

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PERU

WATER RESOURCES REFORM PROGRAM III

(PE-L1050)

LOAN PROPOSAL

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ABBREVIATIONS

AAAs	Autoridades Administrativas del Agua [Administrative Water Authorities]
ALAs	Autoridades Locales del Agua [Local Water Authorities]
ANA	Autoridad Nacional del Agua [National Water Authority]
BCRP	Banco Central de Reserva del Perú [Central Reserve Bank of Peru]
DCPRH	Dirección de Conservación y Planeamiento de Recursos Hídricos [Water Resources Conservation and Planning Bureau]
DGCCI	Dirección de Gestión del Conocimiento y Coordinación Interinstitucional [Knowledge Management and Interagency Coordination Bureau]
DIGESA	Dirección General de Salud Ambiental [Environmental Health Bureau]
DNEP	Dirección Nacional de Endeudamiento Público [National Public Debt Bureau]
ENGRH	Estrategia Nacional para la Gestión de Recursos Hídricos [National Strategy for Water Resources Management]
FONAGUA	Fondo Nacional del Agua [National Water Fund]
GDP	Gross domestic product
IRH	Intendencia de Recursos Hídricos [Water Resources Intendency]
IWRM	Integrated water resources management
LRH	Ley de Recursos Hídricos [Water Resources Act]
MEF	Ministry of Economic Affairs and Finance
MINAG	Ministry of Agriculture
MINAM	Ministry of the Environment
MINEM	Ministry of Energy and Mining
MINSa	Ministry of Health
O&M	Operation and maintenance
PCR	Project completion report
PENRH	Política y Estrategia Nacional de Gestión de Recursos Hídricos [National Water Resources Management Policy and Strategy]
PMGRH	Programa de Modernización de la Gestión de los Recursos Hídricos [Water Resources Management Modernization Program]
PROFODUA	Programa de Formalización de los Derechos de Uso de Agua [Water Rights Formalization Program]
PSI	Programa Subsectorial de Irrigación [Subsector Irrigation Program]
RADA	Registro Administrativo de Derechos de Agua [Water Rights Administrative Registration System]
SENAMHI	Servicio Nacional de Meteorología e Hidrología [National Meteorology and Hydrology Service]
SNIRH	Sistema Nacional de Información de Recursos Hídricos [National Water Resources Information System]
SNGRH	Sistema Nacional de Gestión de los Recursos Hídricos [National Water Resources Management System]
UCPS	Unidad de Coordinación de Préstamos Sectoriales [Sector Loan Coordination Unit]

PROJECT SUMMARY

PERU WATER RESOURCES REFORM PROGRAM III (PE-L1050)

Financial Terms and Conditions				
Borrower: Republic of Peru		Amortization period:		20 years
		Grace period:		5 years
		Disbursement period:		12 months
Executing agency: Ministry of Economic Affairs and Finance (MEF)				
Source	Amount	Interest rate:		Based on LIBOR
IDB (Ordinary Capital)	US\$ 25 million	Inspection and supervision fee:		*
		Credit fee:		*
Total	US\$ 25 million	Currency : United States dollars from the Single Currency Facility		
		Option to convert to Peruvian nuevos soles (PEN): Local Currency Facility (LCF)		
Project at a glance				
Project objective/description: The objective of this third and final programmatic operation is to consolidate the reforms to improve the efficiency, equity, and sustainability of water use, by means of integrated, participatory management. This operation will thus complete a set of policy, institutional, regulatory, and structural reforms in the following areas: (i) macroeconomic stability; (ii) national water resources policy; (iii) institutional framework; (iv) regulatory framework; and (v) decentralization.				
Special contractual clauses: Disbursement of the proceeds from the Bank will be subject to fulfillment of the policy reform measures defined in section B of chapter II (see paragraphs 2.3 to 2.15) and Annex I (Policy Matrix).				
Project consistent with country strategy: Yes [X] No []				
Exceptions to Bank policies: None.				
Procurement: Not applicable since this is a policy-based loan.				
Project qualifies as: SEQ [] PTI [] Sector [] Geographic [] Headcount []				

* The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

I. DESCRIPTION AND RESULTS MONITORING

A. Frame of reference

- 1.1 This loan operation is the third and last of three consecutive single-disbursement operations, which are technically linked to each other, but financed independently as programmatic policy-based loans, pursuant to documents CA-450-1 and CS-3633. On 27 June 2007, the Bank's Board of Executive Directors approved the first operation in this programmatic series (Loan 1878/OC-PE) for US\$200 million. The second programmatic operation was approved on 30 June 2009 (loan 2157/OC-PE) for US\$10 million. The loan proposal corresponding to the first programmatic operation serves as the framework document for the programmatic series (PR-3167-2), which the present document updates, complements, and follows upon, pursuant to the guidelines contained in Memorandum EVP/1/2006 (PO-LO-2006), of 6 March 2006.

B. Macroeconomic framework

- 1.2 Good macroeconomic management, high prices for raw materials, and private investment growth have contributed to the Peruvian economy's strong performance over the last few years. Although there was a significant slowdown in gross domestic product (GDP) growth during the 2009 international financial crisis, the Peruvian economy has been recovering strongly and rapidly in 2010, driven mainly by domestic demand. GDP grew by 8.2% in the first half of the year, and posted an even more vigorous expansion in the second quarter (10.1%). Job creation has also rallied during the course of the year. Against a backdrop of very buoyant domestic demand and foreign capital inflows, the Central Reserve Bank of Peru (BCRP) has implemented a sharp reduction in monetary stimulus, while the Ministry of Economic Affairs and Finance (MEF) adopted prudential measures to rein in public-expenditure growth.¹
- 1.3 Economic prospects for this year are highly favorable. The BCRP recently raised its economic growth projection to between 7.5% and 8%. Inflation has dropped back into the target range and is expected to be between 2.5% and 3% by the end of 2010.² The fiscal deficit is forecast to decline gradually (1.5% of GDP), the external public debt will resume its downward trend (14.6% of GDP), and the current account deficit will be sustainable (1.7% of GDP). Although uncertainties in the international domain and the sociopolitical context point to a number of medium-term vulnerabilities, Peru retains its investment grade rating from DBRS, Fitch,

¹ The BCRP raised its base rate from 1.25% in April to 3% in September. It also increased the minimum legal reserve ratio from 6% to 8% for both currencies (U.S. dollars and nuevos soles), the marginal reserve ratio on short-term external credit from zero to 50%, and the reserve ratio in local currency for obligations from foreign financial institutions from 65% to 120%, among other measures. In addition, it was established that growth of expenditure on goods and services could not be more than 3% over the amount executed in 2009.

² The consumer price index rose by a cumulative 2.06% between January and August, and by 2.3% over the last 12 months.

Standard & Poor's, and Moody's. Public-sector external borrowing requirements for 2010 are projected at US\$3.241 billion, 70% in the form of unrestricted funds.³

1. The management of water resources in Peru

- 1.4 The institutional framework for managing water resources in Peru underwent significant modernization in 2008, with the creation of the National Water Authority (ANA) (Legislative Decree 997) and the Ministry of the Environment (MINAM) (Legislative Decree 1013). In addition, Law 29,338, the Water Resources Act (LRH) was passed on 31 March 2009, creating the National Water Resources Management System (SNGRH); and LRH regulations were issued through Supreme Decree 001-2010-AG on 22 March 2010. In addition, a regulation governing the organizations and functions of the ANA was issued on 8 July 2010, consolidating the mandate and scope of the Authority's responsibilities.
- 1.5 Law 29,338 makes the ANA the technical-regulatory body, lead agency for the management of water resources in Peru, with the following function, among others: definition of the methodology to determine payments for water use and rates; and preparation of the National Water Resources Management Policy and Strategy (PENRH) and the National Water Resources Plan.
- 1.6 The hydrological cycle system in Peru captures 4% of the planet's fresh water. These water resources flow unequally in the country's three watersheds, reflecting their individual characteristics, as follows: (i) 97.7% of the volume flows through the Amazon watershed, where 30% of the population lives and produces 17.6% of the country's GDP. (ii) 0.5% flows through the Titicaca watershed, where 5% of the population lives, producing 2% of GDP; and (iii) the remaining 1.8% flows through the Pacific watershed, where 65% of the population lives and generates 80.4% of GDP.⁴
- 1.7 Given the increased additional pressure of climate change, in the not-too-distant future these users will progressively be partially supplied from groundwater sources. Nonetheless, there are limitations for certain uses owing to its quality and susceptibility to pollution, whether natural or caused by humans in mining and industrial activities. The continuous and rapid degradation of water quality is particularly alarming; and the uncontrolled discharge of wastewater is causing serious pollution problems in urban areas.
- 1.8 Water, sewage, and wastewater treatment services coverage is generally low. In 2007⁵ just 85.6% of the urban population was connected to water supply systems, and 77.2% to sewage systems; it is also estimated that sewage systems operated by

³ These funds are required to meet fiscal targets and, in part, to make progress on specific reforms. This operation covers about 1% of the requirement with unrestricted funds.

⁴ Water Resources Conservation and Planning Bureau (DCPRH) –ANA 2009.

⁵ Status of sanitation services in 2007 among firms regulated by the National Superintendency of Sanitation Services (SUNASS).

sanitation firms in Peru collected roughly 747.3 million m³ of wastewater from domestic connections in 2007, of which 401.9 million m³ was generated in Lima and Callao (SEDAPAL). Nonetheless, only 29.1% of this volume is treated in any way.

- 1.9 Irrigation systems, which are crucial for the growth of agricultural production and account for 80% of all water extraction for consumption uses, is less than 50% efficient. Traditional irrigation methods still predominate; and despite a number of public and private efforts, there are still few areas with efficient systems. This widespread inefficiency is reflected in soil salinization and/or drainage problems and low crop yields.
- 1.10 The hydroelectric power sector (which supplies a large proportion of the nation's electricity demand), along with the navigation sector (which operates along the Ucayali-Amazon waterway), and tourism/recreation, represent water uses with major expansion prospects that will increasingly compete with traditional demands. Moreover, increasingly frequent floods resulting from increases in river levels and intense rainfall affect large sections of the territory, particularly in the north and eastern regions, bringing large-scale negative social, economic, and environmental consequences in urban and rural areas alike.
- 1.11 An updated diagnostic assessment of the water resources situation highlights significant achievements as a result of the modernization of the institutional framework for integrated water resources management (IWRM); and this progress is consistent with the targets set for this programmatic operation. Nonetheless, the problems of IWRM discussed in the loan proposal for the first operation (PE-L1024) have not been overcome and still persist. These include inefficient use of water resources; the fact that water pricing does not represent the opportunity cost or cover management or operation and maintenance (O&M) costs; the facts that water quality continues to deteriorate, the National Water Resources Information System (SNIRH) is just getting started, and decentralized management of ANA has only recently been put in place; and lastly, the need to deepen and consolidate the creation of a water culture, by publicizing the economic, social, and environmental value of water resources.

2. The Water Resources Reform Program

- 1.12 **The Water Resources Reform Program**, as designed, aims to improve the efficiency, equity, and sustainability of water use by means of integrated, participatory management. It was prepared on the basis of various diagnostic exercises and management strategies developed by the Water Resources Intendency—IRH (now the ANA), and following consultations with the various stakeholders comprising the multisector spectrum of IWRM, such as: the Ministry of Agriculture (MINAG), the Ministry of Energy and Mining (MINEM), MINAM, the Ministry of Health (MINSA), regional governments, the National Water Users Board, and other relevant stakeholders.

- 1.13 **Prioritization of the reforms.** To logically and consistently rank the reforms prioritized in the PENRH,⁶ the Peruvian government has grouped them into five components: (i) macroeconomic stability, which aims to ensure a stable and consistent macroeconomic context, with modern water resources management; (ii) the National Water Resources Policy, which aims to generate a concerted participatory and multisector vision for efficient, equitable, and sustainable IWRM; (iii) the institutional framework, which aims to strengthen the multisector, participatory institutional framework, by generating management mechanisms and tools to enable IWRM, using watersheds as the management unit; (iv) the regulatory framework, which seeks to establish legal, technical, economic, financial, environmental, and social measures to standardize methodologies for the valuation, quality assessment, and allocation of water resources; and (v) decentralization, which aims to create and strengthen water management capacities at the watershed level.
- 1.14 Implementation of the first programmatic operation made it possible to start the process of explaining, publicizing, and gaining approval of a National Water Resources Management Policy and Strategy based on IWRM, with the watershed as the management unit. In addition, foundations were laid for creating the National Water Resources Management System (SNGRH), which encompasses the three government levels and the different sectors involved in IWRM and required a national agency to serve as a technical-regulatory authority. Initially that function was taken on by the IRH in MINAG, which subsequently became the ANA. The National Water Fund (FONAGUA) was created to finance actions promoting sustainable water use; but, once the LRH was passed, FONAGUA was deactivated and its functions taken over by the ANA's Knowledge Management and Interagency Coordination Bureau (DGCCI). A process to create the Water Rights Formalization Program (PROFODUA) was initiated; a special rates scheme was set up for each irrigation project in concession; a process was set in motion to define guidelines for calculating the new rates structure for agricultural use that would cover operation, maintenance, management, and investments in large-scale irrigation infrastructure. Basic criteria were defined, and contracting began for studies to define the methodology for calculating the economic value of water resources at the source and payment for water use, as provided for in the LRH. A proposal for environmental quality standards for water was prepared. A legal framework was created for closing down environmental liabilities caused by mining activity, and the program to close down those liabilities began. Large-scale water infrastructure of a regional scope was transferred from the national government to regional governments.

⁶ The water resources sector reform needs were prioritized and adopted in the ENGRH, which formed the basis for structuring the reform program through the Water Resources Programmatic Series. The LRH subsequently incorporated the sector policy guidelines identified in the PENRH, thus making significant structural progress in reaching the targets identified in the reform program by raising the PENRH guidelines to the status of law.

- 1.15 The second programmatic operation continued with support for the government in approving and implementing the PENRH, and passing the LRH in that framework. This legislation consolidates the ANA as the head of the SNGRH and creates decentralized management agencies such as Administrative Water Authorities (AAAs) and Local Water Authorities (ALAs). A plan of action has been started to implement the ANA's Interagency Knowledge Management and Coordination Department (DGCCI), with responsibility for undertaking actions to promote efficient and sustainable use of water, such as: training, research, education, and awareness-raising on the social, economic, and environmental value of water, providing technical assistance, development of technological services markets, water-use culture, and other activities. Implementation of the SNIRH has begun, providing timely and reliable information on the quantity and quality of water resources. The methodology for formalizing rights to water use by the population has been validated and its application has started. A methodology for calculating charges for the use of water infrastructure and the monitoring and use of groundwater has been formulated and approved. The process to develop regulations on payment for water use has begun; and, as a prior step, a methodology for calculating the payment has been developed. The water quality standards developed are being applied. Seven programs to close down environmental liabilities arising from mining activities are currently underway; and a plan for generating water resources management capacities in regional governments has been implemented. Water resources management plans are also in place in two watersheds.
- 1.16 Execution of the two previous loan operations revealed a need to implement various priority actions; and, with a view to reinforcing the government's effort to deepen the reforms and strengthen its new institutional framework, the Water Resources Management Modernization Program (PMGRH) is being implemented, with funding from the IDB (US\$10 million), the World Bank (US\$10 million), and three technical-cooperation operations financed by the IDB (the economic value of water) (PE-T1206), National Water Resources Plan (PE-T1180), and regularization of community water use rights (PE-T1151). The loan aims to support the decentralization of ANA actions in three selected watersheds (the World Bank made a similar loan acting in three other watersheds).

C. Challenges in the water sector

- 1.17 The main challenges in overcoming the problems laid out in paragraphs 1.11 and 1.12 are as follows: (i) institutional strengthening of decentralized water resources management mechanisms; (ii) consolidation of integrated water management mechanisms, including a plan to modernize existing irrigation infrastructure, with the aim of raising the overall efficiency of the systems from 35% to 45-50%; (iii) improvement of control and supervision mechanisms for better water quality, for which it will be essential to set up an operational water resource information system that strengthens water quality and quantity control networks; (iv) implementation of a regulatory framework for water use rates, thereby making it possible to reduce the State's O&M subsidies for large-scale irrigation

infrastructures;⁷ (v) strengthening of the operational and administrative capacity of the ANA, AAAs and ALAs; (vi) improvement of the financial capacity of the SNIRH to fulfill its objectives and functions; and (vii) deepening and consolidation of the development of the water use culture, by publicizing the economic, social, and environmental value water resources.

- 1.18 **The Bank's strategy in the sector.** The Bank has formulated an IWRM strategy that aims to help countries: (i) conserve water through more efficient allocation of the resource, taking social equity into account; (ii) resolve disputes between competing uses and users, including environmental uses; (iii) take into account the social, economic, and environmental value of water in the sustainable development process; and (iv) increase community and private-sector participation in decision-making and financing (document GN-1908-4). The operation also represents one of the main focuses of the Bank's water program with the country, which supports the three pillars of the country strategy (document GN-2472-2): (i) to strengthen Peru's foothold in the global economy and enhance competitiveness (environmental sustainability); (ii) to promote social development and inclusion; and (iii) to deepen reform of the State and improve public management (decentralization and improved management in subnational governments and modernization of the national government). The operation is consistent with the Bank's Water and Sanitation Initiative (document GN-2446-3) in relation to the water defenders program, mainly because it supports the implementation of the watershed management process, and in terms of sector priorities relating to climate change.
- 1.19 **Coordination with other Bank operations and with other institutions.** This program is being developed in close coordination with the World Bank, which has had a major presence in the sector by financing the Subsector Irrigation Program (PSI) and Water Rights Formalization (PROFODUA), and through the PMGRH for US\$10 million, which will help strengthen the ANA, develop the water resources information system, and implement IWRM in three watersheds (Chancay-Lambayeque, Ica, and Chili). At the same time, the IDB has approved operation PE-L1070, which is similar to the World Bank's PMGRH, to implement IWRM in the Tacna, Santa and Chira-Piura watersheds. The program is complemented by actions under other loans such as the IDB's Sanitation Sector Reform Program, the World Bank's environmental reform program, which supports the establishment of environmental quality standards and the remediation of environmental liabilities in the mining sector, and the IDB's programmatic loan to support the climate change agenda (PE-L1080). To complement this, the Bank has approved five nonreimbursable technical-cooperation programs (see paragraph 1.17).

⁷ Large-scale irrigation infrastructure is represented by dams for water catchment and large distribution channels that convey the water to the entrance of the small-scale irrigation systems at the entrance to the areas under cultivation, which are managed by the associations of water users.

D. Design of the third operation

- 1.20 Preparation of the third and final operation drew on the achievements of the first two, and the evolution of the sector in Peru. Preparation of the first operation placed heavy emphasis on approval of the PENRH, since the Water Resources Act was under discussion in Congress, and there was no clear prospect of its approval while the programmatic loan was being developed. Following the enactment of the LRH, which sets out the PENRH guidelines, the emphasis shifted towards sustainability of IWRM funding. In this regard, efforts are focused on implementing the technical-cooperation operation on the economic value of water (PE-T1206), preparing the National Water Plan (PE-T1180), and implementing the PMGRH (PE-L1070). This new focus of actions is reflected both in this report and in the results matrix.

II. THE PROGRAM

A. Program objectives

- 2.1 The objective of this third and final programmatic operation is to consolidate the reforms to improve the efficiency, equity, and sustainability of water use, by means of integrated, participatory management. The operation will thus complete a set of policy, institutional, regulatory, and structural reforms aimed at improving the sector situation described in paragraph 1.12, in the following areas: (i) macroeconomic stability (ii) national water resources policy (iii) institutional framework (iv) regulatory framework; and (v) decentralization.
- 2.2 This is the third and last of three single-tranche operations that are technically linked but independently financed. The operation is structured under the programmatic loan modality, because of: (i) the complex nature of the reforms; (ii) the implementation deadlines involved; (iii) the need to foster public discussion of the reforms; (iv) the need to maintain continuity; (v) institutional complexity; and (vi) the flexibility needed to fine-tune the reforms and policy commitments of programmatic loans as progress is made, as provided for in the Bank's policy on policy-based lending (PR-301).

B. Program components

- 2.3 The following paragraphs describe the objective of each component and the policy conditions for disbursing the proceeds of this third operation. The final commitments, adjusted during the technical coordination exercises with the MEF, are set out in the Verification Matrix link.
- 2.4 **Component I - Macroeconomic stability.** This component aims to ensure that the macroeconomic context is consistent with the program's objectives and with the guidelines set out in the sector policy letter.
- 2.5 **Component II - National water resources policy.** The objective of this component is to implement a participatory multisector strategy for IWRM in Peru, which promotes efficiency, equity, and sustainability in the use of water resources,

as well as participation by all stakeholders. Since the LRH was passed and its regulations issued, the expectations of this programmatic operation have been exceeded, as described in paragraph 1.21. Under this third operation, the PENRH will need to be presented to the Minister of Agriculture in order to continue with its approval process, and evidence will be provided of the progress made in fulfilling the key aspects of this strategy, such as the formulation of the legal and institutional framework, water use rights, water quality, water resource information, water resource planning, human resources, capacity building, and water use culture, which are related to the other components of this operation.

- 2.6 **Component III - Institutional framework.** The objective of this component is to deepen actions aimed at strengthening the recently created SNIRH, with a view to managing water resources on an integrated and multisector basis.
- 2.7 **National water resources management system.** This activity aims to consolidate and strengthen the SNGRH for the purpose of coordinating State actions aimed at achieving IWRM. This objective has been achieved, initially, through the enactment of the LRH, which creates the SNGRH and promotes a new institutional framework for decentralized management of water resources, pursuant to the guidelines of Programmatic Loan I. Nonetheless, in particular, it is more clearly reflected through the publication of the ANA regulations on organizations and functions and the allocation of public sector budgetary funding to enable the AAAs and ALAs to function. This third operation calls for the startup of the SNGRH with implementation of 68 of the 70 ALAs and the AAAs set up in three pilot watersheds to support PMGRH execution. The ANA executive board is also expected to be appointed and start operating, as indicated in Article 19 of the LRH.
- 2.8 **National Water Authority (ANA).** This activity will specify new functions and develop operating procedures for the ANA. The second programmatic loan supported the continuity of reforms aimed at consolidating the process of creating the ANA and its implementation, with new functions and autonomy to regulate aspects of quality, quantity, and timeliness based on the IWRM principle, and with financial resources allocated for its operation. Under this third operation, execution of the National Water Resources Plan is expected to begin. It is one of the SNGRH's planning tools, which will be financed with resources from PE-1180, approved by the Bank's committees in August 2010. Execution of the PMGRH is also expected to start, and technical and financial instruments to implement IWRM will be designed for the six selected pilot watersheds. The ANA is being strengthened on the basis of the commitments of the second operation, the most important achievements of which are: (i) approval of the regulations to the LRH on 24 March 2010; (ii) approval of its organizations and functions regulations in July 2010, which integrates the Water Quality Management Division that was in the Environmental Health Bureau (DIGESA), the National Water Resource Information System Office, and the Watershed Boards into the institution; (iii) preparation of the consolidated text of administrative procedures that is currently in the Office of the President of the Council of Ministers, for approval via

Supreme Decree; (iv) creation of 14 AAAs, of which four have a budget in 2010; (v) financing of 68 of the 70 ALAs; and (vi) hiring at the national level of 1,077 people and expansion of the stock of goods and equipment.

- 2.9 **Water use culture.** The objective here is to promote a water use culture among users and other stakeholders involved in water management, raising awareness of the need to change attitudes and practices. Following the demise of FONAGUA, the water use culture program was incorporated into the ANA's Interagency Knowledge Management and Coordination Department (DGCCI). In that framework, a Culture of Water Capacity-building and Awareness Plan for 2009-2014 was prepared in the second operation, which includes objectives, targets, activities, and expected outcomes, with guaranteed funding through budget resources. This third operation is expected to consolidate its execution, particularly in terms of building IWRM capacities in regional governments. The ANA has its own resources for this task, which are additional to those provided for in the PMGRH.
- 2.10 **National Water Resources Information System (SNIRH):** The objective is to provide an integrated, timely, and reliable system on the quantity and quality of water resources. The second programmatic operation supported: (a) implementation and operation of the Water Rights Administrative Registration System (RADA); and (b) design and implementation plan for the RADA for nonagricultural use at the national level. Nonetheless, as a result of the regulatory changes, in particular the LRH, the SNIRH has been developed to incorporate timely information on water resource quality and quantity. For this reason, the third operation proposes to consolidate the SNIRH by incorporating information on water quality; and in the context of the PMGRH, a consulting firm will be hired to design and implement the National Water Resources Information Center.
- 2.11 **Component IV - Regulatory framework.** The objective of this component is to work out the definition of legal, technical, economic, financial, environmental, and social measures and instruments, providing for efficient and sustainable management of water resources.
- 2.12 **Water rights:** The objective is to set up a system of water rights to provide legal certainty and promote the efficient allocation of water resources in blocks, promoting its protection, conservation, and efficient use. For this third operation, it has been agreed that the methodology for human consumption, mainly in small localities defined as population use will be applied, and that evidence will be provided of the system's progress in granting water use rights in the ALA zones, providing basic water allocations based on available resources at water sources, and ensuring its efficient, equitable, and sustainable use. These activities are financed by technical-cooperation operation PE-T1151. For agricultural use rights, the actions for which are being implemented with resources from the World Bank and the country, the following will be used as indicators: (i) the percentage of coastal and mountain plots that have administrative decisions on water rights; and (ii) the number of hectares with pressurized irrigation and formalized water rights.

- 2.13 **Financing of IWRM:** The objective is to set up mechanisms to finance the management of water resources to cover O&M, management, and investment costs, and improve efficiency in the use and conservation of ecosystems that are important for water productivity in the watersheds. MINAG and the ANA concentrated on creating and approving a suitable legal framework for implementing a program beginning with the second programmatic operation to promote IWRM financing. In this context, the Peruvian government has progressed on three major fronts: firstly, regulations have been issued for the law that governs the use of water in special projects operated under concession (Law 2,809). The law provides that rates must include a component that covers O&M and another component to recover investments, as has been applied in the Olmos and Majes Siguanas II concession. Secondly, studies have been undertaken to develop a generally applicable methodology for calculating rates for agricultural use of water in irrigation systems, to ensure that these cover O&M and investment costs (these were done by the University of the Pacific, have already been approved internally, and are in the information dissemination phase, pursuant to national procedures). Thirdly, arrears in collecting revenue from users' associations have been brought below the baseline of 30%, as a result of the PSI, which incorporated as a criterion of eligibility to access its investment financing line, that the users' associations be up-to-date in their payments (see [evaluation of economic considerations link](#)) evaluation of economic considerations link). Accordingly, for the third tranche of the program this methodology is expected to be implemented, which will generate a downward trend in government subsidies for the O&M of large-scale water infrastructure. In relation to payments for water use and discharges into water courses, funds from technical-cooperation operation PE-T1206 are being used to commission studies by specialized consultants to develop a methodology to decide how to charge users. The contracting process has begun and the consulting services are expected to start in December 2010 and last 10 months.
- 2.14 **Water quality.** The objective is to set up mechanisms to protect water quality in watersheds and aquifers, pursuant to approved standards, procedures, and parameters. Under the second programmatic operation, a national surface water quality control and supervision plan was approved; but, as some of the DIGESA functions were reassigned to the ANA under the LRH, a process was set in motion to revise the plan; and roles and responsibilities will also have to be reassigned. Through this third programmatic operation, the work plan on environmental quality standards is expected to be executed in the watersheds given priority based on action needs, the water resource monitoring protocol to be used by monitoring stations of other agencies, the interagency agreements needed to operate the system, and the necessary resources. Implementation of the program to close down four more environmental liabilities associated with mining activities, additional to the targets set in the second programmatic operation, for a total of seven, is expected to begin.
- 2.15 **Component V - Decentralization.** This activity's objective is to consolidate the process of generating water management capacities in watersheds, and the transfer

of functions and competencies to regional and local governments. The second operation made progress in generating IWRM capacities in regional governments, and started to develop management plans in two watersheds. This third programmatic operation will support: (i) implementation of the plan to generate water resource management capacities in additional regional governments; and (ii) preparation and implementation of at least two water resource management plans, in addition to those of the second operation. The ANA has started to execute a Culture of Water Capacity-building and Awareness plan for 2009-2014, as mentioned in paragraph 2.9, which contains annual work plans involving specific actions with regional governments. Some of these actions are financed by the PMGRH and others through the entity's budget.

III. FINANCING STRUCTURE AND MAIN RISKS

A. Costs and financing

- 3.1 This operation, designed as a programmatic policy-based loan, will have a single disbursement of US\$25 million, which is expected to be released in the fourth quarter of 2010, once the loan contract has been signed and the special and general conditions precedent have been fulfilled, taking into account the means of verification presented in the [Verification Matrix](#). This operation will be governed by the Operational Framework for Lending in Local Currency (document GN-2365-12 and GN-2365-6). The proposed program amount is justified in view of the actions and reforms being developed and implemented by the Peruvian government, the continuity of efforts between the various government agencies to modernize the sector's legal and institutional framework, and the expected results and benefits.

B. Borrower and executing agency

- 3.2 The borrower is the Republic of Peru, with the MEF serving as executing agency through the National Public Debt Bureau (DNEP), which is responsible for negotiations related to the operation, and the Sector Loan Coordination Unit (UCPS), responsible for technical coordination in preparing and supervising the program. The MEF is an executive branch government agency that regulates and harmonizes all activities relating to the economy and finance sector. Its mission is to formulate, supervise and evaluate sector policies and plans in harmony with general government policy. To execute this program, participation will be needed from MINAG, the ANA, MINAM, MINEM, and MINSA, on which the MEF will rely in relation to technical issues for fulfilling the policy conditions.

C. Environmental and social impact

- 3.3 The potential environmental effects of the operation were evaluated in the framework of Directive B13 of the Bank's Environment and Safeguards Compliance Policy (OP-703). The first programmatic loan was reviewed by the Committee on Environment and Social Impact (CESI), at meeting 03-07 on

26 January 2007, and no subsequent actions were requested. As this is a programmatic policy-based loan, Bank policy OP-703 was used to assess whether the operation would cause significant direct effects on the environment and natural resources; the conclusion was that the effects would be positive. The loan does not envisage financing physical investments, and the measures set forth as conditions are aimed at achieving more rational management of water resources and avoiding a repetition of the negative impacts caused in the past by a failure to take a comprehensive view of the resource. The actions included in this third programmatic operation will not affect indigenous peoples (OP-765). According to the LRH, the ANA Board of Directors includes representatives of native and campesino communities, thereby creating a mechanism for those communities to participate in decisions on and implementation of the reforms promoted by this program. The operation qualifies as a social-equity enhancing project, as described in the indicative targets for the Bank's activity mandated by the Eighth Replenishment (document AB-1704).

D. Institutional viability

- 3.4 The operation's institutional viability underpinned by the MEF's commitment and capacity to implement this type of project. The Bank has evaluated the performance of the UCPS in implementing various programmatic operations for Peru and has concluded that in most cases it: (i) is well integrated and coordinated with all areas that are relevant to project execution; (ii) manages the disbursements and financial aspects of the projects satisfactorily; and (iii) has very well conceived strategic planning, which is capable of anticipating and adequately resolving both organizational and technical risks and problems associated with project execution. In addition, the Peruvian government is committed to implementing this operation, partly owing to the vast amount of work already done and under way in each of the areas associated with the program's components. Sufficient funding and logistical support have been made available for all the preparation and implementation of all actions and decisions needed to execute the program. The objectives proposed for the program form part of a consistent strategy that the government has been pursuing for more than a decade under various administrations and always with a high priority. The reform program being proposed is viable in the framework of the new LRH.

E. Risks and special considerations

- 3.5 As a special aspect of this operation, it is worth noting that the recently enacted LRH (Law 29,338 of 31 March 2009) adopts IWRM as a principle in the form of: land management; social, environmental, economic, and cultural valuation; priority for domestic access; participation by the population and legal certainty, which requires active participation from the various institutions in the SNIRH. As mentioned above, these guidelines arise from the PENRH.
- 3.6 Institutional complexity is a risk given the need for close coordination to implement the reforms without delays. Several institutions currently participate in water

management, such as the Health Ministry's DIGESA on water quality, and the National Meteorology and Hydrology Service (SENAMHI) with regard to water resource information. Moreover, the decentralization process has transferred functions, responsibilities, and large-scale water infrastructure to regional governments. All of this entails an institutional complexity that has been simplified under the current legal framework by MINAM taking over DIGESA and SENAMHI actions, and by the creation of the ANA with its respective regional and watershed branches (AAAs and ALAs, respectively). Participation by the MEF has been essential to achieving this progress; and execution of the PMGRH guarantees the resources needed to consolidate those reforms.

- 3.7 There is a risk that the completion and consolidation of the structural reforms in IWRM will be rejected by stakeholders in the use of water. To minimize this risk, the water use culture component will promote the cultural change needed for the population to understand that water has a high economic, environmental, and social value; this will help create the favorable conditions needed to consolidate the reforms that have already begun and others that will start in the future. In addition, the creation of the DGCCI in the ANA, tasked with developing corporate and institutional communication strategies, will contribute significantly towards mitigating this risk.

IV. IMPLEMENTATION AND MANAGEMENT PLAN

A. Program execution and administration

- 4.1 Although the technical coordination needed to implement the program successfully is the responsibility of the MEF, the reform actions and their implementation are the responsibility of the corresponding sector bodies. In the MEF, the DNEP will be in charge of financial aspects, including processing the disbursement, while the UCPS is responsible for the following, among others: (i) coordinating in the MEF and responsible agencies for the adoption of measures or technical execution of activities; (ii) monitoring and promoting the fulfillment of program activities to ensure its successful implementation; (iii) maintaining official communication with the Bank on technical issues; (iv) preparing the necessary reports by their deadlines; and (v) foreseeing and adequately resolving strategic, technical, and coordination risks and problems arising from program implementation.

B. Disbursement schedule

- 4.2 As this is a policy-based loan, a single disbursement will be made when the contract is signed and the special and general conditions precedent to that disbursement have been fulfilled, taking into account the means of verification presented in the Verification Matrix link.

C. Monitoring and evaluation

- 4.3 The project team has analyzed the progress made with previous operations and reconsidered aspects of the medium-term reform framework in which this operation

is set. Based on this assessment, the general objective has been defined, along with indicators corresponding to each of the expected outcomes that underpin the program's rationale, together with their cost and type of intervention. The policy matrix identifies milestones and mechanisms to guide the evaluation of progress in the program's implementation and final evaluation. No additional monitoring costs are specified.

- 4.4 The MEF will ensure timely compliance with the corresponding conditions indicated in the policy and results matrix, and will send the relevant evidence to the Bank.
- 4.5 The borrower and the Bank have agreed to monitor program execution through meetings to be held on dates to be decided on by the MEF and the Bank. When this third and final programmatic operation ends, the project team will prepare a project completion report (PCR) and will evaluate the impact achieved and the degree to which the proposed objectives have been attained, within six months following the disbursement scheduled for December 2010. The borrower has agreed with the Bank on indicators and the baseline to be used in the final evaluation (see [Results Matrix](#) link); it will obtain the information needed for monitoring and evaluation; and it will compile, file, and keep available all information, indicators, and parameters to enable the Bank to prepare the PCR.

V. POLICY MATRIX

- 5.1 The Bank has agreed with the Peruvian government on the policy letter, which describes the latter's commitment to the objectives and actions defined for the entire programmatic series, and reaffirms its commitment to the agreed reforms and activities. The policy letter is included in the electronic link. The Bank also agreed on the policy matrix, attached as Annex II, which describes the policy commitments for this third programmatic operation, and the results it is intended to achieve.

Development Effectiveness Matrix Summary

Indicator	Score	Maximum Score
I. Strategic Relevance	Low-High	
1. IDB Strategic Development Objectives	3.2	10
Country Diversification	0.7	2
Corporate Initiatives	2.5	2.5
Harmonization and Alignment	0.0	3.5
Beneficiary Target Population	0.0	2
2. Country Strategy Development Objectives	9.6	10
Country Strategy Sector Diagnosis	6.0	6
Country Strategy sector objective & indicator	3.6	4
II. Development Outcomes - Evaluability	Satisfactory	
3. Evidence-based Assessment & Solution	6.0	10
4. Evaluation & Monitoring Plan	5.8	10
5. Cost-Benefit or Cost-Effectiveness	7.0	10
6. Risks & Mitigation Monitoring Matrix	7.5	10
III. IDB's Role - Additionality		
7. Additionality	3.0	10
Technical Assistance provided prior the project	3.0	3
Improvements in management of financial, procurement, monitoring or statistics internal controls	0.0	4
Improvements in environmental, health and labor performance	0.0	3

I. Strategic Relevance: This is a policy based loan that will take place in Peru, classified as a B country. The project falls under the corporate initiative related to water and sanitation. The project is aligned with the Country Strategy.

II. Evaluability: The problems being addressed through the program are clearly defined however the diagnosis is not empirically based. The main factors that contribute to these problems are clearly specified, as are the interrelationships among factors. The magnitudes of factor deficiencies are not presented. The program's outcomes and outputs are clearly stated and show vertical logic. All indicators have baselines, targets and sources of information. Some indicators are not SMART given that they are not specific and cannot be measured. The program has a monitoring and evaluation plan and an allotted budget for each activity. The program will be evaluated using a reflexive methodology. The operation includes a cost effectiveness analysis for some of its components. The risks of the operation are identified and classified and present mitigation measures, however, no indicators, baselines or targets are included to monitor these measures.

III. Additionality: Several technical cooperations were provided to increase the likelihood of success of the program.

**WATER RESOURCES REFORM PROGRAM III
(PE-L1050)
POLICY MATRIX**

Objectives	Responsible institution	Approved policy measures Programmatic Loan I (2007)	Approved policy measures Programmatic Loan II (2009)	Proposed policy measures Programmatic Loan III (2010)
I. General macroeconomic policy framework: Maintain a stable macroeconomic environment				
General macroeconomic policy framework		A macroeconomic framework consistent with program objectives and the lines of action described in the sector policy letter.	A macroeconomic framework consistent with program objectives and the lines of action described in the sector policy letter.	A macroeconomic framework consistent with program objectives and the lines of action described in the sector policy letter.
II. National water resources policy: Develop a consensus-based, multisector perspective on analyses and proposals for integrated water resources management in Peru based on the principles of efficiency, equity, sustainability, and participation by all stakeholders.				
National water resources policy and strategy (PENRH): Develop a national water resources strategy	MINAG (ANA)	A multisector technical commission for updating the PENRH has been established and the PENRH proposal has been presented for public discussion and has been updated. The PENRH should provide for the following elements, as a minimum: (i) institutional innovations that will enhance multisector management by promoting the creation and development of a new institutional structure for participatory integrated water resources management (IWRM) at the watershed level that is interlinked with the regionalization and decentralization processes now under way; (ii) a form of IWRM that will promote the coordinated development and management, at the watershed level, of multisector water use in conjunction with other natural resources without jeopardizing the ecosystems' sustainability; (iii) protection of water resource quality in watersheds and aquifers in accordance with the relevant	Approval process has begun for the PENRH as State policy.	a. The PENRH has been presented to the Minister of Agriculture to continue with the process of approval in accordance with the guidelines of programmatic loan I (loan 1878/OC-PE). b. The regulations implementing the Water Resources Act pursuant to the guidelines of programmatic loan I have been approved.

Objectives	Responsible institution	Approved policy measures Programmatic Loan I (2007)	Approved policy measures Programmatic Loan II (2009)	Proposed policy measures Programmatic Loan III (2010)
		regulations and parameters; (iv) development of a water-use culture and capacities, strengthening of watershed capacities, and promotion of a water-use culture among the population; and (v) implementation of a timely, reliable water resource information system for use in decision-making.		
III. Institutional framework: Implement a multisector participatory institutional framework allowing for integrated water resources management, using the watershed as the basic management unit.				
National Water Resources Management System: Create and implement a National Water Resources System for the integrated, multisector management of water resources, including assessment, valuation, disposal activities, and the allocation of efficient, sustainable multisector use of water resources.	MINAG (ANA)		The National Water Resources Management System is created.	The National Water Resources Management System is being implemented.
National Water Authority: Define the new functions of the national authority responsible for sustainable water resource use.	MINAG (ANA)	a. The new functions of the national authority responsible for sustainable water resource use have been defined in accordance with the ENGRH. These functions include: (i) development of the national integrated water resources management policy; (ii) assignment and administration of water rights; (iii) supervision of water quality; (iv) promotion of an awareness of the resource's value (water-use culture); (v) organization and management of a national water information system; (vi) establishment of penalties for violators; and (vii) proposal of a	An independent national water authority with newly assigned functions with power to regulate quality, quantity, and delivery based on the integrated management principle is established and the necessary financing is allocated.	National Water Authority is implementing its institutional strengthening plan; and financial resources have been allocated for its operation.

Objectives	Responsible institution	Approved policy measures Programmatic Loan I (2007)	Approved policy measures Programmatic Loan II (2009)	Proposed policy measures Programmatic Loan III (2010)
		<p>system for setting the at-source economic value of water.</p> <p>b. Guidelines have been prepared for the institutional strengthening of the authority so that it can perform its newly assigned duties properly.</p>		
Water-use culture: Promote a water-use culture among users and other stakeholders involved in water resources management by raising their awareness of the need to change practices and attitudes in relation to current water use and generate capacities in the regional governments for IWRM.	MINAG (ANA)	<p>a. Creation of the National Water Fund (FONAGUA), which is to take action to promote efficient, sustainable water use through: training, research, education, and awareness-raising regarding the social, economic, and environmental value of water resources, technical advisory services, development of technological service markets, creation of a culture of water conservation, and creation of competitive funds for water conservation investment projects.</p> <p>b. The FONAGUA Board of Directors has been established.</p>	<p>a. ANA's Knowledge Management and Interagency Coordination Bureau is created.</p> <p>b. The Culture of Water Capacity-building and Awareness Plan for 2009-2014 is approved, including objectives, targets, activities, expected outcomes, and resources for its financing.</p>	<p>a. ANA's Knowledge Management and Interagency Coordination Bureau is operating.</p> <p>b. The Culture of Water Capacity-building and Awareness Plan for 2009-2014, which includes the regional governments, is being implemented.</p>
National water resource information system: Create an integrated, timely, reliable water resource information system	MINAG (ANA)	<p>a. Creation of the Water Rights Administrative Registration System (RADA), which includes a roster of agricultural and nonagricultural users, water-use caps, specified grounds for issuing and rescinding permits, and computerized systems for implementing, updating, and storing the relevant information.</p> <p>b. The design and implementation plan for RADA's application for agricultural water use in coastal areas has been approved.</p>	The RADA system for agricultural water use in coastal areas is in operation.	The national water resource information system is being established (in relation to design, implementation plan, and financing) that has data on users, water supplies, demand, inventory of distribution infrastructure, inventory of the regulation and transfer system, stations and water-quality, etc.

Objectives	Responsible institution	Approved policy measures Programmatic Loan I (2007)	Approved policy measures Programmatic Loan II (2009)	Proposed policy measures Programmatic Loan III (2010)
IV. Regulatory framework: Establish the necessary technical, economic, financial, environmental, and social measures within a regulatory framework that provides for efficient, integrated water resources management.				
Water rights: Establish a system of water rights that provides legal certainty and promotes the use of efficient allocation blocks that will support effective watershed protection, conservation, and resource use.	MINAG (ANA)	The Water Rights Formalization Program (PROFODUA) is being implemented in coastal areas.	PROFODUA is being implemented in the Pacific system.	PROFODUA in the selected pilot watersheds (6) for use by the population is being executed in at least two watersheds.
Financing integrated water resources management: Set up mechanisms to finance IWRM that will cover O&M, administration, and investment costs and that will boost the efficiency of resource use.	MINAG (ANA) MINAM MINAG (ANA)	a. Irrigation projects operating under concession contracts have their own rate schedule. b. Guidelines for the new rate schedule for agricultural use that is to cover O&M, administration costs, and investment have been prepared and submitted to the MEF. c. Guidelines have been defined for developing a methodology for calculating the at-source economic value of water resources.	a. Measures are adopted and a plan of action proposed aiming at: (i) reducing the national government's O&M subsidies program for primary water works (special projects); and (ii) the updating of water rates for agricultural use for distribution by irrigation systems to cover the O&M and investment costs, is approved. b. Legislation establishing the general framework (payment types, efficiency incentives) on the economic system for water use is approved.	a. Measures adopted and a plan of action aiming at: (i) reducing the national government's O&M subsidies for primary water works (special projects); and (ii) the updating of water rates for agricultural use for distribution by irrigation systems to cover the O&M and investment costs, is being implemented. b. Process for the development of regulations on compensation for water use has begun.
Water quality: Set up the necessary mechanisms for protecting water quality in watersheds and aquifers in accordance with approved policies, procedures, and parameters.	MINAM MINS (DIGESA)	a. A proposal on environmental water quality standards has been approved and published. The proposed standards specify the pollution levels, concentrations of substances, or physical, chemical, and biological parameters for substances present in surface bodies of water receiving inflows from other sources.	a. Water quality standards have been subject to public discussion and have been approved. b. The National Surface Water Resources Quality Control and Supervision Program has been approved.	a. Water quality standards are being applied.

Objectives	Responsible institution	Approved policy measures Programmatic Loan I (2007)	Approved policy measures Programmatic Loan II (2009)	Proposed policy measures Programmatic Loan III (2010)
	MEM (General Bureau of Mining Environmental Affairs)	<ul style="list-style-type: none"> b. A legal framework for dealing with the environmental liabilities generated by mining operations has been approved. This framework provides for the identification of such liabilities, the assignment of responsibility, and financing for the remediation of affected areas in order to reduce and/or eliminate those liabilities and thus mitigate their adverse impacts on the population's health, the surrounding ecosystem, and other assets. c. The State's program for eliminating the environmental liabilities from mining operations has been launched. 	<ul style="list-style-type: none"> c. State programs for eliminating three environmental liabilities from mining operations are being executed. 	<ul style="list-style-type: none"> b. Four projects for eliminating four additional environmental liabilities from mining operations are being executed, for a total of seven.
V. Decentralization: Water resources management within the context of decentralization				
Decentralization: Create and strengthen water management capacity at the watershed level and transfer functions and areas of authority to regional and local governments through the development of proposals for water resources management plans in priority watersheds.	MINAG (ANA)	Approval has been given for the national government to transfer primary regional water infrastructure facilities, together with institutional functions and competencies relating to water resources, to the regional governments.	Promotion of integrated watershed management agencies and efficient water use are promoted through measures that include: <ul style="list-style-type: none"> a. A plan for building regional governments' water resources management capacities has been approved. b. At least two watershed management agencies to prepare proposals for water resources management plans have been identified. 	Proposed water resources management plans have been prepared in at least two watersheds and funding sources have been identified.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/10

Peru. Loan ____/OC-PE to the Republic of Peru
Water Resources Reform Program III

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of Peru, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a water resources reform program III. Such financing will be for an amount of up to US\$25,000,000 from the Single Currency Facility of the Ordinary Capital resources of the Bank, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on _____ 2010)