



IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
Executive Board – Seventy-Fifth Session
Rome, 22-23 April 2002

REPUBLIC OF PERU

COUNTRY STRATEGIC OPPORTUNITIES PAPER
(COSOP)



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CURRENCY EQUIVALENTS

Currency Unit	=	Nuevo sol (PEN)
USD 1.00	=	PEN 3.50
PEN 1.00	=	USD 0.29

WEIGHTS AND MEASURES

1 kilogram (kg)	=	2.204 pounds (lb)
1 000 kg	=	1 metric tonne (t)
1 kilometre (km)	=	0.62 miles (mi)
1 meter (m)	=	1.09 yards (yd)
1 square meter (m ²)	=	10.76 square feet (ft ²)
1 acre (ac)	=	0.405 hectares (ha)
1 hectare (ha)	=	2.47 acres

ABBREVIATIONS AND ACRONYMS

COSOP	Country Strategic Opportunities Paper
FEAS	<i>Proyecto de Fomento de la Transferencia de Tecnología a las Comunidades Campesinas de la Sierra</i> (Promotion of Technology Transfer Project to Peasant Communities in the Highlands)
FONCODES	<i>Fondo Nacional de Compensación y Desarrollo Social</i> (National Compensation and Social Development Fund)
IBRD	International Bank for Reconstruction and Development
IDB	Inter-American Development Bank
IFI	International Financial Institution
LSMS	Living Standards Measurement Survey
M&E	Monitoring and Evaluation
MAG	Ministry of Agriculture
MARENASS	<i>Manejo de Recursos Naturales en la Sierra Sur</i> (Management of Natural Resources in the Southern Highlands)
MIPRE	Ministry of the Presidency
NGO	Non-Governmental Organization
PETT	<i>Proyecto Especial de Titulación de Tierras</i> (Special Programme for Land Titling)
SPEP	Social Productive Emergency Programme
USAID	United States Agency for International Development

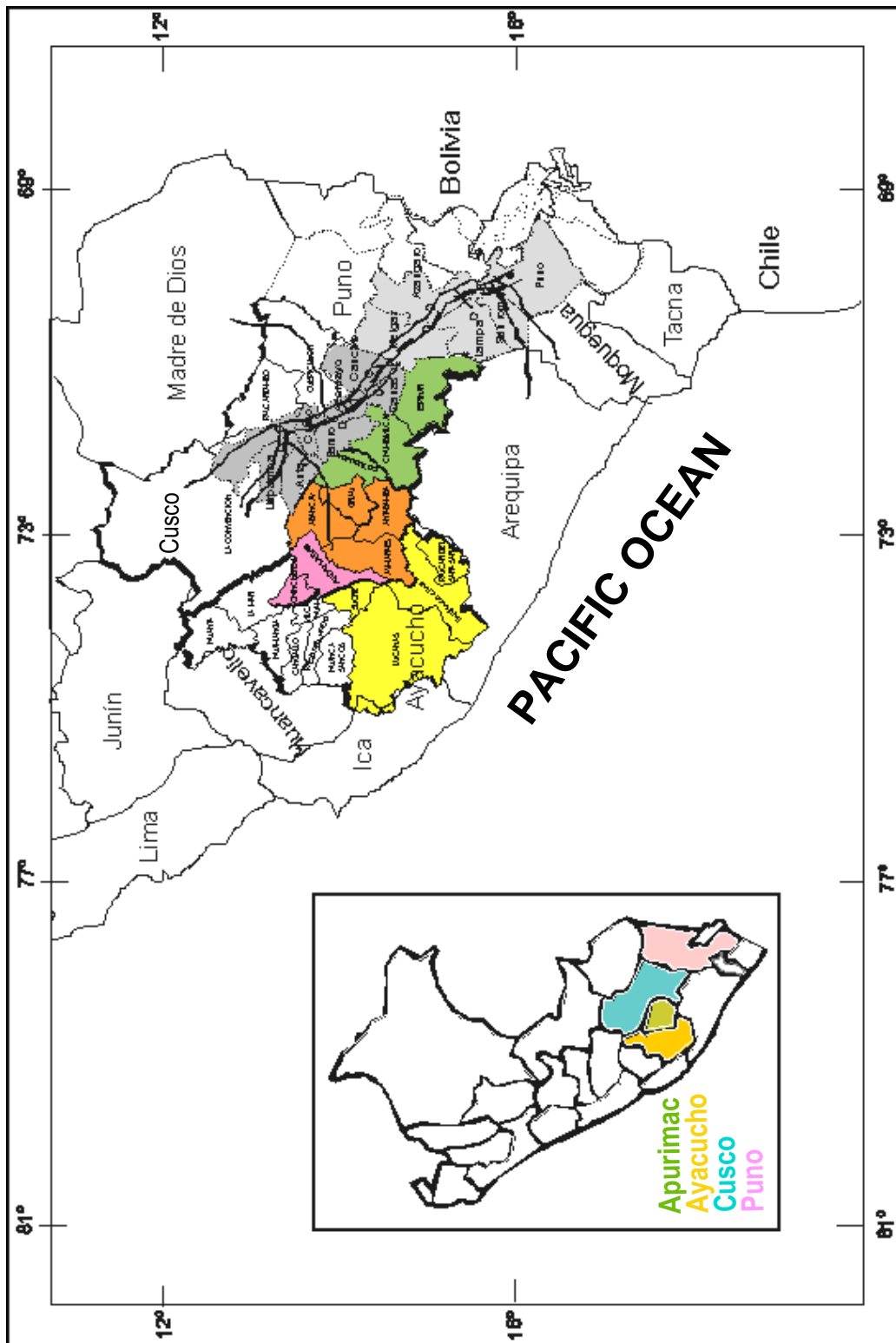
GOVERNMENT OF THE REPUBLIC OF PERU

Fiscal Year

1 January- 31 December



MAP



Source: IFAD

The designations employed and the presentation of the material in this map do not imply the expression of any opinion whatsoever on the part of IFAD concerning the delimitation of the frontiers or boundaries, or the authorities thereof.



EXECUTIVE SUMMARY

A. Macroeconomic and Sectoral Context

1. With an area of 1 285 216 km², Peru is the fourth-largest country in Latin America. Its total population, estimated at 25 661 000 inhabitants in 2001, is growing by 1.75% annually. According to the Inter-American Development Bank (IDB), 38.4% of the total population (about 9 853 800 people) are indigenous as defined in the International Labour Organization (ILO) Convention concerning Indigenous and Tribal Peoples in Independent Countries (No. 169). This fact places Peru as the Latin American country with the largest concentration of indigenous peoples in absolute terms (27%). Peru is divided politically into 24 departments, 194 provinces and 1 812 districts. Geographically it is divided into three distinct zones: (i) the western coastal plain (*Costa*), (ii) the Andes in the centre (*Sierra* or highlands) and (iii) the eastern lowland jungle of the Amazon Basin (*Selva*). The *Costa*, a desert strip representing 11% of Peru's total area, contributes 75% of gross domestic product (GDP). It includes 21% of the country's cultivable area and produces 60% of agricultural GDP. The *Sierra* is an arid broken mountainous terrain, contributing 25% of agricultural GDP. The *Selva* represents 60% of the total area, contributing 15% to agricultural GDP.

2. Peru is classified as a middle-income country with a gross national income (GNI) per capita of 2 100 United States dollars (USD) in 2000. The minimum wage is USD 120 monthly. Agriculture represented 7.2% of GDP in 1999 with more than 30% of the population employed in agriculture. According to the 1994 agricultural census, Peru had 1.7 million farming units cultivating 5.5 million hectares of agricultural land. Average farm sizes are small. In the *Sierra*, 63% of the 1.2 million existing farms are less than three hectares. The agricultural sector performed well during the previous decade except during the years when the El Niño phenomenon (1997-98) affected agricultural activities and disrupted roads and productive infrastructure. Non-traditional agricultural exports rose during this period. Main sector issues range from institutional to operational questions including, *inter alia*: (i) insecurity of property rights to land, forestry and water; (ii) ineffective animal and plant health services; (iii) inadequate agricultural research, extension and rural financial services; (iv) poor transport infrastructure and marketing systems; and (v) undefined territorial organization and planning.

3. In the late 1990s, poverty conditions improved slightly. Living Standards Measurement Surveys (LSMSs) conducted by the Peruvian Government in 1994 and 1997 indicated that social well-being had improved over the period. The percentage of the population unable to purchase a minimum food basket had decreased by several percentage points to 49% (approximately 12 million people). Extreme poverty had also diminished from 19 to 15% of the total population. However, recent studies show a reversal of this trend: 54.1% of the population are poor. Extreme poverty, however, remains stable at 14.8% (or more than 3.5 million people).

4. The administration of President Alejandro Toledo, who took office in July 2001, has proposed a medium-term strategy to combat rural poverty. The strategy, of particular interest to IFAD, proposes strengthening the competitiveness of small producers and Andean and Amazonian native communities in order to increase employment and income levels, increase the profitability of available resources, contribute to household food security and nutrition, and build capacities to take advantage of market opportunities.

B. IFAD Operations in Peru

5. Since 1980, IFAD has granted Peru six loans for a total of 66 million Special Drawing Rights (SDR), equivalent to approximately USD 85 million. With the exception of the Alto Mayo Rural Development Project implemented in the *Selva alta*, all other projects have addressed the needs of small-scale farmers in the *Sierra*, Peru's poorest region. Of the six projects, two are still ongoing: the



Management of Natural Resources in the Southern Highlands Project (the MARENASS project) and the Development of the Puno-Cusco Corridor Project. Peru also benefits from IFAD regional grants for rural development training. The Corporation for Regional Rural Development Training (PROCASUR), for one, has played a crucial role in training human capital within IFAD projects.

C. Lessons Learned

6. During the last decade, IFAD has successfully tested new methodologies for the provision of technical assistance services and the management of natural resources and the development of rural financial services in the highland areas of Peru.

7. IFAD's experience with technical assistance services has shown that these services should not be limited to on-farm activities but should also include business development activities. This results in better-quality products and improves rural producers' access to local, regional and national markets. Regarding natural resource management, IFAD has learned that farmers improve management of natural resources on their own land, and by so doing their assets acquire greater value. Furthermore, the land market, including rental, becomes more dynamic. Links with local elected bodies contribute to project success since municipalities cofinance many activities. Community awards for results obtained have proven to be a useful tool in financing small-scale infrastructure and income-generating activities. Although recent IFAD projects in Peru have not included financial service components, the provision of funds for the contracting of technical assistance has allowed project beneficiaries to access commercial banking services. Small groups of rural women have been provided funds within the MARENASS project allowing them to set up their own savings and loan schemes. These schemes operate as informal communal banks linked with the commercial banking system. In all operations, IFAD's policy has been to support initiatives of the rural poor by strengthening financial and non-financial services markets relevant to them.

D. Strategic Framework for IFAD

8. IFAD's strategy for Peru as a middle-income country takes into account the country's greater vulnerability and the risk it runs of increased poverty because of globalization. The strategy also recognizes, however, that income is not the only measure of poverty and that poverty can be reduced by promoting the growth of poor people's assets and incomes and by introducing policy measures and institutional reforms. In Peru, IFAD has supported the growth of beneficiaries' assets by assisting rural farmers and entrepreneurs in securing land titles and removing barriers preventing their access to markets and livelihood diversification.

9. IFAD's strategy for Peru encompasses four main areas:

- (i) increasing small-scale farmers' assets by investing in externalities and establishing competitive fund transfer mechanisms rewarding results and achievements;
- (ii) improving access to services by fostering market development and beneficiaries' capacity to contract services, and by strengthening institutional and private-sector service providers;
- (iii) increasing access to information and new business opportunities with an emphasis on joint ventures between rural communities and the private sector (artisans, merchants and entrepreneurs in small towns and intermediate cities) and on the promotion of new products and services to achieve diversification; and
- (iv) strengthening local development and identity, especially in areas with substantial cultural and ecological potential, such as those found in the Peruvian highlands.



10. The proposed strategy rests on four main pillars:

- **Enhancing assets.** Enhancing natural resources can contribute greatly to poverty reduction strategies. It is now widely recognized that the assets that the poor possess – or have access to – directly contribute to their well-being, as they increase their ability to alleviate poverty. Experience in Peru has shown that helping the rural poor to preserve land, water and forests allows them to benefit from measures that encourage them to care for and improve their land holdings.
- **Supporting market development.** Supporting the development of technical assistance, financial services, and land and labour markets in rural areas contributes to overall poverty reduction.
- **Contributing to the development of rural-urban linkages.** Providing support for non-agricultural activities helps to create labour opportunities as small-scale entrepreneurs expand their enterprises and local farmers establish agriculturally related enterprises in surrounding small and medium-size towns.
- **Fostering local development.** Decentralizing decision-making and project implementation is crucial for making project interventions more responsive to community needs. Local actors, such as peasant communities, local enterprises and elected local governments, should be strengthened. Mechanisms aimed at making these local institutions directly responsible for decisions regarding the allocation of public funds should be developed or improved.

E. Main Opportunities for Project Interventions and Innovation

11. IFAD's strategy recognizes the need to enhance the productivity of the rural sector including both on- and off-farm enterprises. Its experience in Peru has shown that small businesses and microenterprises need to be developed and municipal services improved in rural areas as part of an overall rural development strategy. This strategy should take into account that in Latin America the rural non-farm economy accounts for 40% of rural employment and from 25 to 40% of rural incomes. The demand-driven nature of projects in Peru has in the past established a balance between on- and off-farm activities (ranging from agricultural and livestock products to, *inter alia*, handicrafts, furniture, brick-making and rural tourism) as promising endeavours for new and diversified sources of income.

12. Main opportunities for project interventions emerge from the importance that both IFAD and the Government place on **improving existing approaches to rural development**. The innovative character of demand-driven technology transfer, competitive fund transfers, market-oriented developmental approaches and rural-urban linkages should be developed further, lessons learned systematized and best practices recorded. Future projects should be **concentrated in Peru's southern highlands**. Project areas continue to be selected on the basis of the extent of poverty and the potential for development. The experience gained from the last four IFAD-funded projects in the highlands should form the basis for future interventions. It now appears feasible to **expand both the approach and the area of the 'economic corridor' concept**. IFAD has learned that a rigid component-by-component design is not always the best support for an approach emphasizing income-generation and that corrections need to be made mid-course.

13. The mission responsible for preparing this Country Strategic Opportunities Paper (COSOP) proposed identifying and formulating a project on **market integration and livelihood diversification in the southern highlands**. This project would be responsive to the Government's request to include a new operation within the framework of the medium-term strategy to combat rural poverty. The project would increase the competitiveness of small-scale producers and communities in the highlands and therefore raise their employment and income levels, enhance their assets, contribute to their food



security and further their capacity to take advantage of market opportunities. As other options, IFAD could consider: (i) a second phase of the MARENASS project; or (ii) a new project on “economic corridors”.

14. **Other potential areas for new projects** or new components were suggested during the consultations held by the COSOP preparation mission with representatives of civil society and government agencies. The most significant included: (i) strengthening of democratic institutions such as local governments, peasant communities and municipalities; (ii) integrating rural migrants’ remittances in non-credit financial services. Migrants should participate in project design, with the Government providing matching funds for any initiative funded by them; and (iii) investing in local human capital by strengthening schools and creating conditions to value identity and local knowledge (including through the use of modern communication media); and (iv) reinforcing the transparency of transactions and the legal process.

F. Areas for Policy Dialogue

15. A policy dialogue has already been established with the new Peruvian authorities both through the COSOP preparation mission and through a visit to IFAD by a high-level government delegation headed by Ambassador Javier Perez de Cuellar in October 2001. Issues discussed included: (i) decentralization and participation; (ii) market development and employment generation; and (iii) alternative ways of dealing with the barriers to land access faced by small farmers.

16. After years of a highly centralized, authoritarian and corrupt administration, Peru is embarking on a process of decentralization. Although the Government is still uncertain on the direction this process will take, IFAD’s experience in Peru and elsewhere has demonstrated the feasibility of decentralized project implementation. Stakeholder participation in the design, implementation and monitoring and evaluation of development projects is also essential. In Peru, IFAD has transformed participation to empowerment by designing projects that transfer not only decision-making, but, more importantly, also financial resources to community groups. IFAD intends to pursue this approach establishing a policy dialogue with the Government to ensure that government programmes follow similar approaches, thus reducing interventions that encourage dependency.

17. IFAD will continue to focus on land-tenure issues in the highlands. In the past, IFAD-funded projects have, as part of technical assistance, provided communities with the funds necessary to solve conflicts on land-tenure issues and supported land-titling projects under the International Bank for Reconstruction and Development (IBRD) and IDB operations. IFAD’s new projects will continue this approach, pursuing policy dialogue with authorities of the Special Programme for Land Titling (PETT) project.

18. Policy dialogue is also needed on such key policy issues as promoting the integration of small-scale farmers and entrepreneurs in the market, and strengthening existing financial and technical assistance, land and labour markets. As employment in agriculture will decrease in the near future, with the exception of high-value export crops, enhancing rural-urban linkages along economic corridors will be essential for generating employment in small and medium-size towns in rural areas.

G. Lending Framework

19. It is proposed that a rolling programme be developed for a time frame of five years starting in 2002. A total of USD 50 million could be established as a ceiling.



REPUBLIC OF PERU

COUNTRY STRATEGY OPPORTUNITIES PAPER (COSOP)

PART I - BACKGROUND

1. IFAD's operations in Peru were guided during the 1980s by the recommendations of a 1981 special programming mission, which resulted in the implementation of three projects: the Alto Mayo Rural Development Project; the Cuzco-Arequipa Highlands Rural Development Project; and the Promotion of Technology Transfer Project to Peasant Communities in the Highlands (FEAS). In 1990, shortly after President Alberto Fujimori took office, IFAD prepared a new strategy for Peru taking into account the significant changes announced in the country's macroeconomic policies. The proposed strategy emphasized support to technology transfer and natural resource management in the highlands region of Peru. It also recognized the importance of addressing the needs of indigenous populations and of targeting poverty pockets in the coastal region. In 1993, IFAD undertook a general identification mission, which proposed two new projects aimed at addressing natural resource depletion in the southern highlands and reinforcing rural-urban linkages in the economically important Puno-to-Cusco corridor. Recommendations made resulted in the preparation and implementation of two projects: (i) the Management of Natural Resources in the Southern Highlands Project (the MARENASS project); and (ii) the Development of the Puno-Cusco Corridor Project.

2. Further to the adoption of IFAD's directives to streamline the project cycle in 1997, this is the first Country Strategic Opportunities Paper (COSOP) to be prepared for Peru. This exercise, initiated in October 2000, was interrupted due to extraordinary circumstances surrounding the fall of the third Fujimori administration after Congress decided to oust him of his duties in November 2000 appointing Dr Valetin Paniagua, the President of Congress, to head a transitional Government. During the transitional Government the country witnessed the discovery of a large corruption scandal and political manipulation of the judiciary and other institutions including the press. The transitional Government organized a clean general election in April 2001, which produced no clear winner. A second round in June 2001 resulted in the election of President Alejandro Toledo who took office on 28 July 2001.

3. During its first months, the new administration developed strategic guidelines for different sectors and appointed new officials in ministries and government agencies. It has since made some progress in defining a coherent strategy for poverty reduction, although further efforts are needed to avoid duplication in social-sector programmes and to define a clear institutional framework. The new government has also had to cope with a more serious economic situation than foreseen, following the devastation created by an earthquake that hit southern Peru in June 2001 and the terrorist attack on New York on 11 September 2001.

4. Drafting of this COSOP benefited from the progress made by the newly appointed authorities in mapping out a new poverty-reduction strategy and from discussions held in Rome by a high-level delegation headed by Ambassador Javier Perez de Cuellar, who met the President of IFAD on 4 October 2001. The COSOP preparation mission¹ met representatives of bilateral aid agencies and international financial institutions (IFIs) in Peru and also organized a consultation with representatives of civil society.

¹ The COSOP preparation mission was composed of Dario Pulgar, mission leader, and Alejandro Diez, rural development consultant. The country portfolio manager for Peru, Roberto Haudry de Soucy, accompanied the mission.

PART II - ECONOMIC, SECTORAL AND RURAL POVERTY CONTEXT

A. Country Economic Background

5. With an area of 1 285 216 km², Peru is the fourth-largest country in Latin America. Its total population, estimated at 25 661 000 people, is growing by 1.75% annually. Indigenous peoples represent about 38.4% of the total population. Peru is divided politically in 24 departments, 194 provinces and 1 812 districts. Geographically it is divided into three distinct zones:

- (i) The western coastal plain (*Costa*) is a desert strip representing 11% of the total area of the country and 75% of gross domestic product (GDP). It includes 21% of the cultivable area and produces 60% of agricultural GDP.
- (ii) The Andes in the centre (*Sierra* or highlands) is an arid broken mountainous terrain that covers 30% of the land mass and contributes about 25% of agricultural GDP.
- (iii) The eastern lowland jungle of the Amazon basin (*Selva*) represents 60% of the total area, contributing approximately 15% of agricultural GDP.

Table 1: Area and Population

Zone	Area (Km ²)	Population (000s)	
		Total	Rural
<i>Costa</i>	136 768	13.4	1.0
<i>Sierra</i>	404 929	8.8	5.1
<i>Selva</i>	743 518	3.4	1.5
Total	1 285 215	25.6	7.6

Source: *Perú en Números 2000, Instituto Cuanto.*

6. **The Economy.** Peru is classified as a middle-income country with a gross national income (GNI) per capita of 2 100 United States dollars (USD) in 2000. The minimum wage for those currently employed is USD 120 monthly.

7. During 1991-97, Peru made major progress in eliminating the large distortions that beset the economy at the beginning of the decade. The fiscal deficit was eliminated and the exchange rate liberalized. In 1998-99, the Peruvian economy weakened under the influence of external shocks, which included the weather disturbance El Niño, a drop in commodity export prices and a liquidity squeeze from turbulence in international financial markets. By 1991 there was a fiscal deficit of 3% of GDP. Output grew by 3.6% in 2000, but slowed sharply in the second half of the year. The slowdown was caused by the weakening of domestic demand as private investment was deterred by political uncertainty and government expenditure was tightened to offset pre-election overspending. By the end of 2000, the combined public-sector deficit remained at 3% of GDP due to a shortfall in general government tax revenue; employment had declined by 2.6%; and inflation had risen to 3.7%.

8. The transitional government quickly confronted the economic situation after taking office in November 2000, requesting the International Monetary Fund (IMF) to approve a stand-by credit and a new Letter of Intent. IMF did so on 12 February 2001, thus providing stability during the electoral process and for the rest of 2001. The one-year stand-by credit, amounting to 128 million Special Drawing Rights (SDR), supported the transitional government's economic programme for 2001 and ensured macroeconomic stability in the transition to the next administration.

9. The Letter of Intent describes the transitional government's economic programme, which the Toledo government subsequently adopted. Of significance for agriculture and rural development are



the commitments it makes to: (i) review surcharges for agricultural imports; (ii) further the land-titling process; (iii) review sectoral tax exemptions; and (iv) refrain from using public resources for the creation of sectoral and/or regional financial institutions.

10. In August 2001, the Toledo government issued a multi-year macroeconomic framework for 2002-04, which projected that real GDP would grow by 0.9% in 2001, inflation would decline to 2.5% and the external deficit would fall to 2.4% of GDP. Priority social programme spending would be protected, while spending for defence and internal affairs would be cut by 0.3% of GDP. It also established that, in 2001, the level of central government current revenue plus transfers from public enterprises would remain at the 2000 level of 17.4% of GDP.

11. The new administration recognized the need to strengthen the financial administration and control system (*Sistema Integrado de Administración Financiera* [SIAF]), which will be extended to all executing units in the budget (including the Ministries of Defence and Internal Affairs). Payroll and inventory control systems will be introduced, periodic financial reporting will be required of public enterprises, and a tax and financial administration module for municipalities will be developed. Congress has also recently approved a law guaranteeing public access to government statistics, procurement records and audit reports.

12. Targeting of expenditure on health, education and rural infrastructure projects will be pursued, and tracking of the effectiveness of the main social programmes will be improved through the use of a set of social indicators developed in 2000. The Social Productive Emergency Programme (SPEP) will be prioritized as part of the poverty-reduction and employment-generation strategy.

13. The new administration has also announced: (i) an increase in salaries in the public sector of about USD 18 monthly; (ii) reduction of an extraordinary wage tax from 5 to 2%; (iii) plans for the reactivation of the construction sector and reconstruction of areas affected by the earthquake; (iv) a gradual reduction of the value added tax; and (v) a reform of the judicial system. It has taken initial steps in the decentralization process by appointing a special committee, funded by the Inter-American Development Bank (IDB), which supports a process of national and regional consultation.

B. Agriculture and Rural Development

14. Agriculture represented 7.2% of GDP in 1999, with more than 30% of the population employed in agriculture. According to the 1994 agricultural census, Peru has 1.7 million farming units cultivating 5.5 million hectares of agricultural land. Average farm sizes are small. In the *Sierra*, 63% of the 1.2 million existing farms are less than three hectares.

Table 2: Land-Use Patterns by Natural Regions, 1994
(Thousand of hectares)

Region	Total	Percentage
<i>Costa</i>	13 637	10.6
<i>Sierra</i>	39 199	30.5
<i>Selva</i>	75 686	58.9
Total	128 522	100

Source: World Bank, An Agricultural Development Strategy, 1998.

15. The agricultural sector performed well during the 1990s except during years when El Niño affected agricultural activities and disrupted roads and productive infrastructure. Non-traditional agricultural exports rose during this period. Nevertheless, the production of subsistence crops and their share in national GDP continued to drop.



16. Sector policies were radically changed in the 1990s. Changes included the elimination of price controls, downsizing and/or elimination of government agricultural agencies, abolishment of the Agricultural Bank and liberalization of the land market. A number of agricultural and rural development projects were launched during this decade, including the two IFAD-funded projects (one for the promotion of technical assistance services and the other for natural resource management). Other IFIs funded land titling and registration, the rationalization of water use, rural credit, and plant and animal health services. During that time, the government provided production inputs, such as fertilizers, seeds and equipment, on a grant basis to small farmers, mainly in the highlands.

**Box 1: Furthering Policy and Academic Debate
The Permanent Agricultural Research Forum**

For more than 17 years, academics and rural development professionals in Peru have met every two years to analyse policies, programmes and proposed solutions to the problems of agricultural development in the country. The 1999 Economic and Social Research Consortium meeting provided an understanding of current thinking in terms of three main topics: (i) regional dynamics; (ii) poverty and public policies; and (iii) biodiversity and markets. Most of the debate has been published and constitutes a valuable element in defining policy options and issues for a policy dialogue with the new administration. Two important issues were also raised and are still pending resolution: (i) management of resources; and (ii) decentralization and local participation.

The three topics raised in 1999 provide a sound research basis to assist in focusing IFAD's strategy. The IFAD-funded Development of the Puno-Cusco Corridor Project addresses the issues of regional dynamics and rural-urban linkages. Implementation of this project is providing useful insights into the contribution this approach can make in reducing rural poverty in Latin America. Concerning poverty and public policies, a number of further research activities have been proposed, which IFAD could support under both the Corridor and MARENASS projects. Proposed research activities include the impact of rural development strategies on rural poverty and the role of intermediate urban centres in rural development. Measuring the impact of rural poverty on natural resources and the environment will be a task of the monitoring and evaluation (M&E) system of the MARENASS project. Taking advantage of the country's biological diversity, as has been proposed, falls within a strategy that supports small-scale farmers in reaching local, regional, national and international markets with their products, including new products that until now have been ignored or poorly developed.

Source: Hurtado, Isabel, Carolina Trivelli and Antonio Brack (eds), *SEPIA VIII – Perú El Problema Agrario en Debate, Seminario Permanente de Investigación Agraria* and *Institut de recherche pour le développement* (IRD), Lima, 2000.

17. Sector issues are well documented by the Economic and Social Research Consortium. However, despite a long tradition of rural and agricultural research, a coherent rural and agricultural development policy has yet to be developed. This has been the fault not just of policy-makers, but also of the researchers themselves who have until recently been unable to transform knowledge into concrete proposals. A number of issues have now been identified and have proven useful in the design of IFAD's strategy. IFAD has a comparative advantage over other IFIs in pursuing rural development within the context of poverty reduction in rural areas. Issues range from institutional to operational questions including *inter alia*: (i) insecurity of property rights to land, forestry and water; (ii) ineffective plant and animal health services; (iii) inadequate agricultural research, extension and rural financial services; (iv) poor transport infrastructure and marketing systems; and (v) undefined territorial organization and planning.

18. The lead agency responsible for agriculture and rural development is the Ministry of Agriculture (MAG) and its agencies: the National Institute for Natural Resources (INRENA), the Agricultural Research Institute (INIA) and the National Animal Health Service (SENASA). Several projects under the aegis of MAG concern land titling and registration, irrigation, agriculture research and extension, natural resource management and watershed management. MAG is also responsible for an agricultural information service. In March 2001, the transitional government decided to restructure MAG, a process continuing under the Toledo government. The main changes foreseen are the



transferral of the National Development Institute (INADE), responsible for large-scale irrigation projects, from the Ministry of the Presidency (MIPRE) to MAG.

19. The transitional government prepared a document entitled *Orientations for Agricultural Strategy 2021*, proposing furthering economic development through economic corridors and small-scale watersheds. An additional strategy document was prepared with international assistance entitled *Carta de Navegación* proposing to expand intensively cultivated areas, with an emphasis on livestock and forestry development in the highlands.

20. The new administration is still firming up its policies. The Minister for Agriculture has had to address electoral promises, including the establishment of an agrarian bank and the construction and rehabilitation of large-scale coastal irrigation projects. Ten crops and agricultural products have been identified as having potential for expansion and export.

C. Rural Poverty Context

21. The analysis of poverty in Peru has benefited greatly from the Living Standards Measurement Surveys (LSMS) conducted in 1994 and 1997 by the Peruvian Government. The LSMSs found that social well-being had improved over the study period. The share of population unable to purchase a minimum food basket decreased by several percentage points to 49% (approximately 12 million people). Extreme poverty also diminished from 19 to 15% of the total population.

22. Recent studies show a reversal in the progress made in poverty reduction: 54.1% of the population are now poor. Extreme poverty, however, remains stable at 14.8% (or more than 3.5 million people, mostly indigenous). A new study to be conducted in 2002 will provide a more accurate picture.

Box 2: Measuring Poverty

Poverty in Peru has been measured using two distinct methods: (i) by using a poverty line defined by income indicators; and (ii) by determining unmet basic needs. The first method, which has been used extensively, is based on the ability to purchase a basket of basic foodstuffs needed to satisfy nutritional requirements. Once the composition of the food basket is determined, the relationship between total consumption and expenditure in food products is calculated. This methodology has been criticized because it fails to take into account a household's clothing, transportation and housing requirements. The second method uses five indicators: (i) overcrowded households (three or more individuals per room); (ii) households without proper sewerage; (iii) housing characteristics (e.g. quality of floors, walls and roofs); (iv) schooling (number of children between 6 and 12 years of age attending primary schools); and (v) economically dependent households (determined by the educational level of the head of household and the number of employed dependants). This method is now being questioned and may be abandoned.

23. An analysis of the LSMS shows that poverty was reduced because of the favourable economic situation during the study period. New jobs were created, although mainly in the informal sector of the economy, which accounts for some 45% of urban employment. During the same period, the Government invested heavily in social programmes and in providing electricity, water and sewerage to inhabitants of urban slums and squatter settlements in order to reduce unmet basic needs.

**Box 3: The Situation of Rural Women and Indigenous Communities**

Rural women. The LSMS provides a profile of rural women in Peru. It shows that 62% of all rural women are Spanish-speaking, 27% have never attended school; and approximately 50% have attended primary school. An estimated 65% of all rural women are married or live under common-law arrangements. They care for an average of three children below the age of 15. The majority of rural women are poor (64%), and of these 69% are considered extremely poor. More than 55% of poorest rural women live in the highlands.

Since rural women are among the poorest of the poor, IFAD will systematically seek to consolidate and further advance the poverty-reduction gains its projects have already made. To promote gender equity and rural women's economic and social advancement, a programme approach will be included in the new lending programme in order to: promote, improve and standardize gender-oriented field methodologies; support the Government's gender-oriented legal framework; and promote policies and actions to improve access of women to assets.

The project proposed in this COSOP (see paragraphs 53 and 54) would enable IFAD to consolidate the full range of its approaches in Peru in the targeted area of the highlands. An initial characterization of the target groups focused on the cultural identity of beneficiary groups, such as Quechua and Aymara communities. Peasant indigenous women, considered the most vulnerable group in Peru, would be assisted by developing specific activities already tried in other projects, such as savings mobilization and the promotion of small-scale enterprises.

Indigenous communities. In the highlands, indigenous groups are of Quechua and Aymara origin and are organized in traditional peasant communities. There are an estimated 5 500 peasant communities, the majority located in the southern highlands. The most recent figures show that more than 73% of the rural *Sierra* population (about 5.1 million people) are living below the poverty line, and 27% in extreme poverty (1.4 million).

By conventional socio-economic indicators, whether based on income data or on unsatisfied basic needs, indigenous peoples are represented disproportionately among both the poor and the extreme poor. Moreover, with very few exceptions, this trend appears to have worsened over the past decade or so. Infant mortality rates are high as are illiteracy rates (more than 33%). Moreover, according to IDB estimates, indigenous women continue to be educated at least three years less than non-indigenous men and women.

24. The World Bank noted in 2000 that economic growth and government programmes did not reach all of the population to the same degree. Growth was centred on and around Lima, while in the highlands rural inhabitants remained poor, although the severity of their poverty had diminished. Poverty reductions were attributed to improvements made in Lima and other major urban centres. Inequalities based on wealth and income indicators had deepened. The World Bank also pointed out that although gender differences had been reduced and some vulnerable groups such as migrants and landless peasants had benefited from economic growth, indigenous groups continued to be extremely vulnerable. Indigenous communities identified by the use of languages other than Spanish had a nearly 50% higher chance of being poor.

D. National Strategy for Rural Poverty Reduction

25. During the 1980s, poverty-alleviation policies in rural areas shifted from encouraging small farmers to increase agricultural production through the provision of subsidized inputs, favourable credit terms, free technical assistance and price supports under centrally run government programmes to more participatory mechanisms. The first Fujimori administration, with international funding provided by the International Bank for Reconstruction and Development (IBRD), IDB and Japanese bilateral assistance, created the National Compensation and Social Development Fund (FONCODES) in 1992, assigning it responsibility for addressing both rural and urban poverty. In 1997, the Government adopted SPEP to combat extreme poverty by creating special programmes for the provision of foodstuffs to poor urban and rural communities.



26. The transitional government involved civil-society institutions in the preparation of a medium-term strategy to combat rural poverty by convening a forum to provide social coordination and mobilization among government agencies, non-governmental organizations (NGOs), local governments and the Catholic Church.

27. The new Administration has launched a SPEP under the banner of “Let’s Put People Back to Work” (*A Trabajar*) aimed at addressing short-term employment and income-generation issues in urban and rural small-scale enterprises and farms. This strategy includes short- and medium-term goals. The proposed medium-term strategy to combat rural poverty is of particular interest to IFAD. It will seek to strengthen the competitiveness of small producers and Andean and Amazonian native communities in order to increase employment and income levels, maximize profitability of available resources, contribute to household food security and nutrition, and develop capacities to take advantage of market opportunities.

28. The main lines of the Government’s Medium-Term Programme 2001-03 include: (i) investment in infrastructure for production and services; (ii) provision of technical assistance services and training to small farmers; (iii) access to commercial information; (iv) promotion and strengthening of economic and business organizations; (v) promotion of eligibility of small farmers as credit subjects; (vi) development of rural women’s productive skills; and (vii) promotion of the social and economic rights of populations affected by terrorism during the 1980s in the southern highlands. The strategy will be implemented along economic corridors and watersheds.

29. The SPEP will be coordinated by an executive board composed of high-ranking officials of the Ministry of Labour and MIPRE. A consultative committee will be established, and a technical secretariat will provide day-to-day operational guidance. Funds for the programme will be placed under funds-in-trust arrangements, and implementation agreements signed with municipalities and other public- and private-sector agencies and organizations. An M&E system will be set up with technical assistance provided by the United Nations Development Programme (UNDP) and the World Bank. Funding requirements are estimated at approximately USD 420 million, of which the Government will contribute USD 180 million.

30. The proposed approach and the overall rural poverty-reduction strategies are central issues in the ongoing policy dialogue and should guide future discussions. Other potential issues relating to overall poverty reduction include:

- (i) **Improving inter-institutional coordination.** Many programmes in the social sector are spread out among several ministries and government departments. There are overlapping educational programmes located within MIPRE and the Ministry of Education. FONCODES and the National Project for the Management of Watershed Basins and Soil Conservation (PRONAMACHCS) also act in similar areas, causing confusion among beneficiaries in terms of their cost-sharing contributions.
- (ii) **Supporting decentralization and strengthening and implementing local decision-making mechanisms.** Local governments should be able to determine priorities and assign available resources. Social programmes have been highly centralized, with decisions being taken in Lima. Involving local governments and private-sector institutions would greatly enhance effectiveness of poverty-reduction programmes. Future programmes and project funding should be provided on a demand-driven basis.

PART III - IFAD EXPERIENCE

A. Operations

31. Since 1980 IFAD has granted Peru six loans for a total of SDR 66 million equivalent to approximately USD 85 million. The Development of the Puno-Cusco Corridor Project, effective since October 2000, is directly supervised. Peru also obtains benefits from IFAD regional grants for rural development training. The Corporation for Regional Rural Development Training (PROCASUR) has played a crucial role in training human capital inside IFAD projects. It has acted as a vehicle to disseminate project experiences through several mechanisms, among which the so-called learning paths. Other technical assistance grants – notably the Regional Programme for the Development of South American Camelids and the Regional Programme in Support of Indigenous Peoples of the Amazon Basin – have also benefited Peru. IFAD's Programme for Strengthening the Regional Capacity for Monitoring and Evaluation of Rural Poverty-Alleviation Projects in Latin America and the Caribbean (PREVAL), based in Lima, assists IFAD projects in the region in improving M&E systems, developing appropriate indicators and identifying best practices and lessons learned. Three Peruvian NGOs have received grants under the IFAD/NGO Extended Cooperation Programme (ECP) for a total of USD 175 000.

B. Lessons Learned

32. IFAD has acquired considerable experience in the provision of technical assistance services and the management of natural resources in the highland areas of Peru and in the provision of rural financial services through the implementation of FEAS and the MARENASS project.

33. **Technical assistance.** FEAS was designed at a time in which traditional extension systems in Latin America had entered into a severe crisis. Its goal was to establish an alternative to traditional extension systems. Its approach consisted in transferring the responsibility for contracting advice to small farmers themselves, providing financial incentives that would allow them to contract, in the open market, the services they required. The project considered the need to create a market for technical assistance with beneficiaries partially assuming the cost of these services. The project's completion and evaluation reports, concluded, *inter alia*, that: (i) incentives for contracting technical assistance services should not be limited only to on-farm activities; (ii) technical assistants contracted tend to stay in project areas when they can implement business plans that result in profitable ventures and when they share the risks with those contracting them, establishing more permanent economic links in a given area; (iii) business development services should be developed in parallel ensuring that the assistance provided, which results in better-quality products, integrates rural producers with local, regional and national markets; and (iv) to achieve better results, the project life should be more than five years. This methodology has been adopted in the two ongoing IFAD-funded projects in Peru and by other projects supported by IFAD in Latin America and the Caribbean.

34. **Management of natural resources.** The MARENASS project aims at expanding cultivable areas and increasing the asset value of farmer-owned natural resources. The project's approach includes use of learning-by-doing methodologies and granting awards to beneficiary groups who compete on the application of technologies selected by them. Conclusions that can be drawn after three years of project implementation are that: (i) farmers improve resource management on their own land parcels; (ii) farmer assets have increased in quality and value; (iii) the land market, including rental, has been made more dynamic; (iv) links with local elected bodies contribute to a project's success as municipalities have cofinanced many activities not included in the project's design; and (v) community awards have proven to be a useful tool in financing small-scale infrastructure and income-generating activities.



35. **Rural financial services.** The projects described above have also had a significant impact on agricultural rural financial services. In FEAS, beneficiaries were able to access commercial banking services through the provision of funds for contracting technical assistance. An interesting approach has also been developed within the MARENASS project, where small groups of rural women have set up their own savings and loan schemes. These operate as informal communal banks linked with the commercial banking system where they place their deposits.

36. Furthermore, the Development of the Puno-Cusco Corridor Project includes a rural financial services component, which is being reassessed in light of the changes in the rural financial services sector as a result of new policies adopted and experience gained. Particular attention should be paid to non-credit financial services and to rural savings.

PART IV - STRATEGIC FRAMEWORK FOR IFAD

A. Strategy and Proposed Actions

37. IFAD's strategy for Peru is being designed in the early stages of the Toledo administration. The strategy benefits from: (i) the experience gained by IFAD in the country; (ii) the results of consultations with the Government, other donors and civil society; (iii) best practices in poverty-reduction programmes in Peru and elsewhere; and (iv) IFAD's strategic framework.

38. IFAD's strategy for Peru as a middle-income country takes into account the country's greater vulnerability and the risk of rapid poverty increases as a result of globalization. Rural poverty is still a major issue in many middle-income countries. The strategy for Peru also recognizes that income is not the only measure of poverty and that poverty can be reduced by enhancing the growth of the poor's assets and incomes and by adopting appropriate policy measures and institutional reforms. In Peru, IFAD has supported the growth of beneficiaries' assets, and it has assisted rural farmers and entrepreneurs in securing land titles and removing barriers impeding market integration and livelihood diversification.

39. The strategy supports and expands IFAD's strategy for Latin America and the Caribbean in terms of supporting income-generating activities linked to the development of markets in favour of the rural poor, enhancing people's assets and local development. It is also consistent with the proposed Strategic Framework for IFAD 2002-2006, which foresees:

- strengthening the capacity of the rural poor and their organizations;
- improving equitable access to productive natural resources and technology; and
- increasing access to financial assets and markets.

40. Proposed strategic actions are based on experience gained in the implementation of previous and ongoing projects in the highlands and on the explicit request made by the new administration to concentrate efforts on what worked well in the past. IFAD's project interventions have been more than pilot experiences, although they cannot be considered massive or national in scope. The new strategy would target the largest segment of the poor, which is concentrated in the highlands. It is estimated that 18% of the national population live in 5 500 peasant communities, of which 4 000 such communities (representing 460 000 rural families of indigenous origin) are located in the southern highlands. Some 11% of all households are headed by women.



41. The proposed strategic actions would aim at:

- Increasing small-scale farmer's assets by investing in externalities and establishing competitive fund-transfer mechanisms rewarding results and achievements;
- Improving access to services by enhancing market development and beneficiary capacity to contract services and by strengthening institutional and private-sector providers of these services;
- Expanding access to information and multiplying new entrepreneurial possibilities, privileging joint ventures between rural inhabitants and the private sector (artisans, merchants and entrepreneurs in small towns and intermediate cities) and promoting new products and services in order to achieve diversification; and
- Fostering local development and identities, especially in areas with substantial cultural and ecological potential such as those found in the highlands.

42. **Enhancing assets.** Enhancing natural resources can contribute greatly to poverty reduction. It is now widely recognized that the assets that the poor possess – or have access to – directly contribute to their well-being and considerably affect their ability to alleviate poverty. Experience in Peru has shown that assisting the rural poor in land, water and reforestation encourages them to care for and improve their land holdings. Environmental degradation is an important factor, especially in the highlands. Future projects should emphasize the proper management of land, water and forests. Community infrastructure, such as rural roads and irrigation canals, needs to be considered as community assets and, the rural poor should be provided assistance enabling them to operate and properly maintain these assets, which in many instances are provided to them through social and productive investment funds. Community operation and maintenance of infrastructure can also provide income-earning opportunities to communities through relevant programmes.

43. **Supporting market development.** Supporting the development of technical assistance, financial services and land and labour markets in rural areas contributes to overall poverty reduction. Through the provision of funding for contracting technical assistance services, small-scale farmers have been able to engage surveyors and local lawyers who assisted them in legalizing their property rights and resolving land conflicts. The transfer of financial resources to farmer groups through the banking system enabled them to establish credibility with banking institutions, eventually leading the banks to accept them as fully recognized clients with access to other financial services including credit. Shared interests between small-scale farmers and technical assistance providers contributed to livelihood diversification and market integration.

44. **Contributing to the development of rural-urban linkages.** Provision of support for non-agricultural activities contributes to the creation of labour opportunities as small-scale entrepreneurs expand their enterprises and local farmers establish agriculturally related enterprises in surrounding small and medium-size towns. Facilitating farmer access to income-generating opportunities in these towns and in intermediate cities, and establishing joint ventures in new activities, such as aquaculture and rural tourism, also contribute to increased farmer income and poverty reduction.

45. **Strengthening local development.** Decentralization is the key to making project interventions more responsive to community needs. Although IFAD cannot finance a much-needed national decentralization process or capacity-building programmes for local institutions, it can contribute to enhance beneficiary participation in identification and demand formulation mechanisms. The proposed strategy would support decentralized decision-making processes including mechanisms related to the approval of beneficiary initiatives, thus ensuring transparency in the allocation of resources in favour of the poor. Experience already gained in Peru has demonstrated that this approach results in beneficiary ownership and confidence. Local actors, such as peasant communities,

local enterprises and elected local governments, would be strengthened. Mechanisms aimed at making these local institutions directly responsible for decisions on the allocation of public funds should be developed or improved. Some progress has been achieved in this regard; however, the risk of political interference by the central government still remains.

B. Main Opportunities for Project Interventions and Innovation

46. IFAD's strategy recognizes the need to enhance the productivity of the rural sector, including both on- and off-farm enterprises. IFAD's experience in Peru underlines the need to develop small businesses and microenterprises and to improve municipal services in rural areas as part of an overall rural development strategy. This strategy takes into account that in Latin America the rural non-farm economy accounts for 40% of rural employment and between 25 and 40% of rural incomes. The demand-driven nature of projects in Peru has in the past established a balance between on- and off-farm activities – ranging from agricultural and livestock products to, *inter alia*, handicrafts, furniture, brick-making and rural tourism – as promising endeavours for new and diversified sources of income.

47. During discussions with the high-level and technical delegations in Rome and in meetings held by the COSOP preparation mission with authorities of the Ministry of Finance and FONCODES, it became clear that opportunities for future projects should fall within the Government's overall poverty-reduction and medium-term productive strategy and be conceived along the following lines.

48. **Improving existing approaches.** Such innovative approaches as demand-driven technology transfer, competitive fund transfers, market-oriented development and rural-urban linkages should be improved, the lessons learned systematized and best practices recorded, especially in terms of the ongoing implementation of the MARENASS and the Development of the Puno-Cusco Corridor projects.

49. **Concentrating on the southern highlands.** The project area would be selected on the basis of poverty conditions and of the potential for development of areas in the southern highlands. The last four IFAD-funded projects have intervened in the highlands and the experience gained would form the basis for future projects.

50. **Expanding both the economic corridors approach and area.** Experience has shown that a rigid component-by-component design is not always the best solution to the income-generation and that corrections have had to be made in mid-course. It is conceivable then to incorporate natural resource management as a way of increasing the value of the rural poor's assets in the rural-urban linkages and market development approach. It would be up to the formulation mission to consider the appropriate mix of components and to explore the expansion areas of the Puno-Cusco Corridor and MARENASS projects.

51. **Other potential areas for projects** or project components were suggested during the consultations held by the COSOP preparation mission with representatives of civil society and government agencies. The most significant included: (i) strengthening of democratic institutions including local governments, peasant communities and municipalities; (ii) incorporating rural migrants' remittances to integrate non-credit financial services. Migrants should participate in the design of projects, with government providing matching funds for migrant-funded initiatives; and (iii) investing in local human capital by reinforcing schools and creating conditions to value identity and local knowledge (including through the use of modern communication media); and (iv) reinforcing the transparency of transactions and the legal process.

52. The strategy outlined in this section will be supported by IFAD regional programmes and technical assistance grants. Special attention will be given to streamline gender-oriented field



methodologies with the help of the Regional Programme to Coordinate Gender-Mainstreaming Strategies in IFAD-Financed Projects of Latin America and the Caribbean (PROGENDER).

53. The following projects could be pursued:

- (i) **Market Integration and Livelihood Diversification in the Southern Highlands.** This project would reflect the Government's request to include a new project within the framework of the medium-term strategy to combat rural poverty. The project's objective would be to strengthen the competitiveness of small-scale producers and communities in the highlands, thereby raising their employment and income levels, enhancing their assets, contributing to food security and furthering their capacity to take advantage of market opportunities.
- (ii) **Management of Natural Resources, phase II.** The MARENASS project is scheduled to close in 2004. The design of a second phase could therefore be initiated to include areas in the departments of Ayacucho and Huancavelica.
- (iii) **Development of the Mantaro River corridor.²** This potential project would replicate the approach being tried in the Puno-Cusco Corridor project. It would also complement with the United States Agency for International Development (USAID) Poverty Reduction and Alleviation Project operating in the same area, whose objectives are to contribute to poverty reduction through support to income-generating activities and the creation of sustainable employment.
- (iv) **Soil and Water Management Improvement.** This project, proposed by MAG, has as its objective strengthening water users' associations, building on the innovative approach being pursued in the San Juan River Basin. In that region, water users are willing to pay user fees because the money collected will serve to community finance forestry projects and the improvement of soil and water management, hereby enhancing community natural resources.
- (v) **South American Camelid Breeding and Product-Marketing.** This proposal, also suggested by MAG, would be modelled after an IFAD-funded project now being implemented in Bolivia. Its objective would be to strengthen farmer organizations, provide technical assistance and facilitate access to financial services.

54. IFAD and the Government consider development of the first option (i) as the most worthy as it would allow for the consolidation of the full range of IFAD approaches in Peru in the prioritized area of the highlands. An initial characterization of the target groups focused on the cultural identity of beneficiary groups such as the Quechua and Aymara communities. Peasant indigenous women, considered to be the most vulnerable people in Peru, would be assisted by developing activities that have already been tried such as savings mobilization and small-scale enterprises.

² The Government has adopted the economic development corridor concept as a way to address rural poverty. The objective of this approach is to increase the income of the rural poor and reduce extreme poverty by strengthening linkages and access to markets in a geographical area. Specific objectives include: (i) improving, increasing and diversifying agricultural production and that of small-scale and microenterprise producers by fostering better business opportunities; (ii) favouring efficient linkages between agricultural activities and industrial processing; (iii) enhancing entrepreneurial and productive practices, taking into account the need for modernization, competitiveness and efficiency; (iv) furthering local development projects based on beneficiary demands; and (v) favouring the generation of a market for private technical assistance services. Specific tools include: (i) cofinancing, through a competitive and transparent mechanism, technical, administrative and legal assistance needed for the development of the potential of small businesses with economic rural and urban linkages at a regional scale; and (ii) financing public infrastructure to complement the development of local businesses.



C. Linkages with Bilateral and Multilateral Donors

55. IFAD interventions should take into account the activities of other donors, mainly IBRD, IDB, the European Union and USAID. Concrete linkages may also emerge as a result of the donor meeting held in Madrid, Spain, in late October 2001, attended by IFAD.

56. Donors are discussing their strategies with the new government while IFAD is studying ways to complement its activities with those of the international donor community. The World Bank and IDB will prepare country strategies for Peru in early 2002. The multilateral agencies are planning to invest USD 200 million in three years, mostly in productive infrastructure and rural roads. The German Agency for Technical Cooperation (GTZ) and the European Union are planning to invest in rural financial services, emphasizing institutional strengthening. IFAD could support this initiative by fostering savings mobilization. The Spanish International Cooperation Agency (AECI) is planning to strengthen the development of Peru's cultural assets. The Government of Italy has recently approved a debt-swap initiative, and projects to be financed under this initiative are currently being discussed.

57. Linkages could be sought with two existing IBRD-funded projects: (i) the recently launched Agricultural Research and Extension Project, *Innovación y Competitividad para el Agro Peruano* (INCAGRO); and (ii) the ongoing Sierra Natural Resources Management and Poverty Alleviation Project.

- (i) **INCAGRO.** This adaptable programme loan for a total of USD 116 million includes an initial disbursement of USD 9.6 million. The purpose of this project is to increase the productivity and competitiveness of the agricultural sector through the adoption of environmentally sound technologies generated and disseminated by a private-sector-led, decentralized system for technology innovation. This project will deliver technical assistance to 20 000 farmers and strengthen 123 farmer organizations. Project design for the extension advisory services grants component follows the same lines as those incorporated in the design of the IFAD-funded FEAS. It differs in that financial resources will not be channelled directly to beneficiary communities but to private-sector providers. The project's target groups, mainly commercial farmers, do not correspond to IFAD's target groups. However, in view of the long-term nature of this project, IFAD's target groups could possibly benefit from this loan at some point. The project, still in its initial stages, has gathered useful information on the supply and demand for technical assistance services, which could assist in future design work.
- (ii) **Sierra Natural Resources Management and Poverty Alleviation Project.** The objectives of this project are to assist the poor in improving sustainable management of natural resources through soil conservation measures and reforestation at the micro-watershed level and to increase rural production and productivity through the introduction of irrigation and improved agricultural practices. This USD 51 million loan finances participatory identification and formulation of rural investments in soil conservation works, small-scale irrigation, reforestation and agroforestry, and improved seeds and pastures.

58. Two other IDB projects (in land titling and plant and animal health) are supportive of any future IFAD projects. The recently approved loans for rural roads are also significant. IFAD can contribute by supporting the creation of community enterprises to maintain roads as a way to diversify income.



D. Areas for Policy Dialogue

59. A policy dialogue with the new Peruvian authorities was established during a visit to IFAD by a high-level Peruvian Government delegation in October 2001 and by the COSOP preparation mission in Peru. Issues discussed in this initial policy dialogue included: (i) decentralization and participation processes; (ii) market development and employment generation; and (iii) land tenure. These three areas include sets and subsets of issues, which should be addressed in a comprehensive manner.

- (i) **Decentralization and participation processes.** Experience in Peru and elsewhere has shown that participation in the design, implementation and monitoring of development projects is essential. In Peru, IFAD has transformed participation to empowerment by designing projects that transfer not only decision-making, but, more importantly, also financial resources to community groups. IFAD intends to pursue this approach and to influence government programmes to follow similar approaches thus reducing interventions that encourage dependency. Participation as empowerment also requires removing restrictions to the transfer of public resources to community groups.
- (ii) **Market development and employment generation.** It is foreseen that employment in agriculture per se will decrease in the near future with the exception of high-value export crops. That notwithstanding, IFAD's Puno-Cusco Corridor Project will provide an opportunity for analysing an approach that sees rural-urban linkages as essential for generating employment in small and medium-size towns in predominantly rural areas. Implementation of SPEP can also provide valuable lessons for pursuing this approach.
- (iii) **Land tenure.** IFAD will continue to seek solutions to land-tenure issues in the highlands, promoting a discussion on alternative ways to deal with the issue of land access. In the past, IFAD-funded projects have, as part of technical assistance, provided communities with the funds necessary to solve conflicts on land-tenure issues and supported land-titling projects under IBRD and IDB operations. IFAD will continue this approach in its new projects, pursuing policy dialogue with authorities of the PETT project.

E. Action Areas for Improving Portfolio Performance

60. There are two ongoing IFAD projects: (i) Management of Natural Resources in the Southern Highlands project; and (ii) the Development of the Puno-Cuzco Corridor Project.

- (i) **Management of Natural Resources in the Southern Highlands Project.** According to project portfolio performance reviews, the MARENASS project is classified as problem-free, although minor implementation problems arose regarding the establishment of the M&E system and the need to preserve the administrative autonomy of the project management unit.
- (ii) **Development of the Puno-Cusco Corridor Project.** This project became effective in October 2000. The 2001 performance review notes a major problem relating to non-compliance with loan covenants and a minor problem in compliance with procurement procedures. Performance can be improved by negotiating with the new government in order to obtain proper autonomy for the project management unit and to open project accounts in the project area to be managed by project staff instead of the project executing agency located in Lima.



F. Lending Framework and Non-Lending Activities

61. It is proposed that the rolling programme be developed for a five-year time frame starting in 2002. A total of USD 50 million could be established as a ceiling.

APPENDIX I

COUNTRY DATA

PERU

Land area (km² thousand) 2000 1/	1 280	GNI per capita (USD) 2000 1/	2 100
Total population (million) 2000 1/	25.7	GNP per capita growth (annual %) 2000 1/	1.9
Population density (people per km²) 2000 1/	20	Inflation, consumer prices (annual %) 2000 1/	3.8
Local currency	Nuevo Sol (PEN)	Exchange rate: USD 1 =	PEN 3.50
Social Indicators		Economic Indicators	
Population (average annual population growth rate) 1980-99 2/	2.0	GDP (USD million) 2000 1/	53 882
Crude birth rate (per thousand people) 2000 1/	24 a/	Average annual rate of growth of GDP 2/ 1980-90	-0.1
Crude death rate (per thousand people) 2000 1/	6 a/	1990-99	5.0
Infant mortality rate (per thousand live births) 2000 1/	39 a/	Sectoral distribution of GDP 2000 1/	
Life expectancy at birth (years) 2000 1/	69 a/	% agriculture	8
Number of rural poor (million) (approximate) 1/	4.5	% industry	38
Poor as % of total rural population 2/	65	% manufacturing	24
Total labour force (million) 2000 1/	9.7	% services	55
Female labour force as % of total 2000 1/	31	Consumption 2000 1/	
Education		General government final consumption expenditure (as % of GDP)	8
School enrolment, primary (% gross) 2000 1/	123 a/	Household final consumption expenditure, etc. (as % of GDP)	71
Adult illiteracy rate (% age 15 and above) 2000 1/	10	Gross domestic savings (as % of GDP)	20
Nutrition		Balance of Payments (USD million)	
Daily calorie supply per capita, 1997 3/	2 302	Merchandise exports 2000 1/	6 982
Malnutrition prevalence, height for age (% of children under 5) 2000 1/	26 a/	Merchandise imports 2000 1/	8 790
Malnutrition prevalence, weight for age (% of children under 5) 2000 1/	8 a/	Balance of merchandise trade	-1 808
Health		Current account balances (USD million)	
Health expenditure, total (as % of GDP) 2000 1/	6.1	before official transfers 1999 1/	-2 765
Physicians (per thousand people) 1999 1/	0.91	after official transfers 1999 1/	-1 822
Population without access to safe water (%) 1990-98 3/	33	Foreign direct investment, net 1999 1/	1 881 a/
Population without access to health services (%) 1981-93 3/	n.a.	Government Finance	
Population without access to sanitation (%) 1990-98 3/	28	Overall budget deficit (including grants) (as % of GDP) 1999 1/	-2.1
Agriculture and Food		Total expenditure (% of GDP) 1999 1/	19.4
Food imports (% of merchandise imports) 1999 1/	15	Total external debt (USD million) 1999 1/	32 284
Fertilizer consumption (hundreds of grams per ha of arable land) 1998 1/	520	Present value of debt (as % of GNI) 1999 1/	63
Food production index (1989-91=100) 2000 1/	169.7	Total debt service (% of exports of goods and services) 1999 1/	32.7
Cereal yield (kg per ha) 2000 1/	2 871	Lending interest rate (%) 2000 1/	27.9
Land Use		Deposit interest rate (%) 2000 1/	13.3
Arable land as % of land area 1998 1/	2.9		
Forest area (km ² thousand) 2000 2/	652		
Forest area as % of total land area 2000 2/	50.9		
Irrigated land as % of cropland 1998 1/	28.7		

a/ Data are for years or periods other than those specified.

1/ World Bank, *World Development Indicators* database.

2/ World Bank, *World Development Indicators*, 2001.

3/ UNDP, *Human Development Report*, 2000.

PREVIOUS IFAD FINANCING

Project Name	Initiating Institution	Cooperating Institution	Lending Terms	Board Approval	Loan Effectiveness	Current Closing Date	Loan/Grant Acronym	Denominated Currency	Approved Loan/Grant Amount	Disbursement (as % of approved amount)
Credit for Small Farmers on the Highlands Project	IFAD	IDB	I	07 May 80	07 Oct 80	31 Dec 86	L - I - 38 - PE	SDR	9 500 000	100.00%
Alto Mayo Rural Development Project	World Bank: IBRD	World Bank: IBRD	I	10 Dec 82	06 Jun 83	30 Jun 94	L - I - 116 - PE	SDR	17 900 000	99.92%
Cuzco-Arequipa Highlands Rural Development Project	IFAD	CAF	I	29 Apr 86	18 Dec 87	31 Dec 93	L - I - 185 - PE	SDR	6 150 000	99.08%
Promotion of Technology Transfer Project to Peasant Communities in the Highlands	IFAD	CAF	I	12 Dec 91	30 Jun 93	31 Jul 99	G - I - 502 - PE	USD	23 000	
Promotion of Technology Transfer Project to Peasant Communities in the Highlands	IFAD	CAF	I	12 Dec 91	30 Jun 93	31 Jul 99	L - I - 297 - PE	SDR	11 650 000	100.00%
Management of Natural Resources in the Southern Highlands Project	IFAD	CAF	I	14 Sep 95	09 Apr 97	31 Dec 03	L - I - 386 - PE	SDR	8 250 000	70%
Development of the Puno-Cusco Corridor Project	IFAD	IFAD	O	04 Dec 97	17 Oct 00	30 Jun 07	L - I - 467 - PE	SDR	13 900 000	10%





KEY FILES

LOGICAL FRAMEWORK

Narrative	Objectively Verifiable Indicators	Means of Verification	Critical Assumptions
GOAL Strengthen competitiveness of small-scale farmers and entrepreneurs in the highlands of Peru to increase their incomes and living standards	Reduced head-count poverty levels Increased revenues	Regional statistics LSMS	Favourable policy environment Consistency and compatibility of government policies
OBJECTIVES Enhance beneficiary assets Increase and diversify beneficiary incomes Strengthen local governance and build social capital	Better-managed natural resources Increased value of land including rental values New enterprises developed New products and services introduced Local organizations consolidated Solvent local enterprises	Land use surveys Transaction records Municipal registries Public records	Beneficiary participation and interest Streamlined and non-bureaucratic procedures Effective and honest judicial system

Table 1: Agricultural and Rural Development Issues

Priority Area	Major Issues	Actions Needed
Policy Environment	<ul style="list-style-type: none"> • Unclear non-standardized tax policies • Import duties and trade barriers • Government involvement in direct purchasing of agricultural products 	<ul style="list-style-type: none"> • Develop a comprehensive and coherent fiscal policy for agriculture • Pursue development of economic corridors and rural-urban linkages • Deepen development of rural markets (technical assistance, financial services among others)
Institutional Framework	<ul style="list-style-type: none"> • Weak institutional capacity of MAG • Numerous uncoordinated institutions involved in rural development • Weak linkages between rural and urban organizations • Weak organizational and management capacity of farmer organizations 	<ul style="list-style-type: none"> • Create or strengthen local and regional mechanisms for decision-making • Strengthen resource transfer mechanisms to beneficiaries • Facilitate beneficiary organizational development and management capacities • Facilitate a decentralization process
Land	<ul style="list-style-type: none"> • Undefined legal status of peasant community land parcels. • Land fragmentation 	<ul style="list-style-type: none"> • Streamline and accelerate the land-titling process. Extend present PETT project. Initiate negotiations for additional financial assistance from IDB and others.
Forestry	<ul style="list-style-type: none"> • Illegal logging • Lack of management plans • Institutional weaknesses and enforcement capacity 	<ul style="list-style-type: none"> • Encourage the creation of joint ventures between rural communities and the private sector • Explore use of international carbon reduction agreements
Water	<ul style="list-style-type: none"> • Lack of legal framework • Investment concentrated around large multi-purpose projects in the coastal region • Poor maintenance of existing infrastructure and use of inefficient irrigation technologies • Weak water users' associations 	<ul style="list-style-type: none"> • Strengthen and reorganize water users' associations • Review water distribution patterns in the highlands • Award water rights to existing users • Establish realistic tariffs • Establish autonomous water authorities
Rural Finance	<ul style="list-style-type: none"> • Limited access to credit • Lack of longer-term loans • Limited access to deposit services • Limited number of financial institutions in rural areas • Lack of collateral • High transaction costs 	<ul style="list-style-type: none"> • Reduce risk through improved availability of collateral • Reduce transaction costs • Discourage directed credit • Support development of financial services other than credit
Public Goods	<ul style="list-style-type: none"> • Animal and Plant Health • Research and Extension • Information 	<ul style="list-style-type: none"> • Numerous plant and animal diseases make agricultural products, mainly fruits, subject to trade restrictions • Limited resources allocated to INRENA • Supply-driven extension • Limited dissemination of information





Table 2: Target Group Priority Needs and Proposed Interventions

Typology	Priority Needs	Proposed Interventions
Small-scale farmers	<ul style="list-style-type: none"> • Secured land tenure • Better access to rural services (technical assistance, financial and information services) • Rural infrastructure • Better management of natural resources • Better access to local, regional, national and international markets for their products 	<ul style="list-style-type: none"> • Assistance in market integration and provision of incentives for acquisition of technical assistance services and better management of natural resources. Development of rural-urban linkages. Assistance in land titling and development of management capacities. Deepening local decision-making processes.
Small-scale rural entrepreneurs	<ul style="list-style-type: none"> • Better access to rural services (technical assistance, financial and information services) • Better access to local, regional, national and international markets for their products • Better understanding of environmental compliance requirements 	<ul style="list-style-type: none"> • Assistance in market integration and provision of incentives for acquisition of technical assistance services and information. Support in compliance of environmental protection requirements
Rural women	<ul style="list-style-type: none"> • Better access to social services (education and health) • Equality in access to land property rights • Participation and empowerment 	<ul style="list-style-type: none"> • Inclusion and positive discrimination in project interventions
Indigenous communities	<ul style="list-style-type: none"> • Better access to social services (education and health) • Better access to productive investment funding • Better access to culturally based investments • Land tenure and territorial rights 	<ul style="list-style-type: none"> • Assistance in territorial security • Funding of culturally based indigenous initiatives • Provision of technical assistance and organizational development

Table 3: Institutional Matrix (Swot Analysis)

Institution	Strengths	Weaknesses	Opportunities	Threats
MINISTRY OF AGRICULTURE INRENA	<ul style="list-style-type: none"> • International donor support for protected area management • Access to substantial work carried out previously and deposited with the institution 	<ul style="list-style-type: none"> • Limited enforcement capacity • Concentration on rain forest systems 	<ul style="list-style-type: none"> • Influence decision-making on overall management of natural resources • Possibility to contribute to improvement of living conditions of indigenous communities in protected areas • Enhanced environmental protection and conservation 	<ul style="list-style-type: none"> • Illegal loggers, miners' infringement
PRONAMACHCS	<ul style="list-style-type: none"> • Government commitment to programme • National coverage 	<ul style="list-style-type: none"> • Top-down approach • Limited farmer ownership of initiatives • Political interference • Limited capacity for organizational administration 	<ul style="list-style-type: none"> • Possibility to induce farmers to manage resources from a watershed perspective • Integration of existing network in a demand-driven system 	<ul style="list-style-type: none"> • Political decisions to use institution for proselytizing
SENASA	<ul style="list-style-type: none"> • International funding • National coverage 	<ul style="list-style-type: none"> • Limited enforcement capacity • Lack of comprehensive rules and regulations 	<ul style="list-style-type: none"> • Contribute to export potential of agricultural products • Expand market possibilities 	<ul style="list-style-type: none"> • Slow and cumbersome procedures for approvals of rules and regulations • Inability to comply with international standards
MINISTRY OF INDUSTRY PROMPEX (Commission for Export Promotion)	<ul style="list-style-type: none"> • International presence in coordination with the Ministry of External Affairs 	<ul style="list-style-type: none"> • Uncoordinated efforts with other sectors 	<ul style="list-style-type: none"> • Possibility to develop an aggressive export-driven programme 	<ul style="list-style-type: none"> • Lack of interest and cooperation from diplomatic posts abroad



Cont.'d Table 3: Institutional Matrix (Swot Analysis)

Institution	Strengths	Weaknesses	Opportunities	Threats
MINISTRY OF LABOUR PROMPYME (Commission for the Promotion of Small Business)	<ul style="list-style-type: none"> • International donor support for development of small and microenterprises • Provision of assistance for market development and product promotion 	<ul style="list-style-type: none"> • Direct government purchasing of goods produced by small-scale entrepreneurs 	<ul style="list-style-type: none"> • Possibility to support small-scale agro-industries • Increasing rural-urban linkages 	<ul style="list-style-type: none"> • Bureaucratic culture of Ministry of Labour
MINISTRY OF THE PRESIDENCY PRONAA (National Programme for Assistance Relief)	<ul style="list-style-type: none"> • National presence • Beneficiary identification with programme 	<ul style="list-style-type: none"> • Direct government purchasing of goods. • Fostering dependence • Lack of transparency 	<ul style="list-style-type: none"> • Social investment targeting 	<ul style="list-style-type: none"> • Increasing dependence
FONCODES	<ul style="list-style-type: none"> • Long-term experience • Use of local executing agencies 	<ul style="list-style-type: none"> • Building focus on social infrastructure • Political interference 	<ul style="list-style-type: none"> • Possibility to use executing agency model for productive investments 	<ul style="list-style-type: none"> • Lack of institutional definition
CTARs (decentralized regional administrations)	<ul style="list-style-type: none"> • Decentralized operations 	<ul style="list-style-type: none"> • Uncertain legal status • Political interference • Limited resources • Limited local legitimacy 	<ul style="list-style-type: none"> • Possibility to become an instrument for expanded decentralization efforts and a financial transfer mechanism 	<ul style="list-style-type: none"> • Transitional character • Legal changes required • Parliamentary approval for changes
Municipalities	<ul style="list-style-type: none"> • Elected body • Citizen participation • Knowledge of local problems 	<ul style="list-style-type: none"> • Limited resources • Limited technical capacities • Poor administrative controls 	<ul style="list-style-type: none"> • Possibility to channel funds more directly to beneficiary communities • Community control 	<ul style="list-style-type: none"> • Political instability and interference • Legislative framework changes
NGOs	<ul style="list-style-type: none"> • Independence from government controls • Field experience 	<ul style="list-style-type: none"> • Pursuit of self-interest • Weak administrative controls 	<ul style="list-style-type: none"> • Possibility to channel grant resources 	<ul style="list-style-type: none"> • Government mistrust • Reduced grant resources



Table 4: Donor Operations/Partnership Potential

Donor	Project-Programme	Coverage	Status	Synergy Potential
IBRD	• Agricultural Research and Extension Project	• <i>Costa, Sierra and Selva</i>	• Ongoing	• Strong. small-scale producers could, after initial incentives, have access to resources from this project
	• Highlands – Natural Resources Management and Poverty Alleviation Project	• <i>Sierra</i> • <i>Costa</i>	• Ongoing • Ongoing	• Weak. Conflicting approaches
	• Irrigation Subsector Project	• <i>Costa, Sierra and Selva</i>	• Ongoing	• Weak. Focus on coastal farmers
	• Rural Roads Project			• Strong. Community maintenance and development of rural enterprises
	• Indigenous and Afroperuvian People Development Project	• <i>Costa and Sierra</i>	• Pending effectiveness	• Weak. Limited scope. Concentration on rain forest areas
IDB	• Rural Land Titling Project	• <i>Costa, Sierra and Selva</i>	• Ongoing	• Strong. Supportive in assuring land tenure
	• Animal and Plant Health Project	• <i>Costa, Sierra and Selva</i>	• Ongoing	• Medium. Supportive in increasing export potential of small-scale producer products
European Union	• Food Security Support Programme	• 419 Extreme Poverty Districts	• Ongoing	• Strong. Supportive of regional and local government participation in rural development productive investments
FAO (Food and Agriculture Organization of the United Nations)	• Integrated and Participatory Management of the Vilcanota River Basin	• Cusco	• Pipeline	• Strong. Supportive of the Development of the Puno-Cuzco Corridor IFAD-funded Project
UNDP	• Technical assistance for Modernization of the State	• National	• Ongoing	• Weak. Support to regulatory agencies.
	• GEF Mid-Sized Environmental Projects	• Protected areas	• Ongoing	• Weak. Limited scope
AECI	• Modernization of Productive Sectors and Infrastructure	• <i>Sierra and Selva</i>	• Ongoing	• Strong. Supportive in the provision of assistance for income-generating initiatives in agricultural-related endeavours



Table 5: Multilateral Financing

Institution	Project	Amount	Disbursed
IBRD	• Agricultural Research and Extension Project	• USD 9.6 million	• USD 00.7 million
	• Highlands – Natural Resources Management and Poverty Alleviation Project	• USD 51 million	• USD 40.0 million
	• Irrigation Subsector Project	• USD 85 million	• USD 47.8 million
	• Rural Roads Project II	• USD 50 million	• USD 00.0 million
	• Indigenous and Afroperuvian People Development Project	• USD 5 million	• USD 00.0 million
IDB	• Rural Land Titling Project II	• USD 23.3 million	• USD 00.0 million
	• Animal and Plant Health Project	• USD 45.6 million	• USD 13.9 million
	• Rural Roads Project II	• USD 50 million	• USD 00.5 million
	• Emergency Earthquake Fund	• USD 20 million	• USD 00.2 million
	• Rural Roads Project II	• USD 50 million	• USD 00.0 million
KfW (German Credit Institution for Reconstruction)	• Irrigation South Andean Project III	• USD 8.4 million	• USD 3.6 million
JBIC-ODA (Japan Bank for International Cooperation – Official Development Assistance)	• Irrigation Subsector Project	• USD 61.2 million	• USD 00.0 million
	• Highlands – Natural Resources Management and Poverty Alleviation Project	• USD 155.9 million	• USD 33.6 million
	• Social Development in Highland Area Project	• USD 121.9 million	• USD 7.7 million
	• Rural Roads Project	• USD 223.0 million	• USD 132.9 million
IFAD	• Management of Natural Resources in the Southern Highlands Project	• USD 11.9 million	• USD 6.2 million
	• Development of the Puno-Cuzco Corridor Project	• USD 19.0 million	• USD 0.9 million

