

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

Report No.: PIDA1068

Project Name	Cusco Regional Development (P117318)
Region	LATIN AMERICA AND CARIBBEAN
Country	Peru
Sector(s)	Sub-national government administration (20%), Solid waste management (30%), Flood protection (20%), General industry and trade sector (30%)
Theme(s)	Natural disaster management (25%), City-wide Infrastructure and Service Delivery (30%), Cultural Heritage (35%), Pollution management and environmental health (10%)
Lending Instrument	Specific Investment Loan
Project ID	P117318
Borrower(s)	Ministry of Economy and Finance
Implementing Agency	Cusco Regional Government
Environmental Category	A-Full Assessment
Date PID Prepared/Updated	25-Jul-2013
Date PID Approved/Disclosed	31-Jul-2013
Estimated Date of Appraisal Completion	05-Aug-2013
Estimated Date of Board Approval	22-Oct-2013
Decision	The Decision Meeting was held on July 19, 2013. The team was authorized to proceed with appraisal.

I. Project Context

Country Context

1. Peru has enjoyed a period of broad-based rapid economic growth. Sound macroeconomic management during the boom years created the fiscal space needed for countercyclical policies to soften the impact of the global economic crisis. Despite the magnitude of the challenges generated by the global economic crisis, financial and exchange rate stability was preserved. Economic growth decelerated sharply in 2009 but remained positive, as external demand and an anti-cyclical public spending program propped up growth. A two-year economic stimulus plan was launched in 2009 amounting to US\$4.9 billion, or about 3.5 percent of GDP. The plan focused primarily on increased public expenditures and attempted to balance the need for a stimulus in the short term, which also reflected medium-term priorities. Infrastructure projects accounted for approximately US\$2.4 billion, around 51 percent of planned expenditures, out of which US\$912 million were earmarked for infrastructure projects to be selected and implemented by regional governments. As with any stimulus plan, the challenges included: (i) to ensure the effective implementation of these

investments, especially at the sub-national level; and (ii) to ensure that these investments promote economic activity in a socially and environmentally sustainable way.

2. Growth has been resilient, despite the recent global economic crisis. Economic activity has recovered since 2009, after rebounding sharply in 2010 to 8.8 percent. In 2011, GDP grew at a rate close to 7 percent, led by strong domestic demand and in 2012, despite the weak macroeconomic external environment, GDP expanded by 6.3 percent. The main contributors to GDP growth were private investment and private consumption that grew by 13.6 percent and 5.8 percent, respectively. In 2012, economic activity expanded on the back of investment dynamism. Private investment was driven by positive entrepreneurial expectations and an expansion in the construction sector. Public investment recovered, and increased by 20.9 percent, driven by the fiscal stimulus plan. Based on the 2008-2009 experience, in 2011 the Ministry of Economy and Finance launched a “preemptive” Stimulus Plan, designed to support the economy in the continued external uncertainty. This Stimulus Plan was implemented in two tranches. The first one was launched in November-October 2011, and totaled about US\$900 million (nuevos soles 2.5 billion or 0.6 percent of GDP). This tranche’s main objective was to revive public spending as execution declined when the new government took office in 2011.

3. Fast economic growth has been accompanied by growth in employment and incomes, yielding an important decline in poverty rates. Poverty fell from 55.6 percent to 27.8 percent between 2005 and 2011, while extreme poverty was reduced from 15.8 percent to 6.3 percent. The continued reduction in poverty is remarkable given that 2008 saw high food price inflation and that economic growth slowed down in 2009 as a result of the global economic crisis. However, poverty incidence remains unequal in geographic terms, with rural poverty rate above 50 percent. While inequality of opportunity remains high, Peru has made substantial progress in addressing it, supported by increased public investments in infrastructure, water, sanitation and electricity in recent years. Despite this progress, large gaps remain in terms of infrastructure investment needs and quality, reflected in Peru ranked 19th out of 23 Latin America and the Caribbean countries in a 2008 infrastructure ranking.

4. Peru’s strong economic performance over the past decade was accompanied by a significant shift in public expenditure authority and resources to the subnational level. Until 2002, Peru was one of the more centralized countries in Latin America, with only 12 percent of its public expenditures managed by subnational governments. A policy shift that year led to the passage of the Decentralization Framework Law, which established the guiding principles of a political and fiscal decentralization process which has since made significant strides. A new autonomous level of regional governments was formally created in 2002, to complement the existing provincial and municipal district governments at the local level. As part of the decentralization process, more responsibilities, functions and resources have been transferred from the central government to subnational governments. These measures have been accompanied by mechanisms to ensure efficient use of these resources and an adequate provision of public services at the sub-national level. Accordingly, the non-financial expenditure of the subnational governments increased from 34 percent of non-financial general government expenditure in 2004 to 38 percent in 2011. Likewise, the share of subnational governments in public investment increased from 44 percent in 2004 to 58 percent in 2011. However, there are ongoing significant challenges in the decentralization process, related to allocation of resources from mining revenues and the local capacity for implementing the public investment programs.

Sectoral and institutional Context

5. Tourism in Peru has been growing steadily. Between 2002 and 2012, international tourist arrivals grew from 1.1 to 2.8 million foreign visitors while foreign exchange earnings quadrupled from US\$837 to US\$3.288 million. In 2012 tourism generated 1,081,035 jobs and directly contributed 3.7% to national GDP. It is estimated that by 2021, 5.1 million foreign tourists will visit Peru and foreign exchange earnings will have increased to US\$6.852, with about 1.274 million employed in the tourism sector. Tourism will contribute more to national GDP in the future and is expected to comprise 4.24% of GDP in 2021. The growth potential of the tourism sector is high, both in international and in domestic tourism. The number of international tourists is growing at 8.1% per year, which is well above the Latin American average of 3.7% and the world average of 2.2%. Additionally, the increased purchasing power of the middle class in Peru is also contributing to the considerable increase in domestic leisure travelers (Figures from Peru's National Ministry of Foreign Trade and Tourism).

6. Due to its historic and cultural heritage, the Cusco Region is one of the most visited tourist destinations in South America and is the principal tourist destination in Peru, accommodating 88% of the country's international visitors. Over the last 10 years the number of tourist arrivals has grown more than two and a half times to over 2.8 million per year, a growth which has not been matched by an equivalent improvement in provision of tourism services. Additionally, the Region of Cusco is important in terms of trade and industrial production. However, despite the Region's high potential for development, its human development index indicators are below the national average.

7. The Cusco Regional Government (CRG) developed the 2021 Cusco Strategic Development Plan (Plan Estratégico de Desarrollo Regional Concertado, Cusco a 2021), which outlines the goal of continued development of the region in a way that adequately accounts for its unique social, cultural and environmental values. The plan specifically proposes investments in infrastructure that would accommodate the ongoing growth in the tourism sector with adequate consideration for environmental concerns and disaster risk mitigation. Responding to this regional strategy, the following key sectoral strategies have been developed:

(a) **Development of tourism activities:** The Regional Strategic Plan for Tourism (Plan Q'ente) promotes the development of tourist activities in the region with social, cultural and environmental responsibility as well as the consolidation of the Cusco region as a nationally and internationally competitive tourism destination, promoting local investment initiatives. The CRG is committed to the management, conservation and preservation of archeological, cultural and natural patrimony with the participation of the local population, the government and the private sector.

(b) **Environmental Management:** The Institute for the Management of Water and the Environment (Instituto de Manejo de Agua y Medio Ambiente) has adopted a regional strategy that supports institutional development; watershed management; management of natural resources; development of coordination and dialogue; capacity development; and, awareness and adaptation and mitigation of climate change. Among the activities to be promoted is the planning of integrated management of solid waste which was supported under the World Bank financed Vilcanota Valley Rehabilitation and Management Project (PRRVV). The management, collection and disposal of solid waste is a critical issue in the provinces of Cusco, Calca and Urubamba, which form important parts of the tourism circuit in the Sacred Valley.

(c) Natural Disasters: The Regional Disaster Prevention and Reduction Plan (Plan Regional de Prevención y Atención a los Desastres de la Región Cusco) outlines the vision and actions for management of natural disaster risk and prevention in the region including improving risk estimation, monitoring and information; undertaking activities to prevent and reduce risks; mainstreaming risk prevention in planning; improving community participation in the prevention of disasters and optimizing the response to disasters. The tourism industry and the associated infrastructure, including Machu Picchu Pueblo are highlighted as economically important zones that are vulnerable to natural disasters. In 2010, severe flooding affected the Sacred Valley causing nearly US\$240 million in damage to infrastructure and the agriculture sector and washing out the only railway line to reach Machu Picchu. This event left over 3,000 tourists stranded in Aguas Calientes (the access point for the ruins). The estimated losses to the tourist industry were estimated at US\$1 million a day for each day the access was cut off. The CRG estimated 15,000 people in the tourism business would be unemployed for months.

8. To mobilize financing for these key aspects of the Cusco Strategic Development Plan in an integrated way, the CRG has elaborated the Programa de Inversión Pública “Consolidación y Diversificación del Producto Turístico – Valle Sagrado de los Incas entre las Provincias de Cusco, Calca y Urubamba de la Región Cusco,” which is being developed through the public investment process of the Peruvian government. The program amounts to S/.231 million (US\$86 million) and consists of three major components: (a) Consolidation and Diversification of Tourism sites including a pilot competitive fund for micro and small enterprises to enhance their ability to access the tourism market; (b) Integrated Solid Waste Management; and (c) Disaster Risk Management; and (d) Program Management, Technical Assistance, and Monitoring.

9. The proposed project, PRODER-Cusco, will finance key elements of this program, with the exception of investments in diversification of new tourism sites. The reason for excluding this sub-component from the project is due to high levels of complexity to support archeological investigation required to open up new sites for increased access to tourists. This process would involve the Ministry of Culture’s oversight, require high levels of force account, and would take much longer than the five year timeframe of the proposed project. The CRG has agreed to finance this component with a separate source of funds. Though it is not included in the Bank-financed project, the diversification sub-component remains in the overall program to be implemented by the GRC and will be executed by the same coordination unit as the rest of the Bank-financed project, ensuring the coherence of investments.

10. In addition to PRODER Cusco, the CRG is preparing the Cusco Transport Improvement Project (P13205, also known as “METRA”) to upgrade the main road in Cusco city with World Bank financing with a total project cost of approximately US\$130 million, which is expected to be presented to the World Bank’s Board of Directors in the first quarter of 2014.

11. The CRG has started a modernization process aimed at improving its efficiency and achieving long term sustainable development. The CRG underwent a credit rating assessment in 2011 to expand its financing options and facilitate its access to financial markets. The work of the credit rating was expanded on in 2013 with a financial capacity assessment designed to assess the CRG’s ability to incur loan and counterpart obligations in connection with PRODER-Cusco and the METRA projects. The objective of the financial capacity assessment was to base decisions on the size of the two projects as well as the counterpart and loan proportions of the two projects on a

forward assessment of resources available vis-à-vis current investment commitments and keeping in mind investment needs of the other nine provinces in the region not covered by these operations.

12. In alignment with the World Bank Group strategy, the proposed PRODER-Cusco will be among the first IBRD-financed investment operations to be prepared and implemented by a regional government in Peru.

13. The proposed operation builds on the longstanding relationship between Peru and the Bank, including the Peru Rural Roads Program (PCR), which was initiated in 1995 and scaled up from a focus on the poorest 12 departments to subsequent phases covering the entire country. The PCR integrated community participation in a large-scale rural roads program with best practices in terms of flexibility and adaptability in project implementation, increased ownership, and efficient management of road assets. The PCR's positive impacts on rural transport, local economic development and local governance in Peru earned it the World Bank's President's Award for Excellence in 2001.

14. The proposed operation is directly linked to the work already begun under the PRRVV (approved in 2004) to enhance the CRG's capacity to identify, prepare, and implement infrastructure investments at the regional level. Most importantly, the PRRVV supported the preparation of the solid waste management component as well as studies and capacity building with local governments that are being built upon in the disaster risk management component. Moreover, the proposed operation incorporates lessons learned during the design and implementation of PRRVV, and the CRG will benefit from PER Plan COPESCO's experience in implementing World Bank funded Projects. PER Plan COPESCO (Special Regional Project of Plan COPESCO, or Proyecto Especial Regional Plan COPESCO) is the implementation agency for regional development projects focused on improving the quality of life of its citizens through investments in tourism and basic infrastructure. PER Plan COPESCO was founded in 1969 as the Special Oversight Commission of the Touristic Cultural Plan Peru-UNESCO. In 2004, it was integrated as the implementation unit of the CRG in the area of tourism infrastructure investments to support socioeconomic development in the region of Cusco. PER Plan COPESCO is a government agency within the GRC and is no longer affiliated with the United Nations.

15. The IFC is also preparing an advisory service on "Improving the Investment Climate for Tourism in Peru," focusing on streamlining the procedures related to opening and operating a tourism business in the Cusco Region, such as lodging establishments, restaurants, tourism and travel agencies. This work by the IFC is complementary to the Bank financed project, as the advisory services will build private sector capacity and improve the business environment in the tourism sector, while the Bank financed project will focus on enhancing the quality and resilience of tourism related infrastructure and services.

II. Proposed Development Objectives

To improve the quality of tourism and solid waste management services and increase the resilience of the tourism sector to the impacts of natural disasters in the provinces of Calca, Urubamba, and Cusco.

III. Project Description

Component Name

Development and Consolidation of Tourism Services

Comments (optional)

This component will improve the quality and coverage of tourism services in the Sacred Valley by consolidating classic tourist attractions and developing a pilot fund to support micro enterprises.

Component Name

Integrated Solid Waste Management

Comments (optional)

This component will improve local capacity for cleaning of public spaces and to efficiently collect, transport and dispose of solid waste in the provinces of Cusco, Calca and Urubamba.

Component Name

Disaster Risk Management and Disaster Preparedness

Comments (optional)

This component will increase the resilience of the local population, tourists, and infrastructure in touristic areas with high vulnerability to natural disasters.

Component Name

Institutional Strengthening, Management and Monitoring and Evaluation

Comments (optional)

This component will support the capacity building of the PCU within PER Plan COPESCO and other principal institutions involved in the operation of tourism activities in the Sacred Valley.

IV. Financing (in USD Million)

Total Project Cost:	58.00	Total Bank Financing:	25.00
Total Cofinancing:		Financing Gap:	0.00
For Loans/Credits/Others			Amount
Borrower			33.00
International Bank for Reconstruction and Development			25.00
Total			58.00

V. Implementation

16. The CRG will have overall responsibility for the project. As the investments to be financed under the project are focused on basic services and tourism services (which are in the mandate of PER Plan COPESCO), it was agreed that PER Plan COPESCO would be the logical implementing agency. The implementation timeframe of the project is expected to be five years.

17. Implementing Agency. PER Plan COPESCO has established a Project Coordination Unit (PCU) that will be responsible for overall implementation and will coordinate all the actors involved in the Project's execution. This unit builds on the previous capacity built through the PRRVV to ensure an adequate implementation pace and to allow for accountability. PER Plan COPESCO will be responsible for implementation of all Project activities, internal and external communications, financial management, procurement and compliance with safeguards. The PCU will also coordinate with relevant subnational and national institutions on component implementation. The PCU will be staffed with personnel from PER Plan COPESCO and will be strengthened as needed with additional staff and consultants to ensure adequate capacity.

18. Project Strategic Committee. This committee will provide strategic oversight of the Project and

will be chaired by a high-ranking official of the CRG. The PER Plan COPESCO Executive Director and the mayors of the three participating provinces (Cusco, Calca and Urubamba) will also be included in the Committee. The Committee will meet at least quarterly during the first year of implementation and at least semi-annually thereafter to review the Project's work plan, budget and implementation. The TORs for the Committee will be included in the Operational Manual (OM), which will be drafted prior to appraisal and adopted prior to effectiveness.

19. Institutional Assessment. Considering that the Project is much larger than the PRRVV, an institutional assessment of PER Plan COPESCO has been carried out, focused on capacity building and project implementation. On the basis of its conclusion, the team and resources of CRG are being adjusted to ensure an adequate Project execution. The fiduciary team of the new PCU has experience executing credit projects with the World Bank, including procurement of small civil works and contracting of consultants. The Project design includes capacity building and implementation support, providing the executing agency with the necessary tools and training to carry out their functions more effectively. The institutional assessment also evaluates and recommends a structure for involving key stakeholders (provinces, districts, etc.).

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	x	
Natural Habitats OP/BP 4.04	x	
Forests OP/BP 4.36		x
Pest Management OP 4.09		x
Physical Cultural Resources OP/BP 4.11	x	
Indigenous Peoples OP/BP 4.10	x	
Involuntary Resettlement OP/BP 4.12	x	
Safety of Dams OP/BP 4.37	x	
Projects on International Waterways OP/BP 7.50		x
Projects in Disputed Areas OP/BP 7.60		x

Comments (optional)

VII. Contact point

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Implementing Agencies

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