | <i>Urban-rural gap (%)</i> | <i>Source</i> | <i>Year</i> |
|---|--------------|--------------|----------------------------|---------------|-------------|
| Basic services and infrastructure | | | | | |
| Connection to the public water network inside the home (% total homes) | 85% | 62% | 23% | INEI | 2014 |
| Connection to the public drainage network inside the home (% total homes) | 79% | 14% | 64% | INEI | 2014 |
| Use of electricity for lighting (% total homes) | 99% | 74% | 25% | INEI | 2014 |
| Paving of road networks (% road network) ¹ | 37% | 2% | 35% | MTC | 2013 |
| Education | | | | | |
| Net primary school attendance rate (% total population ages 6-11) | 93% | 93% | -1% | MINEDU | 2014 |
| Net secondary school attendance rate (% total population ages 12-16) | 87% | 75% | 12% | MINEDU | 2014 |
| Level of reading comprehension (% students at satisfactory level) | 50% | 17% | 33% | MINEDU | 2014 |
| Level of mathematics comprehension (% students at satisfactory level) | 29% | 13% | 16% | MINEDU | 2014 |
| Health | | | | | |
| Infant mortality during the first year of life (per 1,000 live births) | 16 | 25 | -9 | INEI | 2013/14 |
| Chronic malnutrition under WHO definition (% total under age 5) | 9% | 28% | -18% | MINSAs | 2015 |
| Anemia (% total children ages 6 to 36 months) | 43% | 49% | -6% | MINSAs | 2015 |
| Childbirth in healthcare establishments (% total births) | 92% | 74% | 18% | MINSAs | 2015 |

Source: OVE based on data from various ministries and public agencies.

Note: ¹ The urban area includes the national and departmental road network (linking urban centers), while the rural area includes the rural and farm-to-market road network (linking district capitals and population centers).

Although it has made great strides in terms of public-private partnerships (PPPs), the country must continue working on this issue. To speed up infrastructure investment, the Peruvian government has been working on the regulation and promotion of PPPs, developing one of the best regulatory structures in the region, along with those of Chile and Mexico. Nonetheless, the PPPs still face several challenges, such as building institutional capacity to formulate projects at both regional and local level and strengthening the phases of project prioritization and planning.

The financial system is solvent, liquid, and profitable, but it is highly concentrated, and the level of financial inclusion is low. The system is stable and has an effective regulatory framework stricter than Basle in terms of capitalization levels. Yet as of February 2016 the four largest commercial banks account for 84% of assets of the banking system, which in turn accounts for nearly 83% of all assets in the financial system. Largely owing to the concentration of the banking system and the intensive use of reserve requirements by the central bank, the interest rate spread in Peru is 13.4%, compared to a regional average of 6.8%. Lack of competition is one of the causes of the low level of financial inclusion, which is lower still in rural zones and areas with high poverty rates.

The coverage indicators for health and education services have improved significantly, but still face major challenges. In education, the quality of the services provided is one of the main problems, because it results in low levels of learning. For example, Peru was ranked last in the Program for International Student Assessment (PISA)⁴ of 2012. Moreover, and despite recent wage hikes for teachers, expenditure in the sector is equivalent to about 4% of GDP, one of the lowest in the region. The population has experienced a significant improvement in health levels, but the country is going through an epidemiological transition towards greater prevalence of noncommunicable diseases, which will increase the demand for health services and put pressure on government finances.

The country continues to display significant inequalities between urban and rural areas. According to the official measurement, the poverty rate in Peru fell from 59% to 22% between 2004 and 2015. In urban areas, however, the rate is 15%, compared to 45% in rural areas. In education and health there are also sharp differences (e.g., in levels of reading comprehension and mathematics, and in rates of chronic malnutrition). This is worrying both from the human rights standpoint and because it serves to perpetuate poverty (Table 1.1).

These differences point to a social inclusion problem. One of the fundamental challenges for promoting social inclusion is to improve the functioning and coordination of social programs. The Ministry of Development and Social Inclusion (MIDIS) was created in October 2011 for this purpose, but it is still necessary to strengthen this ministry, consolidate its functions, and improve the performance of the country's social safety net programs.

C. OUTLOOK FOR 2016 AND THE MEDIUM TERM

The BCRP is projecting higher growth than in 2014-2015, at around 4%, due to an increase in mining production and more vigorous public investment. The growth rate in the first half of 2016 was 4.1%. The higher expected growth is associated with the forecasted increase in mining output, given the earlier coming on stream of Las Bambas and expansion of Cerro Verde, and the announcement of an increase in

production targets by some firms. Public investment is expected to be more buoyant in 2016, owing to better management of expenditure by the subnational governments, while private investment is expected to virtually flatline. Inflation is expected to return to the target band by late 2016 and settle around 2.0% in 2017. The fiscal deficit is set to rise in 2016, while the deficit on the current account of the balance of payments should narrow on the back of stronger mining exports. The conventional fiscal deficit is set to grow to around 3.0% of GDP in 2016, while the structural deficit is likely to be 2.4% of potential GDP. Financing requirements should be 4.2% of GDP, pushing the public debt/GDP ratio up to 25.6%.

For the medium term, the economy is expected to grow at its potential rate of 4% per year. At the same time, a gradual process of fiscal consolidation is envisaged, to reduce the structural deficit to 1% of GDP (the limit specified in the Fiscal Responsibility and Transparency Law). To that end, in August 2016 Congress passed a law establishing a more gradual trajectory for the structural deficit, calling for a reduction to 2.2% of GDP by 2017 and 1% of GDP by 2021. Meeting these targets will take major effort.

The Peruvian economy has a number of external and domestic vulnerabilities that could affect its future performance. The main external risks, also affecting many other countries of the region, are a new period of global financial volatility, a more pronounced slowing of growth in China, supply shocks (a significant rise in the price of oil and other imports), or a further deterioration in the terms of trade. Moreover, a persistent strengthening of the United States dollar is also a risk, since the Peruvian economy remains highly dollarized.



The Project to Develop Solid Waste Management Systems in Priority Zones aims to make urban solid waste management more efficient and sustainable in 31 cities, by constructing sanitary landfills, acquiring collection and recovery equipment and vehicles, and preparing and implementing training plans for the segregating organizations.

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2 Relevance of the Bank's Strategy and Program

A. RELEVANCE

The Bank's country strategy with Peru 2012-2016 was structured along two lines of action and nine priority areas of work with the public sector. The two lines of action were defined on the basis of their objectives: the first aimed to "help close the urban-rural gaps," and the second sought to "stimulate sustainable economic growth" (paragraph 3.1 of the country strategy).⁵ The priority areas were: (i) social inclusion; (ii) rural development and agriculture; (iii) water, sanitation, water resources, and solid waste; (iv) housing and urban development; (v) transportation; (vi) climate change adaptation and disaster risk management; (vii) energy; (viii) public management; and (ix) competitiveness and innovation. Table A.2.1 (upper part) shows how the priority areas correspond to the lines of action.

The priority areas were based on sound and extensive technical work and selected through dialogue with the Peruvian government and civil society. The Bank's specialists produced 13 technical notes on different topics, including the nine priority areas. In general, these studies present a well-documented diagnostic assessment of the problems facing the country up to 2012 and their causes. The government authorities expressed their appreciation and satisfaction with the Bank's work and technical dialogue resulting in the formulation of the country strategy. A similar opinion was expressed by the interviewed representatives of the member organizations of the Civil Society Consultative Group (ConSOC).

The country strategy results matrix set numerous strategic objectives. In the results matrix, the nine priority areas (a large number) gave rise to 40 strategic objectives that in some cases showed no clear connection to the country strategy's two lines of action (Table A.2.2). The 40 strategic objectives correspond more to the atomized loan portfolio than to a selective and strategic proposal for work with the country. The majority of the 59 indicators associated with these objectives are SMART and have predefined baselines, targets, and means of verification.

In general, the country strategy is relevant and well aligned with the government's priorities. The two lines of action and the priority areas address some of the main development challenges facing Peru. The concern for the environment in the strategy is not reflected in the multiyear macroeconomic frameworks (MMFs)⁶ in force during the period.⁷ This does not imply disinterest in the environment on the part of the government (after all, Peru hosted the COP20 conference), only that it was not a top priority from the finance ministry's perspective. This difference in priorities had its main impact in the energy area, where the country strategy concentrated on contributing to "efficient, sustainable management of energy resources in Peru" (paragraph 3.27), whereas the MMF sought to close the urban-rural gap in electricity coverage. Another difference is in housing and urban development, which is not a priority in the MMFs; again, there are other planning documents, such as the Bicentenary Plan, that give more weight to the housing issue. In terms of lines of action, the country strategy is fully aligned with the MMFs. The first line of action corresponds directly to the first main economic policy guideline of the 2012-2014 MMF, while the second coincides with the third and fifth main economic policy guidelines (particularly the emphasis on fostering the creation of PPPs).

B. STRATEGY IMPLEMENTATION

Sovereign guaranteed (SG) loan approvals have exceeded the lending envelope envisaged in the country strategy; nonetheless, achieving that level of approvals has not been easy. The Bank would benefit from increasing its exposure to Peru, given the country good credit rating, but the Bank's shrinking lending space in Peru is a complicating factor. The lending envelope for 2012-2016 was US\$1.028 billion, and total approvals were US\$1.565 billion.⁸ This means that the lending envelope has already been exceeded by 52%; however, this is the result of three atypical operations, each for US\$300 million.⁹ Excluding these, loan approvals would be US\$665 million (Figure 2.1). Although approvals have been high, the Bank's financial exposure to Peru is less, since US\$600 million corresponds to two contingent operations that may never disburse. In general, the trend is toward an ever smaller lending space for the Bank in Peru (the previous period's lending envelope was 65% larger than for 2012-2016, and SG loan approvals were 5% lower).

Despite the high volume of approvals, prepayments by the country meant that the Bank could not maintain its share of Peru's multilateral debt or a net positive capital flow to the country. The annual approvals scenario in the country strategy would have allowed for a net capital flow of approximately US\$56 million, *ceteris paribus*. This would have lowered the Bank's share of Peru's total external debt from 16.4% in 2012 to 14.9% in 2016, but its share of the multilateral debt would remain around 40% of the total (the largest multilateral creditor). Nonetheless, in 2013, Peru prepaid several operations totaling US\$1.342 billion, thus making the net capital flow to the country negative (Figure 2.1), and reducing the Bank's share in Peru's multilateral and total external debt to 35.14% and 10.7%, respectively, in 2013.

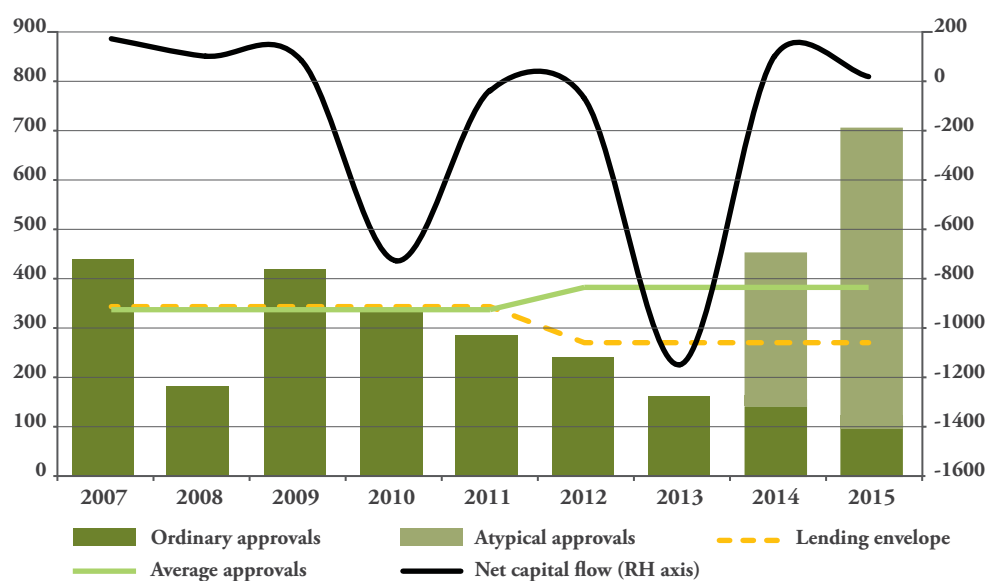


FIGURE 2.1
Approvals, lending envelope, and net capital flow

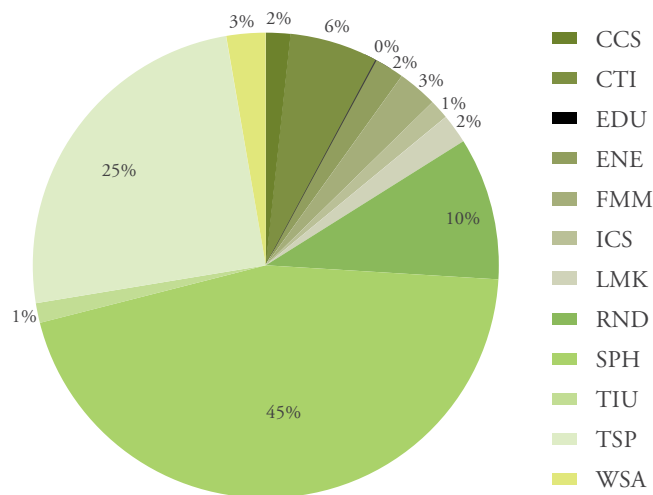
Source: OVE.

The smaller lending space for the Bank in Peru reflects the country's improved access to financial markets, and the fact that the Bank's lending charges have risen. Peru's credit rating has held steady at investment grade since 2008. As a result, its access to financial markets has been improving. During the period, the Peruvian government issued four bonds on international markets for a total of over US\$3.56 billion equivalent. It also brought its debt level down from 41.7% of GDP in 2005 to 23.3% in 2015. As a result, Peru's multilateral financing needs have been declining. Moreover, loans from the Bank charge a higher interest rate and fees than those of the World Bank. According to the Peruvian authorities, this is a very important factor when deciding on the amounts to be borrowed from these institutions. For example, in 2015, the Bank approved two programmatic policy-based loans with deferred drawdown option (PBP DDO) for US\$600 million, whereas in February 2016 the World Bank approved two similar operations for US\$2.5 billion. The CAF, meanwhile, has higher lending charges, but lower transaction costs. Accordingly, the shares of the World Bank and the CAF in Peruvian debt did not decline by as much as the IDB's (Figure A.2.1).

The approved SG lending program was concentrated in five of the Bank's divisions, corresponding to four of the priority areas identified in the country strategy. The Bank's Social Protection and Health (SPH) and Transport (TSP) divisions had the largest number of approvals during the period, with 70% of the total approved amount (Figure 2.2).¹⁰ In terms of the number of operations approved, the main divisions were Environment, Rural Development, and Disaster Risk Management (RND), SPH, Competitiveness and Innovation (CTI), Fiscal and Municipal Management (FMM), and TSP, with 72% of approvals among them.

The 2012-2016 country strategy sought to address the recommendation on targeting made in the previous CPE (document RE-403 2), but the program remained atomized. The previous CPE highlighted the 2007-2011 program's lack of targeting and recommended a focus, going forward, on sustainable growth and reduction of inequality. The 2012-2016 country strategy proposed those two focal issues as lines of action, but maintained a large number (nine) of priority areas (the 2007-2011 country strategy had a similar number). In terms of operations, a total of 27 SG loans was approved during the period in the nine priority areas (except housing) and two of the dialogue areas (Table A.2.3). In addition, each priority area contained several work areas, so the Bank's support was divided among many different specific topics. Moreover, the legacy portfolio at the start of the period was large, which contributed to the fragmentation of the program: 13 loan operations under nine of the Bank's divisions, with a total undisbursed amount of just over US\$191 million. As of June 2016, nine of these operations had already disbursed 100% of their funds.

FIGURE 2.2
Approved portfolio
by sector (amount
approved)



For work with the private sector, the country strategy was even less specific. It proposed the objective of promoting “private sector participation, encouraging the formation of public-private partnerships (PPPs) and other mechanisms in areas such as transportation infrastructure, delivery of basic services, access to social

services, and development of economic opportunities” (paragraph 3.1 of the country strategy). It also listed over 10 areas in which it expected the IDB Group’s four private-sector windows to work (Table A.2.1, lower part).

The IDB Group’s private-sector windows concluded a large number of operations with the financial sector, which had not been envisaged in the country strategy. The Structured and Corporate Financing Department (SCF) obtained approvals in all of the areas on which it would focus, apart from health, climate change, and energy.¹¹ The Opportunities for the Majority Sector (OMJ) obtained approvals only in the areas of education and housing finance. The Inter American Investment Corporation (IIC) approved four operations in renewable energy, 10 operations with the financial sector, and nine in other sectors (Table A.2.4). Lastly, the Multilateral Investment Fund (MIF) approved 28 operations (US\$20.5 million), 10 of which seek to make a direct contribution to rural social inclusion, and nine to promoting entrepreneurship, while six are focused on the financial sector.

A crosscutting issue proposed by the country strategy involves the promotion of private sector participation through PPPs, an area where the Bank has been supporting Peru for several years. For example, through the Public Expenditure Quality and Management Improvement Facility (PE-L1013, 2005-2012, US\$3 million), the Bank supported the development and approval of the methodology for valuing the contingent liabilities associated with PPPs, as well as the implementation of the institutional and operational framework for private sector participation in public investment, the development of the methodology for evaluating PPPs under the National Public Investment System (SNIP), and the PPP monitoring system, among other things.

Since 2012, the IDB Group has continued to support the development of PPPs in Peru in specific sectors. In the water and sanitation sector, a technical cooperation operation (PE T1234, 2012) was approved to support capacity-building for the implementation of PPPs. In health, the Management Modernization for Universal Health Coverage Program (PE-L1169, 2015) and a technical cooperation operation (PE-T1327, 2015) are supporting capacity-building at the Ministry of Health for the implementation of PPP projects, among other things. In the transportation sector, the IDB Group is financing the construction of Line 2 of the Lima Metro through an SG operation (PE-L1147, 2014, US\$300 million) and another NSG operation (PE-L1160, 2014, US\$450 million). In the energy sector, the IIC approved five operations to finance the construction of hydroelectric plants: Canchayllo (PE3949A-01, 2012, US\$7.2 million), Hidrocañete (PE3976A-01, 2014, US\$6.65 million), Andean Power Generation (PE3984A-01, 2015, US\$3.5 million), and Yarucaya (PE3971A-01, 2015, US\$12 million). SCF financed construction of the Chaglla hydroelectric project (PE-L1113, 2011, US\$150

million) and approved two further operations for the construction of wind farms (PE-L1139 and PE-L1156, 2014), although both were cancelled because the clients obtained better terms on the market.

The IDB Group's involvement in PPP projects is valued highly by external financiers. The Peruvian financial market is deep enough to finance PPP projects; nonetheless, the IDB Group, and multilateral banks generally, still have an important role to play when financing large, flagship projects, mitigating risks, or introducing new technologies. Additionally, external financiers view their participation as a seal of approval, indicating that the project is well-designed and will comply with high-level environmental and social safeguards. This "seal" makes it possible to raise external funding for all projects.

Between 2012 and June 2016, Peru was the Bank's fourth largest borrower in terms of the number of technical cooperation operations (TCs) approved. The Bank approved 70 TCs for Peru, surpassed only by Bolivia, Colombia, and Mexico. The total approved amount was nearly US\$52 million, the highest in the whole of the Bank; however, this includes one operation for over US\$18 million (PE-X1007) financed by the Canadian International Development Agency (without this, Peru would be the third largest recipient of funds, after Brazil and Colombia). The Bank also approved four investment grants for just over US\$74 million.¹² This intensive use of technical cooperation operations was only partly tied to support for loan operations (28 TCs) but mostly (64 TCs) targeted to the priority areas of the country strategy.

In operational terms, the country strategy proposed deeper changes were successfully implemented. Firstly, the strategy envisaged that 60% of SG approvals would be investment loans, and the remainder policy-based loans (PBLs). This did not occur, as 55% of approvals were through PBLs, but this is still an improvement on the period 2007-2011, when loans of this type represented 73% of SG approvals. Secondly, the country strategy envisaged using fee-for-service contracts¹³ in some priority areas; country demand, however, was limited to a single operation ("Technical Assistance in the Design of the Beca 18 Impact Assessment," PE-R1001).¹⁴ Lastly, the strategy was to be implemented, at least partially, through "development combos" consisting of coordinated projects with a multisector approach encompassing several of the country strategy priority areas (paragraph 5.1). This approach posed significant challenges for both the Bank and the country and was not implemented because of difficulties in coordination between the different government entities.

C. PORTFOLIO EXECUTION

In 2012-2016, the pace of execution of the Peruvian portfolio increased, particularly the legacy portfolio. The disbursement curve¹⁵ of SG investment loans that *were active* in 2012-2016 (i.e., legacy plus approved portfolio; Figure A.2.3 a and b)

shows a faster pace of disbursement than the active loans in 2007-2011. Moreover, the SG investment loans *approved* in the period 2012-2016 have been disbursing at a similar rate to loans approved in 2007-2011 (Figure A.2.3 c and d). Nonetheless, as the disbursement curve for the rest of the Bank eased slightly, the median of the Peruvian portfolio converged on the Bank median.¹⁶ These two observations together suggest that legacy portfolio execution speeded up. Virtually eight of the 11 legacy investment loans completed execution during the period, including three in the transportation sector approved in 2005 and 2006. In addition, the Bank made efforts to gain a better understanding of the functioning of the SNIP and to reconcile the project preparation process with that system.

However, execution ran into a number of problems that caused delays in several cases. Firstly, the high rate of staff turnover at government agencies has resulted in a loss of knowledge and experience with operations and, sometimes, changes in their direction. Secondly, in some cases the design of the projects, as agreed between the Bank and the Peruvian government, was overly ambitious (programmatic loans) or inadequate (several operations for infrastructure construction). Among the latter, there were some projects in which the redesign of the works led to major cost overruns. A third execution problem frequently noted by the government authorities and Bank staff is the lack of institutional coordination. Two other factors that commonly delayed execution were weak execution unit capacity and difficulties with procurement processes (Figure 2.3).

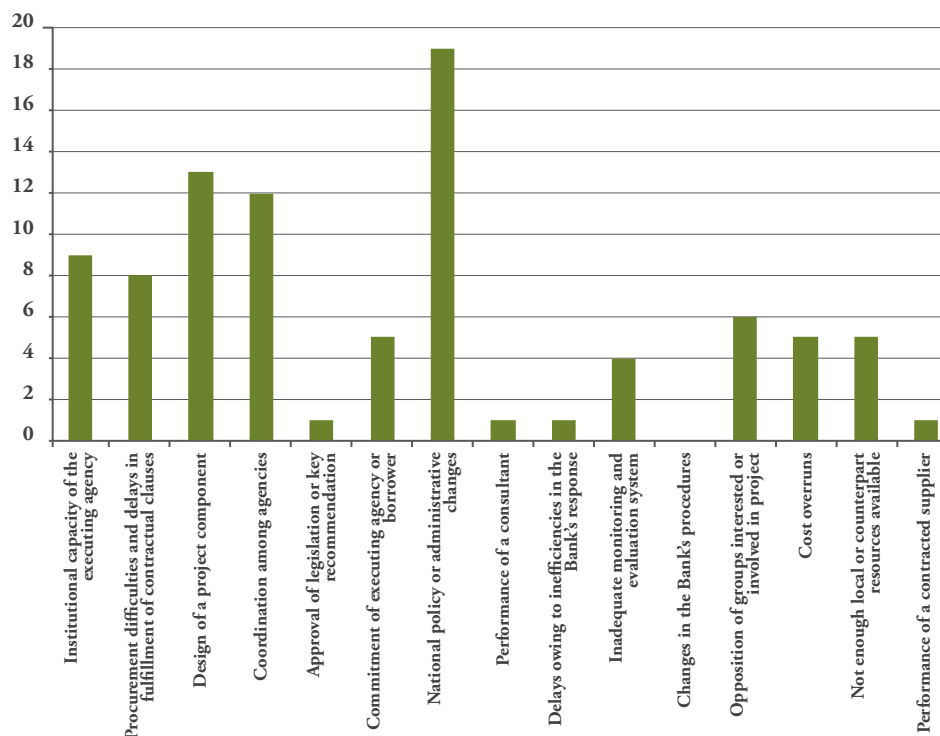


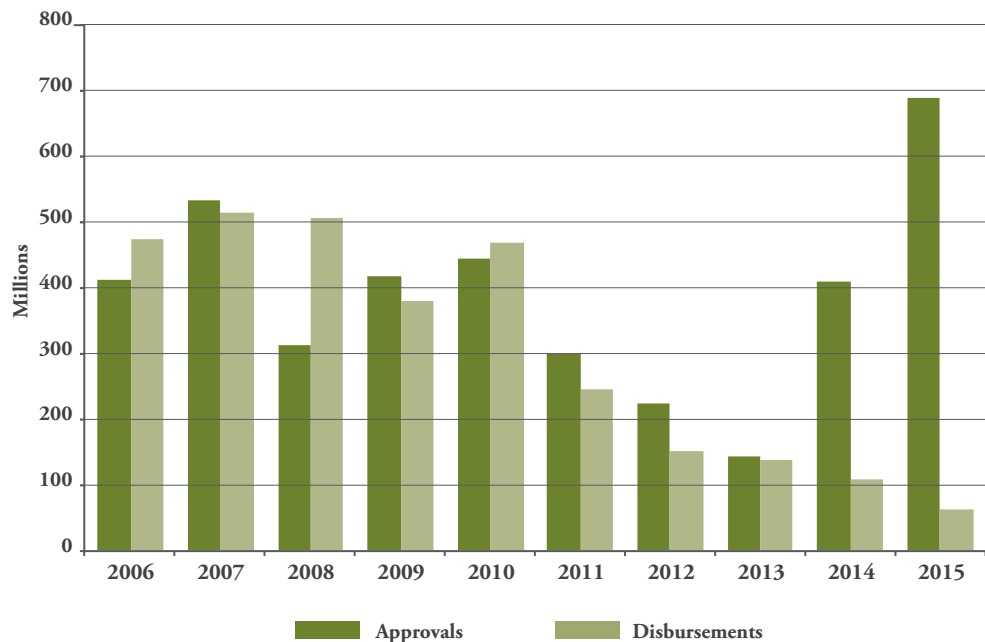
FIGURE 2.3
Frequency of execution problems reported

Source: OVE based on multiple supervision and evaluation documents and interviews.

Although execution was speedier, disbursements continued to trend downward due to smaller loan amounts. Over the last 10 years, the total volume of disbursements has been declining, but they are expected to rebound in the next few years, following the approval of the loan to build Line 2 of the Lima Metro (PE-L1147). In addition, if the PBP DDOs approved in 2015 are executed, total disbursements could rise even further (Figure 2.4).

The Bank also supported Peru in improving its country systems, but the majority of the targets included in the country strategy were not met.¹⁷ Through several different loans and TCs, the Bank has been supporting work to improve Peru’s financial management, audit, and public contracting and procurement systems. Nonetheless, the targets set in the country strategy were overly ambitious and are far from being met. Only one has been fully achieved: currently 100% of the SG portfolio is using the information and dissemination subsystem of the State Electronic Procurement and Contracting System (SEACE), whereas only 10% was doing so in 2012. Another indicator that shows significant progress (albeit not attributable to the Bank) is the percentage of the national budget prepared on a results basis, which rose from 20% in 2012 to 62% in 2016 (Table A.2.5).

FIGURE 2.4
Sovereign guaranteed approvals and disbursements



The Bank’s work in Peru shows a high level of coordination with other cooperation agencies. In general, OVE did not find cases that suggested a duplication of efforts or allocations between Bank-financed operations and those financed by other international cooperation agencies. On the contrary, a relatively high proportion of the portfolio is cofinanced with other donors. The clearest example

is the transportation sector, where eight of the 11 SG loan operations approved in the past 15 months have been cofinanced by the IDB and the World Bank in equal amounts.



Although the country strategy objectives for the sector (improve transportation infrastructure, the logistics sector, the efficiency of border crossings, urban mobility in cities, and road safety conditions) entail considerable investments in infrastructure, Bank financing has been maintained at US\$50 million per operation, while the counterparties have increased their contributions.

3 Progress and Outcomes of Active Operations During the Period

This chapter provides an overview of the achievements and progress made by the portfolio of active operations during the period. In addition to the operations approved since 2012, the evaluation also looked at those inherited from the previous period, often including operations that disbursed a small percentage of their resources between 2012 and June 2016. Also included were a number of operations completed before 2012 that are part of a coordinated set of projects, at least one of which was active between 2012 and 2016. This chapter focuses on operations that are already generating results and is organized according to the strategic objectives of the country strategy (grouped within the priority areas), considering the Bank's work in terms of lines of work or programs, rather than individual operations.

The country strategy results matrix shows a low level of attainment of targets. Up-to-date information is available for only 29 of the 59 indicators included, and the targets have been met or are close to being met in just 13 cases (Table A.2.2).

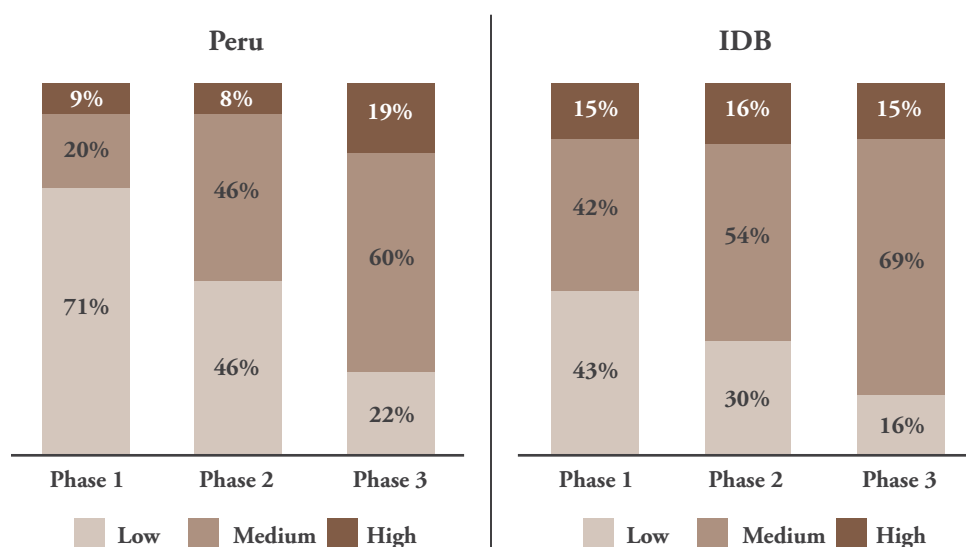
In general, the Bank's operations were focused on helping to improve public management and the Peruvian institutional framework. This is seen in virtually all work areas (not just the one named "public management"). In fact, much of the Bank's support has been aimed at strengthening the planning and management capabilities of line ministries and other public entities and improving the effectiveness and efficiency of government programs and policies, as well as reforming the institutional framework itself and creating new institutions.

Much of this work has been through programmatic series of policy-based loans (PBPs). In a very positive development for Peru, programmatic series there tend to be longer (three or even four phases) than in the Bank's other borrowing member countries,

and all phases are completed (document RE-485-6). In other words, all of the phases planned at the start of the series are implemented, although in most cases the policy conditions are adjusted as the series moves forward. These adjustments generally involve policy reforms on a smaller scale than originally proposed. An analysis of structural depth (such as the one performed by the IMF, see document RE-485-6) applied to all the programmatic series discussed below (mostly proposed before 2012) shows that the policy reforms undertaken in Peru generally had a depth rated between low and medium (lower than those of the aforementioned evaluation, although in that case the analysis covered different sectors and years than this CPE, so the results are not strictly comparable) (Figure 3.1).

FIGURE 3.1
Structural depth of policy reforms

Source: OVE.
Note: The results for Peru are not strictly comparable with those for “IDB” because the IDB’s correspond to a sample that included different sectors and periods.



A. SOCIAL INCLUSION (MORE HEALTH, EDUCATION, AND EMPLOYMENT)

The Bank was a key partner in setting up the Ministry of Development and Social Inclusion (MIDIS) in 2011. This support was not provided under any specific operation, but through technical support by Bank specialists. In the opinion of those who formed part of the MIDIS during its setup phase, such personalized support was pivotal and much greater than that of any other cooperation agency. Thus, in 2011, the Bank had positioned itself as Peru’s key partner on social inclusion and protection issues. However, following staff changes at MIDIS and the Bank, that positioning has weakened, and both the World Bank and the United Nations Development Programme (UNDP) have taken over the spaces for dialogue and cooperation vacated by the Bank.

The Bank’s work in social protection and early childhood development had the strategic objectives of expanding the coverage of the JUNTOS and Cuna Más programs (in the country’s 600 poorest districts), respectively. Significant progress was made in the coverage of JUNTOS, but the target set in the country strategy for the coverage of Cuna Más was not met (Table A.2.2). The Bank’s contribution in both cases was provided

indirectly, by helping to improve the effectiveness and efficiency of the programs. The Social Sector Reform Program (PE-L1072, PE-L1078, PE-L1100, and PE-L1105; 2009-2012; US\$186 million) (Table A.3.1) helped to improve some of Peru's main social and employment programs targeting poverty reduction and improved job opportunities. The program made important contributions in four areas. Firstly, it supported the JUNTOS conditional cash transfer program with a communication strategy, the new operating manual, and the baseline for the impact assessment.¹⁸ Although a differentiated payment for all households was not achieved, studies were undertaken with a view to begin doing so. Progress was also made in consolidating information of the regional offices and other institutions related to education, health, and social development and inclusion, to verify the fulfilment of co-responsibilities. Secondly, the budgeting methodology and operation of the Integrated Health System (SIS) were strengthened substantially. Thirdly, evaluations were made of the Construyendo Perú and Jóvenes a la Obra employment programs; and the rules of operation of the latter and of the Trabaja Perú program were improved. Fourthly, the program strengthened the SISFOH Household Targeting System and progressively succeeded in getting social programs to use the general household census to target their actions (Table A.3.2).

The Results-based Management Program for Social Inclusion (PE-L1129 and PE-L1154; 2013-2015; US\$330 million) continued to strengthen social programs, particularly JUNTOS and Cuna Más. The program supported an impact assessment of one care modality of the Cuna Más National Program (PNCM)¹⁹ that identified positive impacts on the cognitive and noncognitive capacities of the children covered. The Bank's operations also supported operational evaluations of JUNTOS, launching, with this, the systemization of monitoring of conditionality fulfilment nationwide. Support was also provided for the design of different aspects of the social programs, such as quality management, monitoring, communication, staff training, preparation of diagnostic studies, piloting of JUNTOS exit strategies, and financial inclusion among the beneficiaries of MIDIS programs. Lastly, support was provided for the development of program management mechanisms at the local level. It has not been possible to gauge the impacts of these actions (Table A.3.3).

In health, the country strategy proposed to “increase the coverage and enhance the quality of health services in the country's 600 poorest districts,” “reduce chronic malnutrition in rural areas,” and “reduce iron deficiency anemia in rural areas”. The country has succeeded in reducing malnutrition and the incidence of anemia, but it has been impossible to verify progress towards the first objective (Table A.2.2). Although the Bank's work has been directly aimed at this first objective, the increases in coverage and quality of the services have occurred as part of a national plan, so it is impossible to attribute them to the Bank's operations (Table A.3.4). During the period, the Health Sector Reform Support Program—PARSALUD (PE L1005; 2008-2015; US\$15 million) completed execution.²⁰ This operation sought to increase the use of mother-child health services and reduce infant morbidity in the under-threes, among families living in rural zones in the country's nine poorest regions. The operation exceeded its capacity-building targets,

but not those for the provision of equipment. The Bank is continuing to work to improve the public supply of health services, reduce system fragmentation, and consolidate public financing of the sector through the Program to Modernize Investment Management for Universal Health Coverage (PE L1169; 2015; US\$300 million).

In education, the Bank proposed to “improve the quality of services for children aged 3 to 5 in rural and indigenous areas,” “improve learning outcomes in key subjects” and “close educational gaps with emphasis on rural children and youth”. On the first objective, the Bank is funding the Program to Improve Early Education in Ayacucho, Huancavelica, and Huánuco (PE L1062; 2011; US\$25 million), which is financing the construction and rehabilitation of 127 classrooms and the equipping of early education centers, the provision of educational materials, and teacher training in three predominantly rural regions with high levels of poverty (Table A.3.5). On the other two objectives, operations PE T1232 and PE-T1243 financed a program to help preschool children learn the fundamentals of numbers and geometric forms through new educational materials, and a program to improve the science skills of third graders in Lima through teacher training. Impact assessments of both programs showed positive results. Furthermore, the Bank’s actions—support for teaching reform in 2012 and improvement of the quality of the supply of initial education—could make an indirect contribution to strategic objectives in the future. Although Peru generally relies more on the World Bank for support in the education area, the IDB was able to approach the sector authorities and helped to advance the teacher appraisal agenda, defining the evaluation tools to be used (PE T1303; 2013; 500,000).

B. RURAL DEVELOPMENT AND AGRICULTURE

In this area, the Bank proposed two strategic objectives: “increase... rural incomes” and “promote and set up mechanisms to reduce emissions from deforestation and forest degradation”. Although two of the five targets set in the country strategy were far from being achieved, and the rest could not be verified due to a lack of available data (Table A.2.2), the Bank supported programs that could contribute to greater agricultural competitiveness and forest conservation in the medium and long terms (Table A.3.6). On the first issue, the Bank continued to support the country through the Agricultural Competitiveness Program (PE L1066, PE L1097 and PE L1126; 2008-2013; US\$70 million), which contributed to the development of agricultural value chains and the structuring of the Compensation for Competitiveness Program (PCC) to mitigate the impact on the economy of small and medium scale producers caused by the free trade agreement signed with the United States in 2009. The Bank’s program also supported the implementation of the Fourth National Agricultural Census in 2012, and the creation of two important public services to improve the sector’s competitiveness: the National Agricultural Innovation System (SNIA), which gave greater space for private-sector participation, and the Agricultural Statistics Information System (SIEA). The Bank has continued to support the development of the SNIA and the SIEA through two loan operations (PE L1125; 2013; US\$40 million; and PE L1122; 2014; US\$15 million), but both have encountered delays in satisfying the conditions precedent and have not started disbursements (Table A.3.7).

The Bank also continued to support Peru in consolidating agricultural health and food safety services, through the Individual Loan for the Agricultural Health and Agri-Food Safety Program (PE L1023; 2008-2013; US\$25 million). This operation is the latest in a series through which the Bank has been supporting the successful development of the National Agricultural Health Service (SENASA), over nearly two decades. The operation targeted its efforts on continuing to eradicate fruit fly (a task that started with the operations PE0143 and PE L1007); but it also sought to strengthen the permanent and temporary services of SENASA. The operation helped SENASA to fulfil the goals of improving access to Peruvian agricultural products on international markets through their health certification. In addition, thanks to Bank support, in 2013 Peru gained recognition from the World Organisation for Animal Health (OIE) as a country that is free from foot and mouth disease, with and without vaccination, in the different areas of the country. Lastly, several impact evaluations of earlier phases of the program to control and eradicate fruit fly found that the program generated increases in agricultural income, better yields in a number of permanent crops, and higher land sale and rental prices, so similar benefits are expected from this operation.

Lastly, the Bank has supported the implementation of the Reducing Emissions from Deforestation and Forest Degradation (REDD) scheme through five TCs (PE T1225, PE T1287, PE T1294, PE T1298 and PE T1317). These operations supported work on the forestry issues that the country had been doing with a large amount of funding for forestry management and conservation: the Climate Investment Funds (CIF) and the Forestry Investment Program (FIP), together with the Forest Carbon Cooperative Fund (FCPF). The resources in question come from a variety of international grants and are managed by the World Bank, so the operations have entailed close coordination with that organization. The Bank's technical support in the process of advancing the National Forest Strategy and the FIP has been significant; but it is important to stress that this is an issue on which the country is already receiving financing and technical support from various cooperation agencies.

C. WATER, SANITATION, SOLID WASTE, AND WATER RESOURCES

The Bank's participation in this sector during the period was significant but financially small. The new operations focused on generating institutional capacities in the public governing bodies involved, whereas some of the legacy operations contributed to expanding the coverage of drinking water and wastewater treatment services. In the case of solid waste, collaboration has been given slowly and cautiously, following a logical sequence; but, contrary to the spirit of the country strategy, the resources were not invested specifically in rural zones. Lastly, in financial terms, the two loans approved during the period (US\$40 million in total) were very small for the sector, since they represented little over 3% of the total amount approved in 2012-2016, and less than 30% of the US\$141 million in grants received by Peru in the same period for drinking water and sanitation alone (Table A.3.8).

The Bank's support since the previous period has enabled the water and sanitation sector to make essential reforms to the governance of the service and its technical, environmental, and financial sustainability. The Second-Generation Sanitation Sector Reform Program (PE-L1091, PE-L1107, and PE-L1140; 2010-2014; US\$100 million) sought to help improve the efficiency, equity, sustainability, and environmental conditions of the provision of drinking water and sanitation services. The last operation in the programmatic series (PE-L1140, 2014) achieved the following: (i) the formulation and approval of the National Sanitation Sector Investment Plan 2014-2021;²¹ (ii) the preparation of regulatory and normative instruments; and (iii) the strengthening of environmentally sustainable sector management. Nonetheless, the issues of coverage expansion, wastewater treatment, promotion of new technologies, and private participation were not included in the program (Table A.3.9).

The country strategy proposed “universalizing access to water and sanitation services”. Nonetheless, progress in the infrastructure investment projects is slow, and only one of the four associated targets in the country strategy is close to achievement, whereas the other two are very distant (Table A.2.2). The Program to Improve and Expand Water and Sanitation Services in Peru – PROCOES (PE X1004, 2010, Spanish grant of US\$72 million) has helped to increase the coverage of drinking water and sanitation services in the rural areas and small cities of Puno, Cusco, Huancavelica, Apurimac, and Ayacucho, through the construction of community drinking water systems and individual bathrooms in each house. The project is displaying delays and significant cost overruns for multiple reasons, but they were due mainly to a change in the sanitation solution implemented (instead of latrines, a sanitary core unit including a sink, toilet, shower, and utility sink, is being installed in each household. As a result, the project has been extended until December 2017, and its amount has been increased by 486% (to US\$422 million) with local funds to be able to meet its targets. The project entitled “Cajamarquilla, Nievería and Cerro Camote scheme—expansion of the drinking water and sanitation systems of sectors 129, 130, 131, 132, 133, 134 and 135 – district of Lurigancho and San Antonio de Huarochiri” (PE L1060; 2011; US\$100 million) is delayed, and no progress has been made with the works in question.

In relation to solid waste, the Bank proposed to “strengthen solid waste disposal and handling at the municipal level.” Although the two targets proposed are a long way from being achieved (Table A.2.2), the Project to Develop Solid Waste Management Systems in Priority Zones (PE L1092; 2012; US\$15 million) is possibly the government's most important effort in the sector over the last few years. This program aims to make urban solid waste management more efficient and sustainable in 31 cities, by constructing sanitary landfills, acquiring collection and recovery equipment and vehicles, and preparing and implementing training plans for the segregating organizations. The program is cofinanced with the Japan International Cooperation Agency (JICA) (the leading cooperating agency in the solid waste sector in Peru), which is financing the program in 23 of the 31 cities. In the opinion of the beneficiaries consulted, the components already executed (equipment, training, and institutional strengthening) have started to display partial positive impacts, such as an improvement in cleanliness conditions in population settlements.

The Bank's collaboration in the water resources sector was significant but unduly modest. The country strategy proposed to "adequately value the availability of water resources" and "improve water resource management in watersheds" (Table A.2.2); and the operations were targeted on the strategic issues supporting the country's sector policies. Nonetheless, the funds invested were insufficient relative to the requirements (and importance) of the management and administration of water resources in Peru. The Project to Modernize Water Resource Management, (PE L1070; 2009; US\$10 million) for example, has succeeded in setting up a new institutional framework in three of the country's 159 river basins (six if the three financed by the World Bank are considered).

D. HOUSING AND URBAN DEVELOPMENT

The priority given by the country strategy to the Housing and Urban Development area was not aligned with the government's priorities, as indicated in the MMFs. Although the country strategy and some Peruvian government planning documents such as the Bicentenary Plan make housing a priority, the MMFs did not do so. This difference in priorities was reflected in the portfolio of operations which did not include any SG loan on housing issues. The IDB Group's participation in housing occurred mostly through loans made from the private-sector windows through financial institutions (Table A.3.10), seeking to improve access to home financing for medium- and low-income families. Supporting this population segment is very important given the shallowness of the mortgage market and the housing deficit faced by that population group. Although that positioning may be highly positive, it is impossible to say whether it is having a development impact, since the monitoring and evaluation scheme for these operations has major shortcomings (as do the majority of lending operations with financial intermediaries; see paragraph 3.36).

E. TRANSPORTATION

The value added by the Bank to transportation programs is becoming associated less with financing and more with technical support in structuring and implementing them. Although the country strategy objectives for the sector (improve transportation infrastructure, the logistics sector, the efficiency of border crossings, urban mobility in cities, and road safety conditions) entail considerable investments in infrastructure, Bank financing has been maintained at US\$50 million per operation, while the counterparties have increased their contributions. The Peruvian government authorities expressed their appreciation of the Bank's technical contribution made, and also the order, consistency and budgetary security associated with the execution of operations cofinanced with the Bank. Portfolio execution in the transportation sector has generally been slow. All loans at an advanced stage of progress have been restructured, some of them more than once. Of the nine targets proposed in the country strategy, the two relating to the national road network, where the Bank had a modest contribution, have been easily surpassed; it has not been possible to verify the other targets due to a lack of data available (Table A.2.2).

The portfolio in execution during the period can be divided in four: national road network (RVN), secondary and tertiary road network, border crossings, and the Lima Metro (Table A.3.11). In relation to national roads, the design of the National Highway System Serviceability Improvement Program (PE-L1006; 2006-2015; US\$100 million) did not make it possible to satisfy the needs of the RVN in a context of rapid economic growth. The program was restructured four times, reducing the target for length of roads improved or rehabilitated but increasing the level of complexity and depth. As a result, 124 km of compacted roads and 340 km of asphalted roads were rehabilitated, well below the original targets of 1,273 km and 649 km, respectively (Table A.3.12).

The Bank's intervention in subnational roads has been relevant, effective, and innovative. The Decentralized Rural Transportation Program (PE-L1011; 2006-2012; US\$50 million) and the Departmental Roads Program (PE0236; 2005-2013; US\$46 million) did not meet their original targets for road infrastructure, but did complete the rehabilitation and periodic maintenance of over 500 km in departmental and neighborhood road networks. They were also successful in terms of institution building and local capacity strengthening, in earmarking resource flows for maintenance, and in generating a dynamic of community participation. This is partly due to the continuity and integrated nature of the design, but also to the existence of the IDB and World Bank program;²² this has been crucial for maintaining consistency and technical rigor, and securing funds for the maintenance of the rehabilitated roads (Table A.3.12).

The Border Crossings Program (PE-L1003; 2006; US\$4 million) completed the construction of the Desaguadero pass (between Peru and Bolivia) but with higher costs and longer timeframes than envisaged. The Bank attempted to support dialogue and streamline processes for constructing the border crossing, but it lacked the effective instruments needed to achieve coordination and celerity in approving the designs by multiple binational institutions, which has generated significant delays in program execution. The Bank also supported the preparation of a strategic border crossings plan, which identified a set of work programs and investment needs.

The Lima Metro Line 2 project is complex and unprecedented in scale in Peru. The Bank and other multilaterals formally joined the project after it had been awarded, which limited their participation during the design phase. The IDB Group is participating through an SG loan (PE-L1147, 2014, US\$300 million) and another non-sovereign guaranteed (NSG) operation (PE-L1160, 2014, US\$450 million); it also has another SG operation in the pipeline. The dual participation of the IDB Group (through the public and private sector windows; the only financier in this situation) entails both risks and opportunities; but it was organized without a clear policy determining the conditions under which the IDB Group can play this dual role, and how the conflicts of interest that could arise should be handled. In addition, the project involves institutional, political, and social risks associated with the weakness of the preinvestment studies and lack of an integrated view of transportation in the city.²³

F. CLIMATE CHANGE ADAPTATION AND DISASTER RISK MANAGEMENT

The Program to Support the Climate Change Agenda (PE-L1080, PE-L1108, and PE-L1127; 2010-2013, US\$75 million) (Table A.3.13) was directly aligned with the country strategy objective of “strengthening government capacities and institutional coordination to respond to climate change challenges” (Table A.2.2). The program is based on the diagnostic assessment that the country presented in its National Communications to the UNFCCC. Although several of the policy reforms originally proposed were gradually relaxed, the program succeeded in taking the issue of climate change to the MEF and laying foundations for mainstreaming work on this issue throughout the country. Nonetheless, it was not very effective in promoting greater climate change response capacity in Peru, because the development and implementation of practical adaptation and mitigation actions is slow. Moreover, the program’s additionality was limited, compared to the country’s progress on climate change, since many of the reforms were already being introduced by the country earlier. It did, however, motivate the government to terminate several reforms that had stagnated. The TC operations, however, played a key role in supporting the implementation of PBPs and promoting progress on critical adaptation issues, such as capacity-building in regional governments and the development of the Climate Change Adaptation Program for the Fishing Sector (Table A.3.14).

The Program to Reduce the Country’s Vulnerability to Disasters (PE-L1086, PE-L1104 and PE-L1138; 2010-2014; US\$75 million) was directly aligned with the strategic objectives defined in the country strategy of “reducing the country’s vulnerability to disasters and climate change”. The program arose from the work that the Bank has been doing in the region for several years now. The general objective of the program was to strengthen and modernize the regulatory, institutional, and public policy frameworks for integrated disaster risk management. One of its key goals (raising the risk management index) was included in the country strategy (Table A.2.2), and its attainment is attributable to the Bank. The program succeeded in having the Department of Disaster Risk Management (SINAGERD) created, which enabled the country to transit from a purely reactive management system (run by the National Civil Defense Institute (INDECI) until 2011) to an integrated one that includes prevention and a financial strategy for disaster management, and involves INDECI, MEF, the National Strategic Planning Center (CEPLAN) and sectoral and territorial entities. Nonetheless, SINAGERD faces difficulties in coordination between all the agencies involved, and it is necessary to generate mitigation capacity and disaster services among regional governments (Table A.3.15).

G. ENERGY

Program for the Development of a New Sustainable Energy Matrix (NSEM) (PE-L1061, PE-L1055, PE-L1054 and PE-L1121; 2009-2012; US\$230 million) was directly linked to the country strategy objective of “supporting the development of a sustainable energy matrix” (Table A.2.2). The program, which included the only SG loan operation in the energy sector approved in the period (Table A.3.16), aimed to support the development

of a New Sustainable Energy Matrix (NSEM), consistent with Peru's development objectives of maximizing the benefits of renewable energy sources. The program's main outcome was the formulation of the NSEM proposal and a strategic environmental assessment, along with planning instruments. However, this effort did not elicit the level of ownership needed from the authorities and technical experts to be implemented, nor did it respond to the sector's short and medium-term challenges. Its implementation is further complicated by the fact that the low gas prices for electric power generation reduce the competitive margin of renewable energies. Peru has made progress on unconventional renewable energy sources, but this has been thanks to the legislation promoting its use in the national grid system, which was approved before the start of the programmatic series.

The Program for Efficient and Sustainable Management of Peru's Energy Resources (PROSEMER) (PE X1007; 2012; US\$18 million in Canadian grants) aims to strengthen the sector's institutions in their planning, management and regulatory capacities. One of its components is aligned with the strategic objective of "supporting improvement in the management and transparency of public enterprises in the energy sector" (Table A.2.2). This program is still executing, but it displays similar risks to those that restricted the scope of the NSEM. Firstly, the program was late in involving the Ministry of Energy and Mines. Secondly, despite the studies that have been performed, the capacity to turn them into effective public policies may again be limited by the technical capacity of the sector units involved, which is still low.

In the energy sector, the IDB Group's NSG portfolio was concentrated in renewable energy generation. The most important operation is the Chaglla hydroelectric project (PE L1113; 2011; US\$150 million), since the plant will have a capacity of 456 MW (about 10% of the installed hydroelectric capacity nationwide and 3% of total capacity). Apart from this operation, the IIC is financing four other projects for small-scale hydro power plants, which have obtained contracts through the renewable energy resource auctions convened by the Supervisory Body for Energy and Mining Investment (OSINERGMIN). The MIF was the only IDB Group window participating in rural electrification, through two small-scale operations. These had a positive impact, because the installation of electricity systems generated savings in expenditure on other energy sources, and lengthened time available for study and boosted school attendance rates.

H. PUBLIC MANAGEMENT

The Bank's operations supported four broader aspects of public management: tax administration, management of national and subnational public expenditure, e-government, and modernization of control agencies (Table A.3.17). The country strategy proposed nine strategic objectives for the public management area, of which only three are close to achieving their targets (Table A.2.2). In tax administration, the Bank completed implementation of the Program to Integrate the Tax and Customs Administrations (PE0223; 2003-2013; US\$3 million), achieving significant progress in terms of merging

the domestic tax and customs administrations (Table A.3.18). Nonetheless, this was not sufficient to fully integrate the functioning of the Superintendency of National Customs and Tax Administration (SUNAT), so the program is currently being complemented by the Tax and Customs Administration Consolidation Project (PE L1130; 2014; US\$15 million). Although this project serves important tax administration needs, insufficient emphasis has been placed on several important problems that affect revenue, such as the high level of informality in the economy.

The Bank continued to support the strengthening of the Office of the Comptroller General of the Republic (CGR). Through the program for the Modernization of the Office of the Comptroller General of the Republic and Decentralization of the National Control System (PE L1002; 2004-2013; US\$12 million), the Bank wanted to support a comprehensive rethink of the CGR's mission and decentralize the National Control System (SNC). Nonetheless, resistance to the proposed changes within the institution was the main factor that hindered project success. In 2013, under a new leadership of the CGR, the Bank approved the project for Improvement of the National Control System (SNC) for Effective and Integrated Public Management (PE L1132; 2013; US\$20 million) mainly to resume and consolidate the SNC decentralization process and incorporate management audits into the CGR's activities. The project provides support for a broader program of modernization for the CGR as a whole.

The period also saw implementation of the Program to modernize the Justice Administration System to Improve Services Provided to the Peruvian Population – First Stage (PE L1031; 2011; US\$25 million). The project aims to improve Peru's justice administration system (SAJ), by increasing the coverage, productivity, and quality of its services, supporting the interconnection of its entities and improving the efficiency of spending in the sector. An additional component seeks to reduce the rate of recidivism among young offenders. The project has faced several execution problems, including lack of coordination, which is partly the consequence of the twin headed nature of the project, which has an executing unit and a coordinating unit with very similar functions, but in different entities. The construction of several integrated SAJ centers, where various SAJ entities will converge to facilitate the provision of services to citizens, has been delayed and is now displaying substantial cost overruns. There is also the risk that the proposed interagency agreements for the shared use of premises between the different SAJ entities will not be formalized, which would seriously jeopardize the objective of those centers.

I. COMPETITIVENESS AND INNOVATION

The operations in this area can be divided into three subthemes: science, technology and innovation; productivity and business competitiveness; and trade facilitation (Table A.3.19). On science, technology, and innovation, the Bank provided significant support for the institutionalization of innovation policy in Peru. This was done by creating the Innovation, Science, and Technology Fund (FINCYT), in the framework of the Science

and Technology Program (PE0203; 2005-2013; US\$24 million), which was continued through the Innovation for Competitiveness Project (PE L1068; 2012; US\$35 million). The loan operations financed contestable funds for business innovation and research projects, and for the strengthening of research capabilities, including through postgraduate scholarships. An impact assessment²⁴ of the first operation identified positive effects among the firms benefiting from the contestable funds, in terms of innovations in products, processes, organization, and marketing (Table A.3.20). Nonetheless, these results are too modest to be reflected in the targets proposed in the country strategy relative to the objectives of “developing a comprehensive innovation and development toolkit” and “encouraging innovation and business sophistication in small firms” (Table A.2.2).

To increase business productivity and competitiveness, the Bank supported an improvement of the business environment, the strengthening of the institutional framework, and policies and tools for competitiveness. This was aligned with the strategic objectives of “deepening reforms to improve the business climate” and “achieving a strengthened and articulated national quality system, specified in the country strategy (Table A.2.2). This support was provided through the programmatic series to improve productivity and competitiveness (PE L1076, PE L1098 and PE L1099; 2010-2014; US\$105 million), which succeeded in sustaining a series of reforms that had been started before the change of government. The most substantial reforms included support for the institutionalization of the National Competitiveness Council (CNC), of the National Programme of Innovation for Competitiveness and Productivity (*Innovate Perú*) and FONDECYT, and the creation of the National Quality Institute (INACAL) and Technological Production Institute (ITP). These reforms help Peru improve its position in the World Bank’s *Doing Business* ranking, which rose from 56th in 2010 to 35th in 2015 and surpassed the target set for the programmatic series. Nonetheless, the second impact indicator for the series—the level of business sophistication in the WEF Global Competitiveness Index—was not met, falling from 4.02 to 3.9, below the target of 4.2 (Table A.3.21).

J. PRIVATE SECTOR²⁵

Non-sovereign guaranteed (NSG) operations (Table 2.4) in Peru are very important for the IDB Group, but it is unclear whether many of them are equally important for the country. The portfolio of approved operations in Peru during the period is the third largest of the IIC (including SCF and OMJ) after Brazil and Mexico²⁶ and includes large operations representing 62% of the total approved amount, including cancellations. Moreover, abundant liquidity is available for many segments of the private sector that have access to the Peruvian and international financial market, and the IDB Group has difficulty in finding clients. This is shown by the fact that seven out of 36 operations approved were either cancelled or prepaid by clients who obtained another funding source and many operations did not represent work with new clients (23 operations corresponded to 11 business groups). In addition, loans in dollars are less attractive for financial intermediaries owing to the high reserve requirements imposed by the BCRP to reduce the dollarization of the economy. Lastly, there are signs that some of the IDB

Group's operations could be shifting into the private financial sector, since some clients interviewed by OVE said that obtaining an above-market rate of return is one of the reasons why they decided to take a loan with the IDB Group.²⁷

IDB Group operations with financial intermediaries (44% of NSG operations approved) proposed relevant targeting, but it is impossible to confirm whether this is being achieved. Although the country strategy did not propose the financial sector as a priority (except for SCF), 11 out of 25 IIC approvals, three of the four OMJ approvals, and two out of seven in the SCF division were with financial intermediaries. Through these 16 operations, the IDB Group window sought to increase financing to different groups and for different purposes. The IIC focused on micro-, small and medium-sized enterprises (MSMSEs), justifying its financial additionality by offering longer maturities. The OMJ focused relatively more on housing finance for low-income people, supporting the generation of projects that are not found on the local market. In addition, 18% of operations sought to target part of their funds on rural zones, and 27% to improve women's access to credit. Nonetheless, half of these operations did not provide sufficient indicators to verify that such targets had been met.

The information is too limited to assess the effectiveness, efficiency, and sustainability of operations with financial intermediaries. Of the seven operations (six of them legacy) that attained early operational maturity (EOM) during the period, thus far only one of them has an expanded supervision report (XSR), and another has a PSR. Both operations exceeded their targets in terms of the number of loans granted, although one did not meet the goal of 75% of those loans being targeted on the base of the pyramid (the percentage achieved was 46%). The other operation also exceeded its targets for the growth of the portfolio of micro and small enterprises and in terms of the loan maturities.²⁸ In broader terms, operations with financial intermediaries generally have inadequate indicators to determine the effectiveness of the operations, because they would require the money to be nonfungible.²⁹

NSG operations in other sectors (19 operations) vary greatly in their levels of relevance and additionality (both financial and nonfinancial). The majority of these operations (five in renewable energy and six in education, agriculture, tourism, and transportation) are significant for the country's development; in the remainder, relevance is low (e.g. in many cases the number of jobs they were expected to create was very small). Financial additionality was not well justified in 11 of the 19 operations, because the other financial alternatives that were available to the client were not explained, nor the value added by the loan maturity. In terms of nonfinancial additionality, many operations mention technical assistance, but in only in two cases could evidence be found that the assistance in question has materialized.

It is not yet possible to evaluate the efficiency and effectiveness of most of these operations. Only three of the 19 operations (one of them legacy) have attained EOM; and, of these, only two have an XSR. The efficiency level was satisfactory in one case but unsatisfactory in the other (although in this case the financial target was set for 2019). In neither case can a judgement be made about their effectiveness (in one because the indicators proposed were purely financial and, in the other, because there is no up-to-date information).



The Bank continued to support the country through the Agricultural Competitiveness Program, which contributed to the development of agricultural value chains and the structuring of the Compensation for Competitiveness Program to mitigate the impact on the economy of small and medium scale producers caused by the free trade agreement signed with the United States in 2009.

4 Conclusions and Recommendations

On balance, the Bank's work with Peru between 2012 and 2016 is positive. The country strategy was mostly aligned with the government's priorities and with the country's development needs; some of the operations approved gave signs of continuity and long-term support by the Bank; and in general there was a high degree of coordination with other international cooperation agencies. In addition, program execution gathered pace, attaining the Bank's median performance level.

The Bank made SG loan approvals for a larger amount than the planned lending envelope, but the lending space is closing on it. Approvals were as high as they were thanks to three atypical operations of US\$300 million each (two of which might never be disbursed). Without these, the lending envelope would probably not have been achieved. Peru is comfortably maintaining its investment-grade and has better access to financial markets every day (particularly in the current high liquidity situation). At the same time, the Bank has raised its lending charges, making it less financially competitive with markets and other international cooperation agencies.

Despite this, the country values the relation with the Bank for financial, technical, and continuity reasons. As part of its careful management of public finances, the Peruvian government seeks a diversified set of financing sources. In addition, the authorities are aware that the Bank could be a very important backup in the case of a financial crisis. Moreover, some line ministries express their pleasure in working with the Bank since this is a way of guaranteeing financing and the long-term continuity of the policies. Lastly, the Bank's technical capacity is recognized and appreciated.

The Bank has found a collaboration niche in the improvement of public management. In practice, in nearly all priority areas of the country strategy, the Bank's work has been targeted on strengthening the planning and management capacities of line

ministries and other public entities, improving the effectiveness and efficiency of government programs and policies; and, on occasions, reforming the institutional framework itself by creating new institutions.

This positioning stems both from the narrow lending space and the country's appreciation for the Bank's technical capacity. The vast majority of the loans approved by the Bank are for relatively small amounts (US\$30 million) relative to the size of Peruvian economy, which makes them less suitable for financing large infrastructure works. Loans that finance infrastructure are generally shared but larger than the funds provided by the Bank; and when the operations have incurred cost overruns, the government has often been able to supply the additional funding needed. Thus, lack of financing is not the main reason why the country seeks the Bank's support. On the contrary, there is a lot of institutional support, as described above, both in policy-based loans and in TCs and investment loans.

The Bank also made a number of mistakes, which it will need to correct in the future. One of them is having proposed an atomized program of work in multiple areas, instead of a specific and more strategic focus. By encompassing so many issues, the Bank included some that did not have a comparable priority for the government, which meant that related loan operations did not materialize. Another mistake was failing to consolidate the positioning it had achieved as the leading cooperation agency on social inclusion issues, which were the government's top priority. Moreover, the design of the projects was not always the most appropriate, which resulted in delays and adjustments during execution, changes to the policy reforms originally proposed, or some basic issues not being addressed. Lastly, the Bank's participation in the financing to build the Line 2 of the Lima Metro, began somewhat imprudently, without having clear guidelines on providing simultaneous financing to the public and private sectors.

As a whole, the scale of its work with the private sector is important for the IDB Group, but in many operations the relevance to the country's development is unclear. The NSG portfolio in Peru is the third largest of the IDB Group, but some of the operations have little relevance for development, and many are not well justified in terms of their additionality (financial and nonfinancial). In addition, on many occasions, insufficient information was obtained to verify whether the outputs (let alone the outcomes) have been achieved. For these reasons, it cannot be said that all operations are having positive impacts for the country.

Based on the foregoing, the following recommendations are made for the IDB Group to improve its services to the country:

- a. Adopt a strategic approach focused on strengthening public management, encouraging the country to make deeper changes. The Bank should maintain and strengthen the work niche where it has positioned itself, and continue to

support the improvement of public management, broadly defined. That support should be given by increasing the depth of the reforms and concentrating on a smaller and more select number of areas based on a sound diagnostic assessment of the capabilities of the Peruvian government, identifying the priority areas lagging most, followed by dialogue with the government authorities.

- b. Building on previous success, increase support for the country in institutional areas of social inclusion and poverty reduction. These areas are still priorities in Peru, even though it has made great strides. The Bank possesses capacity to work on these issues, as demonstrated in 2011 when it became the main partner for addressing them. Yet this relationship has weakened in recent years. The Bank should extend an offer to the government to redouble its efforts to address these areas by helping it strengthen the MIDIS, improve the social protection system, and foster financial inclusion, among other things.
- c. Strengthen work with the private sector, selecting the projects to finance more carefully, making greater efforts to expand its population of potential clients, and improving the evaluability of its operations. The IIC should finance projects that have financial additionality and are relevant for the country's development. For this, the IIC needs to make itself more widely known in the Peruvian private sector, and thus expand its portfolio of potential clients to include more firms without a large market share. Lastly, the IIC needs to substantially improve the evaluability its projects, so that it can demonstrate its additionality and effectiveness.
- d. Continue supporting PPP projects, but with clear rules on such involvement established before the fact. The IDB Group should set the terms on which it will participate in this type of projects financing the public sector, private sector, or both. It should also have transparent guidelines in place that determine the scope and the time frames of its participation, financial and nonfinancial, in each case. That way, such projects can be supported without adding uncertainty to the concession processes, and avoiding conflicts of interest.

The Bank should redouble efforts to lower its lending charges and become more competitive. This applies to the institution generally, not just its relationship with Peru. Nonetheless, it is mentioned here because the relationship with Peru highlights the difficulties facing the Bank owing to its relatively low financial competitiveness.

- ¹ World Economic Outlook (IMF), April 2016. Unadjusted per capita income was US\$6,021 in 2015.
- ² See World Bank, 2015. Perú, hacia un Sistema integrado de ciudades: una nueva visión para crecer [Peru, an integrated system of cities: A new vision for growth]. The indicator measures the percentage of the urban population that lives in the largest city.
- ³ Tyndall Center, 2004. Mentioned in the United Nations Framework Convention on Climate Change (UNFCCC).
- ⁴ The 2012 PISA included 65 countries.
- ⁵ The country strategy also envisaged six dialogue areas: (i) trade and integration; (ii) access to financial services; (iii) labor markets; (iv) environmental and territorial management; (v) citizen security; and (vi) gender and diversity.
- ⁶ The multiyear macroeconomic framework (MMF) of the MEF is the Peruvian government's main planning tool. According to Legislative Decree 1088 of 2008, the National Strategic Planning Center (CEPLAN) serves as the apex authority of the National Strategic Planning System (SINAPLAN) with national jurisdiction. This would make the "Bicentenary Plan, Peru 2021" the main planning tool. Yet all those interviewed, including CEPLAN authorities, agreed that the SINAPLAN institutional framework is still weak, and in practice the MMF is the Peruvian government's main planning tool. Moreover, the Bicentenary Plan was published during the previous administration, whereas the 2012-2014 MMF was published during President Humala's administration. This document is available (May 2016) at: https://www.mef.gob.pe/contenidos/pol_econ/marco_macro/MMM2012_2014_Rev.pdf
- ⁷ The 2015-2017 MMF, also expressed concern about the negative effects that "environmental requirements that exceed international standards" have on the business climate in Peru (page 46).
- ⁸ As of 30 June 2016. The pipeline contains one more operation for US\$80 million, which is expected to be approved in November 2016. This CPE covers the period from January 2012 to June 2016, although the country strategy spans June 2012 to June 2016. The reason is to address all the Bank's work since the previous country strategy, which ran through 2011. This CPE includes two operations (PE-L1068 for US\$35 million and PE-L1101 for US\$20 million) approved prior to the country strategy period, since it includes the months of January through May 2012.
- ⁹ These approvals are atypical because: (i) this is the first time that the programmatic policy-based loan with deferred drawdown option (PBP-DDO) instrument is being used (in two of the three operations); and (ii) they are relatively large (the other SG investment loans approved in the period averaged US\$30 million, whereas the average size of other policy-based loans was US\$27 million).
- ¹⁰ Importantly, 90% of the amount approved by SPH during the period corresponds to programmatic operations (PBPs) under the deferred drawdown modality (DDO), which means that the loan might not be disbursed. In addition to the approved portfolio, a legacy portfolio was also executed during the period, which, in early 2012, consisted of 13 loans with a total undisbursed amount of over US\$191 million. Three of those operations were with TSP, two with the Water and Sanitation Division, and another two with SPH.
- ¹¹ SCF prepared, but did not succeed in concluding, two operations for the construction of wind power plants for electricity, which would have counted for the climate change and energy areas.
- ¹² US\$72 million corresponds to the Program to Improve and Expand Water and Sanitation Services in Peru (PROCOES), financed by the Spanish Fund.
- ¹³ This instrument, approved in May 2013 (document GN-2706-1), has been used just six times in the whole of the Bank.
- ¹⁴ Only six operations involving service contracts have been approved in the whole of the Bank.
- ¹⁵ Disbursement curves plot the percentage of an operation disbursed over time.
- ¹⁶ The comparison is not against the entire Bank portfolio, but a synthetic portfolio (the average of 1,000 random selections) based on the whole Bank portfolio, with features similar to those of the Peruvian portfolio (in terms of sector and year of approval).

- ¹⁷ According to Bank Management, more progress has been made recently.
- ¹⁸ Although the baseline was defined, no evaluation has been made.
- ¹⁹ The other modality was not evaluated because the data collected did not permit.
- ²⁰ The first phase (PE0146) was approved in 1999 and completed in 2005.
- ²¹ The PNIS was the outcome of collaboration between a group of cooperation agencies known as “Grupo AGUA”.
- ²² The vast majority of loan operations in the transportation sector have been cofinanced by the IDB and the World Bank in equal shares.
- ²³ The original project design focused on the works and did not include aspects of the project associated with the regulatory and institutional arrangements necessary for integration with other modes, nor the institution-strengthening required for comprehensive management of the project. Technical complications have also been identified that may entail modifications.
- ²⁴ FINCYT, 2013.
- ²⁵ This section summarizes the support provided by the IDB Group’s NSG windows to the Peruvian private sector. The discussion does not include MIF operations, but only those of the three windows that were merged in the new IIC (SCF, OMJ, and IIC). The evaluation considered all operations approved since 2012, as well as all those approved before that year which attained early operational maturity (EOM) in 2012-2016. Owing to the lack of available information, only the relevance dimension was analyzed in most cases. The effectiveness, efficiency and sustainability dimensions were only analyzed for operations that attained EOM, on the basis of the project completion reports (now known as expanded supervision reports, or XSRs) prepared by the IDB Group management.
- ²⁶ In terms of financial exposure, the Peruvian private-sector portfolio is the IDB Group’s second largest NSG portfolio after the Brazilian portfolio.
- ²⁷ It should be borne in mind that these interviews are not a representative sample of the IDB Group’s loan portfolio in Peru.
- ²⁸ These achievements, while positive, were inferior to those obtained in the previous operation with the same client.
- ²⁹ This finding is not exclusive to operations in Peru, but applies in general to operations with financial intermediaries across the entire Bank. See *Evaluation of the IDB Group’s Work Through Financial Intermediaries* (document RE-486-2).