

**PROJECT INFORMATION DOCUMENT (PID)  
APPRAISAL STAGE**

Report No.: AB2519

<b>Project Name</b>	Peru Decentralized Rural Transport Project
<b>Region</b>	LATIN AMERICA AND CARIBBEAN
<b>Sector</b>	Roads and highways (50%); General public administration sector (30%); General transportation sector (20%)
<b>Project ID</b>	P095570
<b>Borrower(s)</b>	GOVERNMENT OF PERU
<b>Implementing Agency</b>	PROVIAS DECENTRALIZADO (former PROVIAS RURAL) Av. Garcillazo de la Vega No. 1351-3er Piso - Centro Civico Lima 1 Peru Tel: (51-1) 330-3465 Fax: (51-1) 330-8554 <a href="http://www.proviasrural.gob.pe">http://www.proviasrural.gob.pe</a>
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## 1. Country and Sector Background

1. **Reducing rural poverty remains a major challenge for Peru.** According to the latest available poverty assessment (2004), more than half of the Peruvian population is poor and 20 percent extremely poor. Poverty levels are much higher in rural areas, particularly in the *Sierra*: In 2002, 9.4 million Peruvians were living in rural areas, of which 78 percent were poor and 51 percent extremely poor. Extreme poverty remains, by and large, a rural phenomenon (only 10 percent of the urban population is considered extremely poor). The impressive sustained economic growth of the past five years (with an average growth of 4 percent) has produced a decrease in extreme poverty levels at the national level (from 24.1 percent in 2001 to 19.2 percent in 2004) although overall poverty has not yet evolved significantly. Nevertheless, the good economic performance has stopped the worsening trend that began during the recession of the late 1990s: Between 1985 and 2000, the number of poor people had increased by 71 percent, a large proportion of these in rural areas.

2. **Peru's infrastructure gap is one of the key determinants of rural poverty.** Peru's well documented infrastructure gap is particularly acute in rural areas<sup>1</sup>. In rural Peru, in 1999, access to electricity services reached only 30 percent. Today, 6 million Peruvians still lack access to electricity. In 1999, only 28 percent of rural households had access to a road in good condition.

<sup>1</sup> See for instance: IPE (*Instituto Peruano de Economía*): "La Brecha en Infraestructura, Servicios Públicos, productividad y Crecimiento en el Perú", 2003.

In 2003, only 9 percent of small urban centers had a public phone and access to a telephone was marginal in villages of less than 500 inhabitants (where 2.7 million Peruvians live). In 2000, only 49 percent of the population had access to sanitation services (62 percent for water services). For all these services, except water, coverage in Peru is less than the South American average and what is generally observed in countries with a similar level of development. The price of services in rural transport and rural electricity is higher than in benchmark countries. Moreover, for all these sectors, except telecommunications, the quality of these services is less than of comparators’.

3. Limited access, poor quality and, sometimes, high prices have dramatic consequences for the rural poor. By limiting productivity gains and affecting the ability to diversify outside subsistence agriculture (eg. poor transport limits access to fertilizers) limits rural growth, which could raise poor households’ income. In addition, the rural infrastructure gap makes the poor more vulnerable and limits empowerment. Indeed, there is ample evidence of the contribution of infrastructure to poverty alleviation and welfare enhancement:<sup>2</sup> For example, better transport means easier access to social services (health, education), safer water improves health, electricity gives children more time to study, cleaner fuels mean less respiratory diseases and telecommunications bring access to knowledge and information.

4. **The Peruvian Government has engaged in a large scale decentralization process to improve both the coverage of rural infrastructure and the quality of public expenditures.** The 1993 constitution mandated decentralization, but regional elections were only held in 2003, following the adoption of a constitutional amendment in 2002 that required the creation of regional governments. Today there are 26 regions and 1,832 municipalities. In the latter category, 194 are provincial municipalities, the rest are district municipalities. Peru’s decentralization agenda was designed to support the following objectives: economic development and competitiveness; modernization and simplification of administrative systems and processes; assigning responsibility for public services to levels closest to the users; and citizen participation in governance.

5. Decentralization offers the opportunity to improve the provision of public goods by tailoring them to local preferences. Furthermore, an advantage of decentralization is that competition, proximity, and transparency provide a strong motivation for local governments to be more responsive to the needs of the public. Decentralization has led to a change in budget allocations: sub-national governments account for 35 percent of non-financial government expenditures in 2006, up from 28 percent in 2003. Similarly, sub-national governments are playing a more important role in public investment; they are responsible for more than half of public investment in 2006, compared to only 20 percent in 2003<sup>3</sup>. In order to preserve fiscal neutrality during the decentralization process, all responsibilities transferred are accompanied by the corresponding allocation of resources. The design of the Peruvian intergovernmental system does not provide for control over rates and bases for local governments and the Peruvian Constitution does not authorize regional level taxation. Consequently, the discretion over own-

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<sup>2</sup> An extensive literature review is presented in Brenneman, A. and Kerf, M., “Infrastructure and Poverty Linkages: A Literature Review”, 2002.

<sup>3</sup> World Bank, 2006. Policy Note on Decentralization.

revenues resources is very limited or non-existent, leaving regional governments with little flexibility in the use of their budget resources.

6. In July 2006, a new Peruvian administration led by President Alan Garcia of the *Partido Aprista Peruano* (APRA) came into power. Despite a clear victory in the second round runoff with 54 percent of the vote, results revealed a marked split across the country with APRA winning Lima and the Northern region, and losing in the Highlands and in the Amazon region. The vote in the highlands and the Amazon region is widely perceived to reflect a feeling of exclusion and dissatisfaction with the way in which the political system responds to these much poorer regions. To respond to this dissatisfaction, the Garcia administration emphasized in its Government's Plan for 2006-2011, that the development of rural areas (with, in particular, the *Sierra Exportadora* Program) would be a priority. The expansion of infrastructure services (roads, electricity and water with the *Agua Para Todos* Program) and the continuation of the decentralization reforms are also a top priority on the new administration's agenda.

7. **Decentralization has been the most successful in the rural roads sectors.** Since 1995, the Peruvian authorities have successfully designed and implemented an innovative approach to rural road management, with the help of the World Bank and the Inter-American Development Bank. The World Bank has lent US\$90 million to Peru for the First Rural Road Project and US\$50 million for the second project. The approach, which is currently applied in half of the country,<sup>4</sup> has aimed at empowering the rural poor in the process of selecting those roads that should be rehabilitated. Then, building on the decentralization reforms, the management of rural roads has been progressively handed over to municipalities. As of April 2006, 14,000 km of rural roads had been rehabilitated and were receiving adequate maintenance. Contracts were let to 612 micro-enterprises, representing 7,000 employment opportunities for poor men and women. In 2005, an evaluation revealed the improvements in transport (a 68 percent reduction in travel time), as well as its impact on access to schools (an 8 percent increase in enrollment), health centers (a 55 percent increase in visits), agricultural productivity (a 16 percent increase in land destined to agriculture) and rural income (a 20 percent increase in men's agricultural salaries). An improved trend in poverty and extreme poverty indicators was also observed.<sup>5</sup>

8. **The learning process contributed to the strengthening of decentralization reforms.** In addition to their positive impact on rural welfare, the first and second rural roads projects have constituted a learning process, which has led to the development of innovative instruments and new rural transport approaches, through the design and implementation of several pilots. There are several examples. The first experimental decentralized "provincial road institute" was in Arequipa: there are now 108 of them with basic or fully-established operational capacity. A "regional road management pilot" has also proved that the rural road management model could be successfully replicated for secondary roads (an experience that is now been scaled up by the Regional Transport Decentralization project).<sup>6</sup> A "gender action plan" has demonstrated that women could participate actively in the road maintenance micro-enterprises (24 percent of micro-entrepreneurs are now women). A "Local Development Window" in 12 provinces made a

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<sup>4</sup> In the 12 *departamentos* that were the poorest when the Project was designed: Ancash, Apurimac, Ayacucho, Cajamarca, Cusco, Hunacavelica, Huanuco, Junín, Madre de Dios, Pasco, Puno and San Martin.

<sup>5</sup> Second Rural Roads Project – Mid-term evaluation, *Instituto Cuanto*, 2005.

<sup>6</sup> Financed by the World Bank and the IDB. Approved by the World Bank Board on July 12, 2005.

major contribution to the preparation of sound “local development plans” that became one of the cornerstones of Peru’s decentralization policy.<sup>7</sup> Finally, a “*Plan Piloto Selva*” has explored ways to customize rural transport solutions (including river-based) to the Peruvian *Selva*.

**9. Despite the progress already achieved, there remain a number of barriers before the decentralization of rural infrastructure management can have the greatest impact on rural poverty reduction.** Reasons include, in particular:

- *The fiscal situation limits financing for rural infrastructure.* Between 1998 and 2002, total average funding for rural infrastructure amounted to US\$97 million (97 percent from public sources) or 0.18 percent of GDP.<sup>8</sup> This is significantly lower than other Latin America countries: Chile spent about 0.28 percent of GDP of rural infrastructure and Guatemala 0.31 percent over the past 5 years. In order for Peru to close its rural infrastructure gap in 10 years with the South American average (and with the average of countries with a similar level of development), total expenditures should be doubled. However, the fiscal situation (indebtedness ceilings, lack of counterpart funds) and rigidities of sub-national governments in the use of their budget resources, have been so far a binding constraint to such an increase.
- *Institutional capacity at the sub-national level remains limited.* In 2003, a survey<sup>9</sup> showed that only 2 percent of municipalities estimated that they had both the technical skills and the financial resources to manage rural infrastructure projects (compared to 42 percent for some social programs). The extreme fragmentation of the municipal sector in Peru reduces dramatically the institutional capacity below the provincial level.<sup>10</sup>
- *The absence of coordination across infrastructure sectors reduces effectiveness.* Planning and prioritization of infrastructure investments remains a sector-by-sector exercise although the decentralization process has brought some alignment with territorial development strategies (particularly for rural roads and rural water/sanitation). Still, less than a quarter of the rural population has access to two or more infrastructure services, although there is evidence that bundling increases impact on rural household incomes.<sup>11</sup> No central government agency is currently promoting greater coordination across sectors.
- *The quality of public expenditures can still be improved.* The reforms engaged in certain sectors to promote greater private sector participation have produced significant efficiency gains (in telecommunications in particular). These reforms still need to be deepened with the use of low-cost technologies, more targeted subsidies and/or pricing reform, improved regulatory environment and the use of incentives to bring the private sector on-board (like minimum subsidy concessions). With the decentralization process, the challenge of improving the quality of public expenditures is particularly acute for

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<sup>7</sup> One of the conditions for accreditation of municipalities by the National Decentralization Council is a prepared local development plans.

<sup>8</sup> Rodriguez, M., 2004. “*Análisis de Gastos de Inversiones y en Provisión de Servicios de Infraestructura Rural y su Comparación con la Evolución de los Indicadores Socio-Económicos de las Áreas Rurales en Perú*”.

<sup>9</sup> Azcueta, M., 2003. “*Análisis de Capacidades en los Gobiernos Locales del Perú*”.

<sup>10</sup> The average size of rural municipalities (districts) in Peru is about 8,000 inhabitants, compared to about 20,000 in Argentina and Bolivia or 26,000 in Brazil or Chile.

<sup>11</sup> Escobal, J. and Torero, M., 2004. “*Análisis de los servicios de infraestructura rural y las condiciones de vida en las zonas rurales de Perú*”.

sub-national governments, especially the ones that receive significant transfers (eg. from *canon minero*).

10. **The experience gained over a decade in the rural roads sector could help tackle these weaknesses.** With the first and second rural roads programs, a number of instruments have been successfully developed that allowed the strengthening of the decentralization process and the improvement of the quality of public expenditures: with the “Provincial Road Institutes” (PRIs), under the authority of the mayors in the province, municipalities have reached sufficient institutional capacity to manage effectively their rural roads assets. The “Participatory Provincial Road Plans,” prepared by the key rural provincial stakeholders, have resulted in better aligned rural roads investments with the territorial development strategy of the province. Another planning mechanism, the “Local Development Window”, has been facilitating the identification and implementation of productive initiatives that became feasible as a result of improved transport conditions. Finally, the quality of public expenditures in roads has been improved with the use of low cost rehabilitation technologies (“gravel roads”) and of a routine road maintenance program with micro-enterprises that have enhanced sustainability. All these experiences are not directly applicable to other infrastructure sectors, but they can provide the basis for the design of an integrated decentralized rural infrastructure approach. In order to increase impact on rural poverty, this approach should promote, in particular, the bundling of rural infrastructure services through the use of common planning instruments (“provincial rural infrastructure plans”).<sup>12</sup>

11. The rural transport sector itself requires further reforms. Only about 14,500 km of a registered total rural roads network of 47,000 km has been rehabilitated over the past decade, and only half of the country (the 12 *departamentos* where poverty was the most acute) benefited from the decentralized rural road management model (provincial road institutes, micro-enterprises) developed by Provias Rural. Lack of access and constrained mobility remains a major obstacle to growth and poverty reduction in many poor areas of rural Peru. In the context of the decentralization reforms, the PRI model should be generalized to the entire country, which implies creating new PRIs in the provinces where the program has not been intervening and strengthening the ones that have been created but have not yet reach full operational capacity. While municipalities have greater control on greater amount of budget resources (especially the ones that have access to *cañón minero*), the generalization of the cost effective and efficient model that combines participatory road planning, contracting out of road works to the private sector, low cost road rehabilitation technologies and micro-enterprises for road maintenance, is an important measure to improve the quality of decentralized public expenditures. Finally, reforms are also needed at both central and sub-national levels to strengthen the regulation of rural transport, beyond just the sound management of road assets.

12. **A gradual approach is needed.** Decentralization is a long-term process and international experience suggests that, to be successful, it has to be gradual. In Peru, the experience of the rural roads projects illustrates the time required to build sufficient institutional capacity at the

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<sup>12</sup> While economies of scale and accountability to rural users’ considerations may explain why each sector could have a different preferred territorial level for implementation (eg. regions for electricity, districts for water/sanitation), the provincial level appears to be the right compromise for such a common planning approach. Indeed, in Peru, provinces are both sufficiently large in order to have a basic institutional capacity and sufficiently close to rural stakeholders to ensure accountability.

provincial level. All the innovative instruments developed under these projects have been developed on a pilot basis, to test and refine the proposed approach and monitor benefits. In a second phase, scaling up was facilitated by the demonstration effects of several success stories (like the Provincial Road Institute of *Arequipa*). But scaling up itself takes time: about one year is needed to prepare a participatory provincial road plan and one to two years are needed to create a fully operational provincial road institute.

13. **The full integration of rural infrastructure into territorial development strategies will also take some time.** No institution in Peru is today capable of handling a full-scale rural infrastructure strategy that would imply identifying and financing combinations of rural infrastructure investments, and merging all the existing sector-specific instruments. The National Decentralization Council (CND in Spanish) has a political and strategic function which is not compatible with the responsibility of implementing an actual investment program and the only multi-sector funding instrument (FONCODES) has failed to implement cost-effective and sustainable investments in a decentralized manner. In fact, with the decentralization process, that responsibility should be progressively taken over by sub-national governments themselves since they are the best positioned to identify and assess complementarities between investments and their relevance for territorial development. Because of its experience in strengthening the institutional capacity of municipalities and in designing and implementing cost-effective solutions for rural roads, Provias Descentralizado can coordinate the efforts of the various existing actors to design and implement on a pilot basis a set of incentives that could improve the coordination between the various rural infrastructure sectors and promote their bundling. In the future, a possible champion for an integrated planning of rural infrastructure investments could emerge with the actual creation of a National Planning Institute (*Centro Nacional de Planeamiento Estratégico*)<sup>13</sup> as envisaged by the new Peruvian administration.

14. **Proposed strategy.** The proposed strategy is, first, to consolidate the progress achieved in the rural road sector to improve the quality of decentralized public expenditures and, second, to experiment with a set of incentives that could enhance the effectiveness of rural infrastructure investments through greater coordination and the promotion of bundling.

## 2. Objectives

15. The project is aligned with the 2003-2006 CAS objectives of strengthening public sector management and decentralization. **[to be updated based on new CAS priorities]**

16. The proposed project aims to improve livelihoods of rural communities by i) expanding to the entire country the rural transport policies that have been successfully designed over the past decade; ii) increasing the developmental impact of rural infrastructure interventions through piloting greater coordination and promotion of bundling; and iii) enhancing the efficiency, sustainability and effectiveness of investments in rural transport through strengthening the decentralization framework and building up institutional capacity at the provincial level.

## 3. Rationale for Bank Involvement

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<sup>13</sup> The creation of the CEPLAN was decided by the Supreme Decree No. 054-2005-PCM but did not yet materialize.

17. **The proposed project is aligned with the Bank strategy in Peru.** One of the main priorities of the Peru CAS for 2003-2006 was public sector management and decentralization. Since 2003, many World Bank operations are or have been supporting the GoP agenda to promote rural growth through enhanced decentralization. These range from sector-specific approaches (infrastructure, social sectors, rural development) to operations that helped put in place a sound institutional and fiscal framework for decentralization. The scope of these operations has either been territorialized (poorest regions, Sierra macro-region, Vilcanota) or with a national coverage (at either the municipal or the regional level).

18. The new CAS for 2007-2011 is under preparation and is expected to be presented to the Board in November 7, 2006. The CAS will balance Peru's need for sustainable macroeconomic growth, where the private sector plays a crucial role, and responsible social policies together with both the government's short term plan in key selected areas as well as its mid-term development program. An extended and decentralized process of consultations with civil society leaders will contribute to the preparation of the CAS. The consultation with civil society will provide recommendations on outcomes and good practices and it will identify limitations to a sound investment climate in poor areas. Three levels of consultations will take place: micro/district level focusing on the poor, mezzoregional/provincial level and macro level on sector and national policies. The CAS will draw upon a comprehensive set of policy notes that have been prepared over the last year for the benefit of the incoming administration. The proposed project draws on the recommendations of one of these policy notes entitled "Decentralization and Rural Infrastructure". The project is also aligned with the Government's priorities to develop rural areas, particularly in the Highlands, and strengthen the decentralization process. **[to be updated based on new CAS priorities]**

19. **Project design follows the recommendations of the Peru Rural Infrastructure Strategy.** The Government of Peru is very interested in finding new approaches to rural infrastructure delivery within the broader context of the decentralization reforms. To this end, the Government began working with the Bank in 2003 on the design of a Rural Infrastructure Strategy to identify areas where existing strategies could be improved. A number of background studies were prepared, including a diagnostic of the selected rural infrastructure sectors (water/sanitation, transport, electricity and telecommunications) and several pieces of analytical work on other cross-sector topics. In particular, an econometric analysis found evidence of the benefits of bundling infrastructure services.<sup>14</sup> Based on the results from these background studies and in particular the need to foster complementarities between the various infrastructure sectors, the rural infrastructure strategy recommended that provincial rural infrastructure plans be prepared and to explore institutional arrangements such as the creation of "provincial infrastructure institutes" (PII) that could facilitate coordination at the provincial level. To enhance efficiency, most tasks related to rural infrastructure management would have to be contracted out to private operators. Finally, the strategy estimated that in order to bridge Peru's rural infrastructure gap in the next ten years, total funding for rural infrastructure would have to be doubled compared to the average level observed in 1998-2002 and sustained at that level during the same period.

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<sup>14</sup> Escobar, J. and Torero, M., 2004. "Análisis de los servicios de infraestructura rural y las condiciones de vida en las zonas rurales de Perú".

#### 4. Description

20. **Component 1: Improvement of Rural Transport Infrastructure (estimated cost: US\$98.4 million of which US\$35.0 million would be financed by the Bank loan).** This component will scale up to the entire country the decentralized rural roads policies that have been successfully developed during the first two rural roads projects (whose scope was limited to the 12 poorest *departamentos*). Activities to be financed include: (1) rehabilitation or improvement of rural roads prioritized through participatory planning; (2) improvement and reconstruction of bridges that are critical to ensure connectivity on rehabilitated rural roads; (3) periodic maintenance of rural roads; (4) improvement of non-motorized transport (NMT) tracks; (5) improvement of other types of rural transport infrastructure (including river-based equipment such as small wharfs that may be more adapted to “Selva” region); and (6) a pilot for the stabilization of slopes and the protection of rural roads against river-based erosion. For each activity, the project will finance feasibility and technical studies, technical assistance (eg. pilot for the stabilization of slopes), safeguards-related studies (eg. environmental impact assessments), works and supervision. All activities will be executed in compliance with social and environmental safeguards as described in [Annex 10](#). Activities will be procured by Provincial Road Institutes (PRIs) whenever they have reached sufficient capacity or, in their absence and on a transitory basis, by Provias Descentralizado.

21. **Component 2: Territorial Development (estimated cost: US\$10.9 million of which US\$4.5 million would be financed by the Bank loan).** The objective of this component would be to enhance the impact that improved transport conditions can make on rural development by enhancing complementarities with other types of investments and by promoting productive activities. This component would: (1) scale up the Local Development Window (LDW) model developed during the second Rural Roads Project; and (2) experiment in 15 Peruvian provinces a Rural Infrastructure Pilot that will include specific incentives to promote greater complementarities across rural infrastructure investments.

22. **Sub-component 2.1: Local Development Window (LDW) (US\$1.0 million)** – The LDW is an instrument which has been developed during the Second Rural Roads project, with the purpose of accelerating the emergence of productive activities in the areas where transport conditions have been improved. For the purpose of the proposed project, the executing agency of the LDW will be selected on a competitive basis, among private operators and NGOs. Eligible activities include productive activities such as the development of agricultural niches (eg. fair trade coffee) or the promotion of eco-tourism. The productive activities identified under the LDW would not be financed under the proposed project, since the LDW would only act as an intermediary to reduce transaction costs for potential sponsors. The LDW will also count on a US\$1.5 million Japanese Trust Fund mobilized by the IaDB and administered by Provias Descentralizado. The LDW would intervene in about 50 provinces (chosen from among the poorest ones).

23. **Sub-component 2.2: Rural Infrastructure Pilot (US\$9.9 million)** – The Rural Infrastructure Pilot aims at developing, in a representative and manageable sample of 15 Peruvian provinces and in the context of the decentralization reforms, specific planning and institutional arrangements, with the ultimate objective of increasing the efficiency and



effectiveness of rural infrastructure investments through enhanced coordination and the promotion of greater complementarities. Provinces have been selected in order to cover a diversity of situations with regards to (1) availability of budgetary resources; (2) presence of infrastructure sector agencies; and (3) strategic considerations (coca-producing areas, provinces affected by terrorism).

24. Activities eligible for financing include: (1) preparation of rural infrastructure plans (see Box 2); (2) leveraging financing to implement these plans; (3) building institutional capacity at the provincial level to manage rural infrastructure interventions; (4) monitoring and evaluation of benefits as well as transaction costs involved; (5) exploring the design of additional incentives for greater coordination and effectiveness of rural infrastructure interventions. This sub-component will also finance transport infrastructure works identified in the rural infrastructure plans, as well as related studies and supervision. These resources for rural transport improvement investments that come out of the rural infrastructure plans (enough to rehabilitate about 40 km of rural roads) will be additional to the usual methodology designed to allocate project resources among provinces (see III.B). Thus, they are expected to become a strong incentive (“bundling premium”) so that municipalities accept to spend the additional institutional effort needed for effective multi-sector coordination. Specific institutional arrangements are applicable to the rural infrastructure pilot and are described in paragraph III. B and in Annex 6. A thorough evaluation of the pilot will be performed in 2009 and will help determine what follow up should be given. In particular, the opportunity for scaling up will be assessed. Such timing is expected to coincide with the reform agenda of the new Peruvian administration with regards to the setting up of a new institutional framework (eg. with the creation of a National Planning Institute) that could take over the responsibility for scaling up the rural infrastructure pilot.

**Box 2: Participatory planning of rural infrastructure in the province of Cotabambas**

The province of *Cotabambas*, located in the *Apurimac* region, has a population of about 44,000 inhabitants, of which 80% live in rural areas, 78% are poor and 47% live in extreme poverty. In October 2005, the provincial municipality of *Cotabambas* started to prepare a rural infrastructure plan (*plan de infraestructura economica multisectorial*), with the technical assistance provided by Provias Descentralizado and in coordination with the various central agencies competent for rural infrastructure. The planning process was organized in a participatory manner, with the consultation of key local stakeholders. It first aimed at identifying economic potential opportunities (mostly in the agriculture and mining sectors) and at mapping existing rural infrastructure. Then, constraints to the development of these economic opportunities were identified and prioritized. While the final plan showed that poor transport conditions were a major bottleneck to growth, insufficient access to water and sanitation services also ranked high in the list of priorities. On the other hand, it appeared that the situation of telecommunications and rural electrification was significantly better than in the rest of the country (the coverage of rural electricity services in *Cotabambas* is, with 87% of the population, one of highest in Peru). The preparation of this first rural infrastructure plan helped Provias and the other competent central agencies, test in real conditions, a multi-sector planning methodology and identify possible areas of improvement (eg. regarding the ranking of economic potential opportunities).

*Source:* Provias Descentralizado.

25. **Component 3: Institutional Development (estimated cost: US\$18.0 million of which US\$7.2 million would be financed by the Bank loan).** This component would provide a comprehensive institutional strengthening package at the local and central levels, in the broader

context of the decentralization reforms. The main objective is to strengthen the regulatory capacity of the national level while empowering municipalities in the definition and implementation of their rural transport policies. At the local level, the main actors targeted will be the provinces which have been identified as the right level to both get the benefits of economies of scale and ensure accountability to key stakeholders. Nevertheless, coordination with other levels of sub-national governments (districts, regions) will also be promoted. At the local level, this component will finance the following activities: (1) preparation or updating of participatory provincial road plans; (2) strengthening of the existing routine maintenance system with micro-enterprises; (3) strengthening local capacity to handle safeguards; (4) mobilizing municipal financing for rural transport; (5) promoting private financing for rural transport; (6) scaling up the Geographic Information Systems experience; and (7) other technical assistance activities for municipalities and PRIs (including the promotion of social inclusion). At the central level, this component will finance the following activities: (1) regulation and definition of policies for rural transport; (2) promotion of research and innovation in rural transport (including the development of new rehabilitation technologies); (3) fiscal revenues and road development pilot; and (4) other technical assistance activities or specific analytical works for MTC agencies.

26. **Component 4: Project Administration (estimated cost: US\$17.5 million of which US\$1.0 million would be financed by the Bank loan).** This component will cover project administration costs, as well as monitoring, evaluation and audits. The Project will be administered by Provias Descentralizado in close coordination with other ministries.

27. **Sub-component 4.1: Monitoring, evaluation and audits (US\$2.5 million)** – This sub-component will finance monitoring activities, in particular related to the updating or expansion of Provias’ monitoring system (SIGAT) or related training activities such as the ones aiming at strengthening the monitoring capabilities of the PRIs. Eligible expenditures will also include mid-term and final impact evaluation studies. A comprehensive description of the project’s monitoring and evaluation system is provided in Annex 3b. Finally, this sub-component will finance the external financial audits, as well as the technical, operational, environmental and social auditing activities to be performed during implementation.

28. **Sub-component 4.2: Administrative costs (US\$15 million)** – This sub-component will include administrative costs incurred by Provias Descentralizado to administer the proposed project. These administrative costs will be exclusively financed by national counterpart funds (ie. from the MTC budget and not from the proposed loan). Operating costs incurred by PRIs and municipalities would not be eligible.

## 5. Financing

Source:	(\$m.)
BORROWER	50
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT	50
INTER-AMERICAN DEVELOPMENT BANK	50
Total	150

## 6. Implementation

29. **At the national level**, the overall responsibility for project implementation and coordination will rest with Provias Descentralizado. *Provias Descentralizado* was created in August 2006 by Supreme Decree No. 029-2006-MTC. Despite its recent creation at the time of project preparation, this unit is not completely new since it comes from the merging of two existing entities: *Provias Rural* and *Provias Departamental*. This evolution is expected to be a positive step towards greater recognition of the decentralization process in the transport sector. In addition, *Provias Rural* was the agency that implemented the First and Second Rural Roads project while *Provias Departamental* was implementing the Regional Transport Decentralization project. These two entities are therefore familiar with Bank and IDB procedures so that *Provias Descentralizado* is likely to become quickly operational. Nevertheless, the merging process created some uncertainties regarding what will be the final organization and it was therefore agreed that the final organizational structure will have to be finalized before negotiations.

30. The decentralization process implies that Provias Descentralizado evolves from an executing agency to a regulatory/promoting/supervising body. This evolution is already taking place with the creation of IVPs in provincial municipalities and the transfer of fiduciary responsibilities to them. Consequently, the activities performed by Provias Descentralizado have evolved from directly managing road rehabilitation and maintenance activities to providing targeted technical assistance to municipalities to help them design and implement their rural transport policies.

31. This evolution has important consequences for Provias Descentralizado: it requires in certain cases downsizing the institution, while strengthening other competences (such as experts in decentralization and territorial planning). In order to formalize the process, a legal covenant has been introduced in the legal agreement so that the management of Provias Descentralizado prepares, by the end of the first year of operation, an institutional plan describing the “Vision” of Provias Descentralizado for 2010 and a timing of actions to ensure the proper implementation of this plan.

32. **At the provincial level**, the overall responsibility for project implementation will rest with the Provincial Road Institutes (PRIs), in accordance with the new decentralized environment. The PRIs are embedded in the provincial municipalities and would therefore benefit from the support of other municipal departments (planning, finances, general services). They include a limited number of staff (generally a manager – *gerente* –, a technical assistant and a support staff). An accreditation system with triggers has been designed to ensure that PRIs have reached sufficient capacity at the time of transfer of fiduciary responsibility. In the 15 provinces where the rural infrastructure pilot will be implemented, PRIs are expected to involve into Provincial Infrastructure Institutes (PII).

33. To provide technical assistance to the PRIs and ensure second-level monitoring, Provias Descentralizado will count on its regional bureaus (*unidades zonales*). In the regions where the program has been active, the 11 regional bureaus have evolved from traditional engineering and technical competences towards becoming centers of expertise in rural transport policies and institutional issues related to the decentralization process. This evolution is more advanced in the

regions where PRIs are more developed. The institutional plan describing the “Vision” of Provias Descentralizado in 2011 will have to pursue this evolution and, ultimately, envisage the closing of these regional bureaus in the regions where PRIs have become completely self-sustainable. In the short term, additional regional bureaus will be opened to ensure presence in the regions where the program has not been active until now. In the context of the merging of Provias Rural and Provias Departamental, these local offices (possibly renamed *oficinas de coordinación regional*) will also monitor the implementation of the Regional Transport Decentralization project and ensure greater coordination between the regional and local levels with regard to transport policies.

#### 34. **Specific arrangements associated to the rural infrastructure pilot**

- At the local level: The provincial level has been acknowledged by all sectors as the most appropriate level to plan rural infrastructure investments. Provincial municipalities will therefore play a key role to implement the pilot. In each provincial municipality, a “technical secretariat” will be designated to prepare the rural infrastructure plan with the help of a consultant contracted and trained by Provias Descentralizado. A broader forum (*comité de coordinación*) will allow involving key local stakeholders (eg. the chambers of commerce) in the planning process. Agreements (*convenios*) will be signed with the district municipalities as well as with the various sector-specific agencies. Further arrangements will also be implemented to ensure coordination with the regional level (in particular with the *Consejos de Coordinación Regional*).
- At the national level: A specific agreement (*declaración de intención*) has been signed between all the various sector-specific agencies and a committee gathering all the Executive Directors of these agencies has been constituted. A higher-level institutional arrangement (Steering Committee at the level of *Vice-Ministros* or their acting) will be installed as well as coordination arrangements with other relevant actors (eg. MEF, PCM, CND). While the exact status of this Steering Committee (eg. Commission chaired by PCM) is still to be decided due to the government’s transition, it was agreed that it would meet at important moments during the implementation of the pilot (in particular to review the outputs from the first rural infrastructure plans and to review the evaluation to be performed in 2009 and decide upon possible scaling up). These meetings of the Steering Committee will be secured through covenants in the legal agreements (see III.F).
- On monitoring and evaluation: a Task Force has been constituted by Provias Descentralizado with the participation of selected economists (eg. Javier Escobal) and experts in game theory to design the evaluation methodology.

35. **Allocation of budget resources between provinces.** A methodology was developed to pre-allocate resources across the various provinces. Underlying objectives for the design of this methodology are: (1) maintaining a “poverty focus” so that the additional resources brought by the project would benefit the poorest provinces; (2) ensuring efficiency by avoiding that resources are not spread too thin; and (3) providing incentives to leverage additional funding for efficient rural transport policies. Regarding this last objective, participation and financing agreements will be signed between *Provias Descentralizado* and beneficiary municipalities before any rehabilitation works be launched. In these agreements, municipalities will confirm their intention to implement sound rural transport policies and detail how many resources have

been budgeted for rural transport activities. Provias Descentralizado will verify that these activities will be performed in order to ensure efficiency and effectiveness (prioritization through participatory planning, low-cost rehabilitation technologies, maintenance with micro-enterprises, outsourcing to private operators, etc.). Given the current level of decentralized public expenditures, it is expected that the financial capacity of local governments could reach about US\$15 million per year (assuming that 2 percent of total budget resources are dedicated to rural transport related activities). A specific indicator has been introduced in the results framework to measure the performance of Provias Descentralizado in leveraging funding efficiently spent by municipalities in rural transport (see [Annex 3a](#)).

36. **Schedule of project implementation.** The speed of implementation will differ significantly between provinces with established institutional capacity to handle rural transport policies (ie. those with an experienced PRI) and provinces where the program has not yet been active. Building on the experienced provinces with active PRI and on participatory road plans prepared or updated during preparation, a pipeline of works is expected to be ready for implementation at the time scheduled for effectiveness. These new participatory road plans are being prepared in priority in the poorest provinces<sup>15</sup> so that positive impact on transport conditions is first achieved where they are the mostly needed. The implementation schedule and disbursement profile reflect the potential of the proposed project to quickly implement activities and achieve results in the ground.

## 7. Sustainability

37. Sustainability is a cornerstone of the overall project strategy to ensure the quality, continuity and reliability of the rural transport interventions, within the broader decentralization agenda. For this reason, the project includes a significant number of dispositions within each of its components in order to ensure a better sustainability.

38. One of the main dispositions is the fact that PRIs are designed to be permanent and perennial structures. Indeed, as Provias Descentralizado will turn into a regulatory body, they will become the only entity in charge of rural transport within the provinces. Moreover, provinces will need to have fully operational PRIs in order to have the rehabilitation and the periodic maintenance of their road network financed by the national level (except on a transitory basis corresponding to the institutional building of PRIs). Sustainability of the project will also be ensured by permanent financial transfers from the MEF to PRIs. These transfers will be specifically dedicated to routine maintenance, an activity which has to be entirely financed by provinces. This disposition is important, because routine maintenance constitutes by nature the core of the sustainability of the rural transport network.

39. Other sustainable dispositions include the adoption of road assets management practices (programming of maintenance activities) that matches the optimal life cycle of roads, but also the financing of studies and activities aiming at mobilizing municipal financing for rural transport (and for rural infrastructure in provinces where the infrastructure pilot will be implemented). Leveraging local financing is very important to ensure the continuity of the current interventions

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<sup>15</sup> 35 new participatory provincial road plans are expected to be completed in the first year of implementation in provinces chosen among the three poorest quintiles.

in the long term. Project's sustainability will also be ensured by the updating of participatory provincial road plans and of rural infrastructure plans. This updating is fundamental because these plans are living instruments and need to be regularly updated in order to be efficient and to constitute powerful planning tools.

40. The impact evaluation studies conducted at mid-term and at the end of the project will constitute an efficient way to check the sustainability of the project, by assessing the quality, continuity and reliability of the rural road network. Other good sustainability indicators, which can be monitored on a more regular basis, are: the number of PRIs with full capacity, the number of transport activities other than routine maintenance co-financed by provinces, the number of plans which have been updated or the number of infrastructure activities co-financed by municipalities.

## **8. Lessons Learned from Past Operations in the Country/Sector**

41. The design of the proposed project builds on the following lessons from other initiatives in Peru or other countries:

a) **The improvement of transport conditions' on rural roads translates into better access to social services (health, education) and to income-generating opportunities** – The 2005 impact evaluation of the rural roads program illustrated the benefits of rural roads interventions on school attendance, visits to health centers but also access to markets and agricultural productivity. These results are a strong advocate for investing in rural roads as part of a poverty reduction and growth strategy for rural areas.

b) **The developmental impact of rural infrastructure interventions can be enhanced with the bundling of infrastructure services** – The econometric analysis performed by Escobar and Torero demonstrated the potential benefits on rural households' income that can arise when several infrastructure services become available. This conclusion provides the theoretical ground for designing and implementing specific incentives that could promote greater coordination and bundling of rural infrastructure services. One of these incentives is the preparation of rural infrastructure plans.

c) **Participatory planning at the provincial level allows identifying the investments which are the best tailored to rural needs** – the preparation of participatory plans to identify key rural roads and NMT paths (or other rural infrastructure in the case of the Participatory Provincial Infrastructure Plans) will ensure that local stakeholders' needs are fully reflected in the prioritization of investment alternatives. For the purpose of implementing the Second Rural Roads project, a methodology has been developed so that local stakeholders can solve key tradeoffs between investment alternatives while limiting the risks of capture of the decision-making process by individual interests. The provincial level has been found the right compromise between the necessity to work at a territorial level that is consistent with the promotion of economies of scale while ensuring proper accountability to rural stakeholders. The methodology to be used for the Participatory Provincial Infrastructure Plans is both inspired by the rural roads' plans and by other international experiences such as the Chile's framework plans for territorial development (see Box 3).

### **Box 3: participatory planning for rural infrastructure in Chile**

The Rural Infrastructure for Territorial Development project became effective in August 2005 and aims at increasing the effective and productive use of sustainable infrastructure services in selected territories of the regions of Coquimbo, Maule, BíoBío, Araucanía and Los Lagos. The infrastructure services include water supply, sanitation, roads, Information Communications Infrastructure technology (ICT) and electricity. In a country where the coverage of rural infrastructure services is already high (eg. 86% in electricity and 90% in water supply), the objective is to design and implement a methodology that will allow expanding coverage in the most efficient way, through the active involvement of local stakeholders. Towards this end, priority investments are identified through a participatory process involving poor rural communities which is formalized through the preparation of “Framework Plans for territorial Development” (*Planes Marcos de Desarrollo Territorial* – PMDTs in Spanish). In these plans, local stakeholders assess the productive potential of their territories (eg. tourism, fishing, agriculture) and prioritize individual rural infrastructure investments – or combination of these – that could have the greatest impact on rural growth. Plans are ultimately approved by the Regional Councils (COREs in Spanish) to ensure consistency with the territorial planning policies defined and implemented at the regional level, and empower regional governments.

*Source:* World Bank project files (2006).

**d) Provincial Road Institutes (PRIs) have proved to be an efficient decentralized model for the management of rural roads, provided they receive adequate technical and management assistance to start them up** – The “PRI model” was successfully tried out under the 2<sup>nd</sup> Rural Roads project. This model proved that municipalities can efficiently manage rural roads assets, provided that the transfer of responsibilities is gradually implemented along with the transfer of sufficient technical and management expertise as well as budgetary resources. The rural infrastructure pilot builds on this experience by proposing to expand the “PRI model” to other infrastructure sectors. The PRIs are acknowledged as a major contribution to Peru’s decentralization process.

**e) Gravel roads routinely maintained by micro-enterprises can be a sustainable and cost-effective technical solution to improve rural transport infrastructure** – There exists a large evidence both internationally and in Peru that paving roads is not the most cost-effective solution to address transport needs on low-traffic roads (ie. below 200 vpd). Most rural roads have traffic levels not exceeding 50 vpd and, therefore, gravel roads constitute by far the most adequate technical solution in rural Peru. A decade of experience under the First and Second Rural Roads project provides large evidence that, under the proper maintenance arrangements, gravel roads are both a cost-effective and sustainable option. In Peru, as well as in other countries such as Colombia, Bolivia or Honduras, routine maintenance is performed by micro-enterprises which both ensure the efficient routine maintenance of rehabilitated roads, while creating employment opportunities for the rural poor (men and women).

**f) Specific incentives such as the “Local Development Window” can accelerate the emergence of productive initiatives in areas where transport infrastructure have been improved** – Past impact evaluation have shown that the rehabilitation of transport infrastructures is followed immediately after by significant improvement of transport conditions (reduction of travel times and travel costs, greater availability and reliability of transport services) but that impact of poverty is a much longer-term effect (see [Annex 3b](#)).

To accelerate the emergence of income-generating initiatives and, hence, the impact on poverty, a specific instrument (“Local Development Window” – LDW) was developed and piloted under the 2<sup>nd</sup> Rural Roads project. The LDW acts as an intermediary to identify and prioritize productive initiatives in areas where roads have been rehabilitated, and reduce the transaction costs for potential sponsors. Based on the success of the LDW, the proposed project includes a scaling up of that instrument in the poorest provinces.

## 9. Safeguard Policies (including public consultation)

<b>Safeguard Policies Triggered by the Project</b>	Yes	No
<a href="#">Environmental Assessment (OP/BP 4.01)</a>	[X]	[ ]
Natural Habitats ( <a href="#">OP/BP 4.04</a> )	[ ]	[X]
Pest Management ( <a href="#">OP 4.09</a> )	[ ]	[X]
Cultural Property ( <a href="#">OPN 11.03</a> , being revised as OP 4.11)	[X]	[ ]
Involuntary Resettlement ( <a href="#">OP/BP 4.12</a> )	[X]	[ ]
Indigenous Peoples ( <a href="#">OP/BP 4.10</a> )	[X]	[ ]
Forests ( <a href="#">OP/BP 4.36</a> )	[ ]	[X]
Safety of Dams ( <a href="#">OP/BP 4.37</a> )	[ ]	[X]
Projects in Disputed Areas ( <a href="#">OP/BP 7.60</a> )*	[ ]	[X]
Projects on International Waterways ( <a href="#">OP/BP 7.50</a> )	[ ]	[X]

## 10. List of Factual Technical Documents

- Environmental and Social Management Framework
- Environmental and Social Assessment Report
- Resettlement Policy Framework
- Indigenous Peoples Planning Framework

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\* By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas



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