

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PERU

SANITATION SECTOR REFORM PROGRAM I

(PE-L1025)

LOAN PROPOSAL

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APPENDICES

Proposed resolution

Electronic Links and References	
Basic socioeconomic data	http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata
Status of loans in execution and loans approved	http://portal.iadb.org/approvals/pdfs/PEen.pdf
Tentative lending program	http://opsgs1/ABSPRJ/tentativelending.ASP?S=PE&L=EN
Annex II – Outputs matrix	http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1146681
Annex III – Verification matrix	http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=1146640
Annex IV – Policy letter	http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1200305
Annex V – Budget for second and third programmatic operations	http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1146410
Annex VI – Local currency loans	http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1146716

ABBREVIATIONS

DNS	National Sanitation Department
EPS	Municipal Water and Sanitation Service Provider(s)
FONAVI	National Housing Fund
IMF	International Monetary Fund
KFW/GTZ	German Development Bank /German Agency for Technical Cooperation
MEF	Ministry of Economy and Finance
MVCS	Ministry of Housing, Construction, and Sanitation
OMP	Optimized Master Plan
PCR	Project Completion Report
PMRI	Rapid Impact Measure Program
PRSS	Sanitation Sector Reform Program
PROINVERSION	Private Investment Promotion Agency
PRONASAR	National Rural Water and Sanitation Program
PROPEF	Project Preparation and Execution Facility
PSP	Private Sector Participation
SBA	Standby arrangement
SEDAPAL	Servicio de Agua Potable y Alcantarillado de Lima [Lima Water and Sewer Utility Company]
SME	Small and medium-sized enterprises
SUNASS	National Superintendency of Sanitation Services
VMCS	Office of the Deputy Minister of Construction and Sanitation

PROJECT SUMMARY

PERU SANITATION SECTOR REFORM PROGRAM I (PE-L1025)

Financial Terms and Conditions ¹				
Borrower: Republic of Peru Executing agency: Ministry of the Economy and Finance (MEF)			Amortization period:	20 years
			Grace period:	5 years
			Disbursement period:	12 months
Source	Amount	%	Interest rate:	Libor
IDB (Ordinary Capital)	US\$100 million	100	Inspection and supervision fee:	*0%
Local	-	-	Credit fee:	0.25%
Total	US\$100 million	100	Currency:	U.S. dollar, from the Single Currency Facility
			Option to convert into Peruvian New Soles:	Local Currency Facility (LCF)
Project at a glance				
<p>Project objective:</p> <p>The program's objective is to improve the efficiency, equity, and sustainability of water and sanitation services in Peru. To achieve this aim, this first operation will support an initial set of actions to facilitate necessary structural, institutional, legal, and legislative reforms in the following areas:</p> <ul style="list-style-type: none"> i. Institutional framework. The investment planning system will be improved; a guide will be developed for preparation of Regional Water and Sanitation Plans; a Sector Master Information System will be established; the regulatory framework will be created for operators in small communities and rural areas, and the contracting of small and medium-sized enterprises (SMEs) to provide sanitation service; and the strengthening of the governing and regulatory bodies will be supported; ii. Financial policy. Transparent criteria will be defined for allocating resources to promote efficiency and equity, and legal instruments will be approved to promote the restructuring of EPS financial liabilities; iii. Rate policy. Methodologies will be defined to set costs differentiated by service; usage categories will be simplified; subsidies will be studied to define the policy and methodology; measures will be approved to adjust rates for inflation, and the Optimized Master Plan process will be simplified; iv. Operator management. An action plan will be developed for the Sector Capacity-building System as part of the Water for All program and the Investment Shock Plan; a model operation contract will be drafted, incorporating corporate governance practices, a reporting system, incentives, and penalties; and v. Private Sector Participation (PSP). A national strategy will be developed for promoting PSP in the sector; implementation of an awareness program will be initiated for local authorities and interest groups; a PSP promotion plan prepared; and adjustments proposed for PSP project approval procedures. <p>The present program is consistent with the sector challenges and programs described in the Bank's water and sanitation initiative. The service provider management component and the rate policy component will develop major areas to be considered in the Efficient, Transparent Enterprise Program; by defining the regulatory system for small cities and rural areas, the institutional framework component will develop aspects linked to the 3,000 Rural Communities Program; the rate policy component, through regulations on the quality and quantity of industrial waste discharges, will develop areas linked to the Water Protection Program, and the investment planning component, defining areas of service and guidelines for prioritizing regional investments, and the private sector participation component, will develop aspects linked to the 100 Cities Program.</p> <p>Special contractual conditions:</p> <p>See Policy, Outputs, and Verification Matrixes, as well as the Policy Letter, Chapter V. (paragraph 5.1).</p>				

Exceptions to Bank policies:

An exemption is requested in respect of the clause on interruption of Bank financing referred to in paragraph 3.15 of document GN-2365-2 on the Local Currency Facility (LCF) (paragraphs 1.3 and 1.4 of Annex VI).

Other financial conditions: To broaden the borrower's financing options, conversion of local currency disbursements and outstanding loan balances would be subject to two financial conditions in addition to those established in the LCF: (i) flexible amortization profiles for local currency disbursements and outstanding loan balances; and (ii) price based on the effective cost of funding to the Bank should the latter raise the financing through a bond issue (see paragraph 3.9 of the loan proposal and paragraphs 1.3 and 1.4 and Annex VI). As specified in paragraph 3.9 of document GN-2365-2 resources from the LCF may be used for up to five operations/transactions per year. As five operations have already been approved, the Board of Executive Directors is being requested to authorize the use of the LCF in the present operation (see paragraph 3.9).

Project consistent with country strategy: Yes [X] No []

Project qualifies as: SEQ [X] PTI [] Sector [] Geographic [] Headcount []

Procurement: Not applicable since it is a policy reform support program.

Verified by CESI on: CESI 04-05-07 and CESI 09-24-07.

¹ The interest rate, credit fee, and inspection and supervision fee mentioned in this document are established pursuant to document FN-568-3 Rev. and may be changed by the Board of Executive Directors, taking into account the available background information, as well as the respective Finance Department recommendations. In no case will the credit fee exceed 0.75%, or the inspection and supervision fee exceed 1% of the loan amount.*

* With regard to the inspection and supervision fee, in no case will the charge 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. FRAME OF REFERENCE

A. Introduction

- 1.1 The present operation has been designed as a program to support policy reform to help improve the efficiency, equity, and sustainability of water and sanitation services. Structured as a programmatic loan, the operation is the first of three independently financed operations. The operation's programmatic structure is warranted by: (i) the complex nature of the reforms; (ii) the time required to implement them; (iii) the need to coordinate the reforms between various sector bodies; and (iv) the importance of tracking the reforms as they are implemented so that the reforms and policy conditions of subsequent programmatic operations can be monitored and adjusted as necessary.

B. Socioeconomic framework

- 1.2 Peru's economic indicators point to a high degree of economic stability, sustained by responsible fiscal management and political consensus on the importance of maintaining a sustainable macroeconomic environment. In the last five years, GDP has grown steadily, at an average annual rate above 5%, with growth of 7.6% in December 2006. The nonfinancial public sector surplus was 2.0% of GDP in 2006, while inflation was 1.1%, and the exchange rate remained stable with substantial net international reserves exceeding US\$22 billion in September 2007. The country risk indicator has improved in recent years, declining from an average of 615 basis points in 2002 to 134 basis points in October 2007. In addition, Peru has met the targets of the 2004 standby arrangement (SBA) with the International Monetary Fund (IMF), and on 26 January 2006 approved a new SBA for 25 months giving continuity to the current economic policies.
- 1.3 Total public debt at year-end 2006 was US\$30.497 billion, of which US\$21.972 billion was external public debt and US\$8.525 billion was domestic. The overall public debt-GDP ratio fell from 44.3% at year-end 2004 to 32.8% at year-end 2006, due primarily to growth in dollar GDP. External public debt declined by 13% of GDP to 23.5%, as a result of the abovementioned factors and prepayment by the government. As to the external debt profile, at the end of 2006, 35.7% of commitments were to multilateral institutions, and total average annual debt service for the next six years (2008-2013) is US\$3.8 billion. The Ministry of Economy and Finance (MEF) will be asking the Bank to disburse US\$350 million¹ in 2007 and US\$250 million² in 2008. The current debt level is considered sustainable and shows the progress achieved in stabilizing public finance.

¹ Consisting of US\$150 million for the reforms under the poverty reduction programs (loan 1600/OC-PE), and US\$200 million for phase I of the water resources reform program.

² Consisting of US\$100 million for this operation, US\$75 million for phase III of the public spending and administration quality enhancement program, and US\$75 million for phase II of the water resources reform program.

C. The water and sanitation sector and its problems

1. The sector

- 1.4 Policymaking, planning, and sector governance, including environmental issues, are the responsibility of the Ministry of Housing, Construction, and Sanitation (MVCS), through the Office of the Deputy Minister of Construction and Sanitation (VMCS) and its National Sanitation Department (DNS). Economic and quality-of-service regulation is delegated to the National Superintendency of Sanitation Services (SUNASS), a task that is complemented by the Ministry of Health, through the Environmental Health Department and the Basic Sanitation Division, in terms of quality, as well as by the National Natural Resources Institute, for water resources management. Services in urban and rural areas are provided by 45 decentralized municipal water and sanitation service providers (EPS), except in Lima, where the service is administered by a State-owned company, Servicio de Agua Potable y Alcantarillado de Lima (SEDAPAL). This scenario is complemented by the Sanitation Administration Boards and municipalities serving rural areas with fewer than 2,000 inhabitants, and municipalities that directly administer services for between 2,000 and 30,000 inhabitants.

2. Problems in the water and sanitation sector

- 1.5 Based on the most recent population and housing census in 2004, water (76%) and sanitation (57%) service coverage in Peru are below the regional average (91% and 77%, respectively), according to WHO-UNICEF. The diagnostics for the National Sanitation Plan (PNS) show that water service continuity is on average 17 hours/day, while 37% of service providers report continuity below 12 hours/day. In rural areas, of a sample of 1,630 systems analyzed, 59% do not disinfect water because they lack the necessary system or inputs. Service providers nationwide report a high level of unmetered water (46%), inactive connections of approximately 23%, average payment arrears of 5 months, and rates not high enough to cover the actual costs of the service (17% operating margin, not including SEDAPAL). In this context, service is unreliable and unsustainable, and the likelihood of failing to meet the millennium goals is high. This situation is caused mainly by problems relating to the sector's institutional framework, financial policy, rate policy, EPS performance, and the private sector participation strategy. Following is a description of the main reasons for these problems.
- 1.6 *Lack of investment planning and quantification of regional needs.* Little planning has gone into government action in the sector; nor has there been sufficient information or a regionalized sector plan that identifies priorities, funding requirements, and sources of financing. The sector has an estimate of the country's overall situation in terms of access to water and sanitation services and the investment required to meet the millennium goals in the National Sanitation Plan, a comprehensive exercise that has not been extended to the regional or enterprise levels. This situation reflects the sector's centralized management, where responsibilities and resources for water and sanitation service have been passed on

increasingly to service providers and local and regional governments. In addition, local and regional projects are slow to materialize and are unreliable due to shortcomings in providers and subnational entities. Given this situation, sector investments are not producing the expected outcomes of increased coverage and better quality service. Lastly, the National Sanitation Plan has set some coverage targets for the regions that are inequitable since, if evaluated individually, they would not meet the millennium goals.

- 1.7 *Weaknesses in the legal and regulatory framework for small cities and rural areas.* Providing water and sanitation services in small cities (population between 2,000 and 30,000 inhabitants) and rural areas is a fairly precarious endeavor, owing to weaknesses in the current regulatory framework, which provides that in the absence of an EPS, it is up to the municipality to step in and perform regulatory, oversight, and service functions. This arrangement leads to conflicts of interest because of the dual role of regulator and regulated party, especially in terms of rate-setting. In addition, a series of operating contracts are being arranged with small and medium-sized water companies (SMEs) with wide-ranging parameters and criteria for assigning responsibilities between the parties, a situation that will pose problems in regulating these providers.
- 1.8 *Insufficient DNS and SUNASS operating and administrative capacity.* DNS technical assistance and support functions for providers pose problems of coordination and administration and insufficient resources for carrying out sector programs efficiently. Fulfillment of the regulatory functions under the responsibility of the SUNASS is limited due to lack of resources to support the operators in preparing their Optimized Master Plans (OMPs). Specifically, the restrictions imposed on public agencies under the Peruvian government's budgetary austerity measures are placing constraints on the effective fulfillment of the policy and regulatory functions. Coordination problems are evident in fulfilling various government functions that place a heavy burden on providers resulting in duplication of government efforts.
- 1.9 *Government financing and intervention is undertaken at a high cost without technical criteria.* Government resources are channeled through the MVCS but also through other entities and levels of government, without transparent, homogenous rules, and without sending signals to the agents to promote efficient management. While the country has a National Public Investment System (SNIP) ensuring that government investment is socioeconomically viable, this system does not ensure that resource allocation maximizes the net benefits of the investments. The existence of multiple executing units and multiple conditions for access to resources creates an incentive for opportunistic behavior by municipalities and service providers that seek to capture revenue with as little effort as possible. Project preparation by providers and regional and local governments is undertaken without defined eligibility requirements for projects or resource allocation, thus missing an opportunity for preparing efficient, sustainable projects.

- 1.10 *EPS financial capacity is jeopardized by the high level of debt.* In the 1990s, the National Housing Fund (FONAVI) accounted for approximately 25% of urban investment in the sector. During the decentralization process, together with the assets for providing sanitation service, FONAVI's debt was transferred as EPS financial debt. Many EPS and municipalities have not recognized these obligations and many others have not met the corresponding payment obligations. If payment to FONAVI is in default, all debt becomes a short-term receivable, producing interest arrears, and pushing some service providers into bankruptcy.
- 1.11 *Rates are insufficient and do not reflect the cost of service.*³ For most EPS, rates are not high enough to cover operating and maintenance expenses. The sewer service rate is charged as a percentage of the water rate, approximately 35% of the water bill, without considering its actual cost structure. A special rate for wastewater treatment or environmental costs has not been considered. In addition, between 1992 and 2006, EPS without approved OMPs were not allowed to update their rates for inflation. While this constraint was lifted by the Sanitation Service Provider Management Optimization Act (Law 28870). These EPS have a large backlog (averaging 18%) and there is no clear rule as to its retroactive application to allow recovery of the cumulative backlog.
- 1.12 *Subsidies are not targeted.* The subsidy funding system in Peru is based on a framework of consumer cross-subsidies, whereby a small number of users (commercial and industrial) subsidize residential users. However, failure to differentiate poor users in the residential user category gives rise to problems of inclusion in the subsidy system, since subsidies are allocated to users who are not poor. Furthermore, since it is a cross-subsidy based on consumption and not income, it poses major problems of inclusion.
- 1.13 *Compliance with the OMP process is hard for EPS.* The EPS have not requested that a new average rate be approved partly because they do not have the technical capacity to have the rate formula approved. Previously, such a formula required approval of a financial plan and a master plan, and three public hearings, a process that took on average more than 180 days. Subsequently, the Consolidated Text of the Regulations governing Law 26338 combined both plans under the OMP, and SUNASS reduced the number of public hearings by board resolution. Nevertheless, the program to draft the OMP still calls for a level of technical precision that exceeds most EPS planning capacity.
- 1.14 *Lack of EPS technical and administrative capacity.* Institutional strengthening of operators has been taking place without a prioritized intervention strategy. To structure training activities in the sector, the Sanitation Sector Capacity-building System (SFCS) adopted a three-pronged approach: training EPS officers, technical assistance for replicating successful experiences, and development of sustainable,

³ Charges for water service depend on the user category, whether the user is metered or not, and where the user is located. The rate increases with consumption (in bands). Metered users are charged for a minimum of 8 m³ per month.

cost-effective solutions for service delivery. The SFCS must now enter its implementation phase, in parallel with the Peruvian government's investment initiatives for the sector.

- 1.15 *Lack of formalization of the rights and obligations between providers and municipalities.* Most local governments or municipalities have not fulfilled the obligation of entering into operating contracts with the public EPS, or concession agreements with private or semi-public EPS for the service. The lack of this contractual instrument explicitly establishing the responsibilities of each party is limiting the effectiveness of the regulatory framework and the ability to channel incentives to providers based on their performance commitments. The regulations of Law 26338, the General Sanitation Service Act, delegated the authority to regulate this instrument to the DNS and SUNASS so that operating contracts could be signed in the short term.
- 1.16 *EPS Management is strongly influenced by political interference.* One consideration that impacts EPS corporate development is the high rate of management turnover, a short-term decision-making horizon without strategic planning, and limited business judgment. The Peruvian government began taking steps to limit political influence in EPS management with Law 28870, which defines a new structure for EPS boards of directors (for larger EPS, five directors maximum, including one member of the regional government, and two members from civil society; for smaller EPS, this structure is adjusted to three, one, and one, respectively). These provisions must still be strengthened with greater transparency in EPS activities and a clarification of the duties and responsibilities of the entities involved in these services through the establishment of a code of corporate governance, and greater transparency in the EPS' activities with the disclosure of their plans, targets, and performance results. These provisions will be incorporated into the operating contracts between municipalities and service providers.
- 1.17 *The DNS, the Private Investment Promotion Agency (ProInversión), SUNASS, and the MEF have failed to simplify the process of structuring private sector participation (PSP).*⁴ In the structuring of PSP projects for Tumbes, Piura-Paita, Huancayo, Pucallpa, and Trujillo, duplication of efforts were noted in information processing, the increased cost of consulting services to prepare the baseline, and significant delays in securing approval. The greatest aggravating factor, however, is that in general, bids by specialized operators are based on an investment plan other than the base case scenario, whereby many of the resources invested in their development are not warranted. In the last 18 months, PSP projects have proliferated through private initiatives requiring support for the investments with public sector resources. This situation not only calls for ProInversión to assign

⁴ As part of loan PE-0142, the Peruvian government launched a campaign promoting the program; obtained support from six local governments; and agreed on an awareness and communications program. After the first successful loan (Tumbes 06/05), the DNS and ProInversión have not been able to replicate the success in other areas.

technical staff to evaluate these projects quickly, but also, taking advantage of a regulatory loophole, the original purpose of these initiatives is distorted by having the private sector finance investments.

D. The country's sector strategy

- 1.18 The Peruvian government has identified the water and sanitation sector as a priority in its current government program. The country's sector strategy is defined in the National Sanitation Plan 2006-2015 (PNS), establishing its core objective as meeting the millennium goals in an efficient, sustainable manner through five strategic objectives and the implementation of this sanitation sector reform program (PRSS).

1. The National Sanitation Plan (PNS)

- 1.19 The PNS strategic objectives are: (i) modernizing sanitation sector management; (ii) promoting service sustainability; (iii) improving service quality; (iv) promoting EPS financial viability; and (v) increasing access to services. This plan has been developed based on the following investment programs: the National Rural Water and Sanitation Program (PRONASAR), to support both increased coverage and improved management of rural systems (World Bank); SEDAPAL water program to increase the wastewater treatment capacity and water service coverage in marginal areas of Lima (World Bank, Andean Development Corporation [CAF], and Japan Bank for International Cooperation [JBIC]); rapid impact measure program (PMRI) to finance emergency and highly profitable works in medium-sized EPS (KfW); and the private sector participation program (KfW and the IDB) to support the linkage of specialized operators in large EPS. These programs and their priority are complemented by the Water for All (PAT), which would expand and improve drinking water and sanitation services for approximately three million residents of poor neighborhoods of major cities. The financing to meet the PNS objective is estimated at US\$4.043 billion, of which US\$3.182 billion would be used to expand coverage, and US\$861 million to rehabilitate the network.

2. The Sanitation Sector Reform Program (PRSS)

- 1.20 The purpose of this program is to improve the efficiency, equity, and sustainability of water and sanitation service delivery through a *sturdier sector framework, more efficient investment, and more equitable public resource allocation*. The PRSS was prepared based on a structured process of sector analysis, dialog, consultation, and consensus on diagnostics, and actions with civil society, service providers, the donor community, and the various stakeholders and beneficiaries. This project was headed by a prestigious local university in Peru and included seven workshops with all parties involved, interviews with multiple agents, and surveys. The sector diagnostic was performed first, followed by an analysis of problems and causes, and then development of the comprehensive reform concept.
- 1.21 As a result of this process, the government prioritized a series of reforms in six areas: (i) the sector's institutional framework, which requires a definition of

regional and EPS investment targets and priorities, technical and management capacity-building for the DNS and SUNASS, and the development of a regulatory framework for services in small communities; (ii) financial policy, to establish objective criteria for the allocation of public resources and the effective consolidation of the EPS' financial liabilities; (iii) rate policy, to simplify rate structures, target subsidies, adjust rates to inflation, and incorporate the idea of environmental costs; (iv) EPS management, requiring good corporate governance practices and reporting by operators, as well as strengthening of the training system on operational and management issues; (v) private sector participation, requiring the development of a single promotion strategy, a method for raising awareness and communication of each process, and optimization of the public-private partnership (PPP) structuring process; and (vi) streamlined land and water resource management in order to achieve integrated watershed and system management, allowing planning of the services. The program's policy matrix was developed based on points (i) to (v) of this prioritization of reforms, while point (vi) is being developed within the framework of the water resources reform program.

3. Peruvian government progress on reform

- 1.22 In the last 18 months, the Peruvian government has taken the following actions: (i) approval of the PNS by Supreme Decree 007-2006-VIVIENDA; (ii) consolidation of the regulations of Law 26338 (Sanitation Service Act) and the definition of the scope of the operating contract; the consolidation of the master and financial plans into the OMP, the extension of the general regulatory framework into rural areas and small cities, and the possibility of charging differentiated rates for water and sewer service; (iii) enactment of Law 28870, authorizing the restructuring of EPS debt with the National Housing Fund (FONAVI), transferring rate authority to SUNASS, modifying the composition of the EPS boards by linking members of civil society and the regional government, and simplifying the SNIP for one year, making it possible to approve investment projects; and (iv) creation of the Special Committee Promoting Investment in the Sanitation Sector (CEPRI Sanitation).

4. Studies for PRSS preparation

- 1.23 During preparation of this program, with the help of the Bank and German assistance from KfW and GTZ, the Peruvian government conducted the following studies that were used as an input to develop the legal instruments that are part of this program:
- a. Service areas and guidelines for prioritizing National Sanitation Plan investments for the overall quantification of viable targets and investment amounts at regional and local levels, considering coverage, efficiency, social, and environmental criteria.
 - b. Regulatory system for small cities and rural areas and a framework for contracting specialized operators for small and medium-sized communities in

order to implement a legislative framework for small communities and rural areas, and improve the transparency of SME management models.

- c. Reorganization plan for the National Directorate of Sanitation (DNS) and the Water for All (PAT) program in order to build the governing authority's management capacity. This consulting project also included a study on adjusting the organizational structure of SUNASS, and an implementation proposal.
- d. Rules for allocating investment resources to sanitation projects in order to improve the public investment resource allocation system to generate efficient investments and sustainable services.
- e. Diagnostic studies on the rate gap, including a study on alternatives for its adjustment to evaluate the feasibility of having the companies update their rate levels that have been stagnant since the late 1990s.
- f. Discharge of industrial waste in order to define quality parameters for industrial waste discharges into receiving bodies.
- g. Model operating contract drafted in accordance with Law 26338, and the establishment of targets, incentives, penalties, reporting mechanisms, and a code of good corporate governance with a view to improving governance, reporting, and institutional sustainability of water and sanitation service management and operation.
- h. Development of an implementation plan for the capacity-building system, to improve the management, operating, and administrative capacity of water and sanitation services.
- i. National strategy for PSP in the sanitation sector, including policies for investment financing by the government in order to promote the sanitation sector's PSP strategy nationally.
- j. Proposal to adjust the necessary operational and functional processes and procedures to advance PSP in its development, transfer, and operating stages in order to optimize the processes and subprocesses involved in each phase.

E. The Bank's strategy in the water and sanitation sector

- 1.24 The Bank's strategy with the country has a three-fold approach: (i) to increase economic competitiveness and productivity; (ii) to make social policy more efficient; and (iii) to create a modern, decentralized, and efficient State. The program supports the main elements of the strategy, insofar as the proposed reforms will optimize investments in a social sector like water and sanitation, will promote national and subnational collaboration between the public and private sectors, and will support municipalities in the context of the decentralization process.
- 1.25 This program establishes synergies with the Water Resources Reform Program (PE-L1024) in aspects related to the water and sanitation sector and is aligned with the objectives of the Bank's recent water and sanitation initiative. With respect to

project PE-L1024, this program strengthens the rational use of water resources from the responsibility of the sanitation sector (relating to rates and user education), and creates an incentive for sector involvement in management decisions and resource allocation by the National Water Authority. As to the water and sanitation initiative, the program is consistent with the sector challenges described therein⁵ and will make it possible to meet the target proposed for policy-based lending during this year. In addition, all of the reforms supported by this program are linked to the Bank's water initiative programs. Paragraph 2.2 describes how the program components are linked to the sector challenges and the water and sanitation initiative programs.

F. Bank actions in the sector and lessons learned

- 1.26 The Bank has provided support for the sector in the form of eight investment programs whereby the Bank helped the Peruvian government implement major institutional reforms, and finance the basic infrastructure expansion and EPS strengthening. Despite these efforts, the lack of continuity in the strategic development plans and efficient EPS management is impacting the sustainability of the service.⁶

1. Bank actions in the sector

- 1.27 Program to Strengthen the Basic Sanitation Sector (loan 847/OC-PE, 1994, US\$140 million). The purpose of this loan was to consolidate the sector's legal, regulatory, and institutional framework and improve the EPS by rehabilitating and expanding their infrastructure. The Project Completion Report (PCR) shows that sector reforms should be complemented with EPS corporate governance reforms, incorporating incentives for efficiency. Despite increased coverage, many EPS that benefited from this loan are still inefficient, do not have strategic development plans, and have problems leveraging resources for investment, thus hindering effective regulation.
- 1.28 Development of the Rate Framework for Basic Water and Sanitation Services in Peru (technical cooperation project ATN/WP-9606-PE, US\$256,000). This project, approved in December 2005 and declared eligible in July 2006, would develop regulatory models based on enterprise size. Initially, its execution was impacted by administrative changes in SUNASS and subsequently one of the bidding processes was declared null and void. The terms of reference (TOR) are currently being reviewed, a request for proposals has been issued for development of a water and

⁵ (i) Achieving sustainable access to quality services, (ii) improving conditions of service quality and reliability, (iii) attracting more investments and management capacity, (iv) obtaining institutions able to implement sustainable development in the sector, (v) ensuring the quality, quantity, and reliability of water resources.

⁶ The PCR for the last loan completed indicates that sector reforms should be complemented with EPS governance reforms, incorporating incentives for efficiency. Despite increased coverage, many EPS loan beneficiaries are still inefficient, lack strategic development plans, and have problems leveraging resources for investment.

sewer service rate subsidy system, and financing is expected for preparation of OMPs in three communities.

- 1.29 Program to Support Development of the Sanitation Sector (loan 1697/OC-PE US\$50 million⁷). This program is designed to create efficient, sustainable service delivery by linking specialized operators through public-private partnerships (PPP). The signature of the loan (1697/OC-PE) was interrupted by the 2006 national and municipal elections, holding up decisions by municipal mayors on the awarding of concessions that was under way. The MEF decided to put off postpone contract signature until the first concession was awarded. During project preparation, there were four PSP processes under way (Piura-Paita, Huancayo, Pucallpa, and Trujillo); of these, Piura-Paita and Huancayo held international competitive biddings and feasibility studies were performed for the cases of Pucallpa and Trujillo.

a. Current status of PSP processes

- 1.30 PROINVERSIÓN is currently reviewing all aspect of the PSP strategy, due primarily to changes in authorities on the municipal councils. In Piura-Paita, the ProInversión Committee is studying the possibility of a new PSP modality (management contract) that would extend to all the remaining districts. If this proposal is approved, the linkage with the specialized operator is expected to take place late next year. In the case of Huancayo, the ProInversión Committee closed the request for proposals and is exploring the possibility of promoting the new modality or a shared-risk partnership. In the cases of Pucallpa and Trujillo, the program's public information stage has been reinitiated and the two areas are expected to have specialized operators by the end of next year. Under this program, the DNS hired a specialized firm to undertake an awareness-building and communications campaign in Pucallpa (department of Ucayali), Trujillo (department of La Libertad), and Chiclayo (department of Lambayeque). The DNS has proposed to focus on these locations as well as to explore various possibilities on the national level.

b. Complementarity between the program content and the program to support the development of the sanitation sector.

- 1.31 PSP processes in Peru are being carried out in three stages. The first is the responsibility of the governing authority, the VMCS, and consists of: (i) disseminating the program among enterprises meeting the eligibility criteria, (ii) conducting or financing preliminary feasibility studies, (iii) entering into dialogs with mayors, municipal district councils, civil society, unions, and other

⁷ This operation includes a Project Preparation and Execution Facility (PROPEF) line (1539/OC-PE). The MEF approved a work plan submitted by the DNS and will again ask the Bank to extend the execution period. The sector ministry established an Evaluation Committee, through a resolution of the Office of the Secretary General of the MVCS, which will be responsible for reviewing and approving the PROPEF procurement processes. The DNS submitted the TOR to the Bank for staff for the program executing agency, which is expected to be set up in late September this year.

stakeholders. This process is initiated with a visit by the national authorities and ends with the acceptance or rejection of the invitation to participate in the program. Acceptance is expressed by entrusting ProInversión with the task of promoting private sector participation. The second stage is the responsibility of ProInversión, a public entity created to promote PSP. To fulfill this duty, ProInversión hires a transaction advisor responsible for performance of the diagnostics, determining the overall viability of the project, and the strategy and promotion of the PSP. This stage culminates with the awarding of the bid to a specialized operator. The third stage involves the transfer and monitoring under the responsibility of the VMCS. This stage begins with the transfer of the assets to the specialized operator, the implementation of a fund transfer mechanism, and a monitoring and supervision mechanism.

- 1.32 This programmatic operation is linked to the three stages in the cycle defined by the country for PSP. In the first stage, support will be provided for the development and definition of a national PSP strategy and the definition of a process promotion methodology that optimizes the use of preinvestment resources. This includes an analysis of strengths, weaknesses, opportunities, and threats, public information workshops, and studies of attitudes and perceptions. These activities will strengthen decision-making and resource allocation. In the second stage, the programmatic operation will support the development of operational and functional processes and procedures necessary to optimize (simplify and streamline) the PSP processes, for preparation of the Optimized Master Plan and the SNIP, and the PSP viability. The third and final stage will review the resource transfer and process monitoring procedures to facilitate more flexible resource transfer and supervision mechanisms.

2. Lessons learned

- 1.33 The main lessons learned show that: (i) it is beneficial to have a sector framework in which the regulatory and policymaking functions are clearly defined and separated; (ii) reforms must be participatory, based on consultation and consensus, and adequately disseminated, especially to the municipal bodies responsible for providing the services; (iii) rate-setting must be a flexible, transparent process that is disclosed to users; (iv) rate adjustments must be implemented gradually, after improvement in service quality, (v) it is important to incorporate monitoring systems that strengthen the regulatory systems and support EPS management; and (vi) the management models must distribute the risks and responsibilities evenly between the public and private sectors using PPP systems.

G. Coordination with other financing and cooperation agencies

- 1.34 This operation is the result of joint work between the Peruvian government, the KfW, the GTZ, and the Bank, within the sector policy framework. During project preparation, both the KfW and the Bank financed consulting projects for the Peruvian government to conduct the studies necessary to meet the commitments for the first programmatic operation. The KfW will also support the reforms planned

under this program with a parallel loan to the Peruvian government (paragraph 3.3). The results of the PRSS were shared with the bilateral and multilateral agency community, including the World Bank, the Japan Bank for International Cooperation, the Andean Development Corporation, and the Swiss Agency for Development and Cooperation.

H. The program strategy in the water and sanitation sector

- 1.35 This program will support the Sanitation Sector Reform Program (PRSS), with a view to addressing the following problems: lack of criteria for the allocation of public investments, quantification of needs, and investment planning; deficient EPS management and performance and excessive political interference; inadequate rate structure for cost recovery and pro-poor subsidy targeting; lack of capacity and coordination in sector institutions and lack of a strategy to promote the linkage of specialized operators using PPP systems. This programmatic loan has been structured as three independent programmatic loans technically linked to each other, since the implementation of these reforms is complex and must be undertaken in a gradual, flexible manner, allowing continuous, corrective monitoring. This method also reaffirms the leadership and commitment of the MEF, coordinating the implementation of the reforms and continuously aligning the interests of the sector entities.
- 1.36 The program has been structured into the following six components: (i) macroeconomic stability; (ii) institutional framework; (iii) financial policy; (iv) rate policy; (v) operator management; and (vi) private sector participation. Proper implementation of the reform will optimize equitable use of investment resources, maximize return on investment; improve service provider governance, transparency, and reporting, while shielding them from political interference in corporate decision-making in order to promote long-term sustainability of service delivery; build up the operational capacities of the governing and regulatory authorities to promote proper execution of government programs; complement the regulatory framework for small cities and rural areas; improve the quality and transparency of the rate system, including compensation for environmental variables, to enhance service efficiency and sustainability; and to link specialized operators to improve EPS management.
- 1.37 This program, developed by the Peruvian government, has received the joint support of the Bank, the KfW, and the GTZ through monitoring of diagnostic workshop, hiring consultants to define the scope of the agreed reforms, and identifying indicators for monitoring the implementation and effectiveness of the reforms. The reform commitments are expected to resolve both general aspects of the organizational structure of the sector bodies (DNS, SUNASS, EPS, and ProInversión), and national financial and rate policy; and specific aspects that have hindered the implementation of major investment programs that are part of the PNS, such as the PSP, the National Rural Water and Sanitation Program (PRONASAR), and the rapid impact measures program (PMRI), delaying their benefits for the population.

II. THE PROGRAM

A. Program objectives

- 2.1 The objective of the program is to improve the efficiency, equity, and sustainability of water and sanitation services in Peru through support for a series of actions. These actions are calculated to achieve resource allocation based on efficiency criteria that maximize the benefits to the country while observing equity criteria, to achieve greater efficiency in service management by service providers, to bring about self-sufficiency for these entities, and to lay the foundations of equitable, universal coverage.
- 2.2 The present program is consistent with the sector challenges and programs described in the Bank's water and sanitation initiative.⁸ The service provider management component and the rate policy component will develop major areas to be considered in the Efficient, Transparent Enterprise Program; by defining the regulatory system for small cities and rural areas, the institutional framework component will develop aspects linked to the 3,000 Rural Communities Program; the rate policy component, through regulations on the quality and quantity of industrial waste discharges, will develop areas linked to the Water Protection Program, and the investment planning component, defining areas of service and guidelines for prioritizing regional investments, and the private sector participation component, will develop aspects linked to the 100 Cities Program.

B. Program components

- 2.3 **Component I – Macroeconomic stability.** The objective of this component is to ensure a macroeconomic environment in keeping with program objectives and with the guidelines established in the sector policy letter.
- 2.4 **Component II – Institutional framework of the sector.** This component would improve the sector planning and organizational instruments, and would create incentives for the efficient management, operation, and administration of operators in small and medium-sized districts. The scope of this component includes the following activities:
- 2.5 *i) Investment planning.* The objective of this activity is to endow the State with a region-based sector planning instrument based on a needs analysis of each service and a tool for prioritizing government interventions efficiently and equitably, so that the country can move forward in meeting the millennium goals without increasing the coverage gap between Lima and the other departments. To meet the objectives, for this first programmatic operation, it was agreed: (a) to identify areas and guidelines for prioritizing PNS investments for the overall quantification of viable regional targets and investment amounts; the plan would include: (i) the

⁸ (i) to achieve sustainable access to quality services, (ii) improve service quality and reliability, (iii) attract more resources and improve management capacity, (iv) create institutions instrumental for sustainable sector development, and (v) ensure the quality, quantity, and reliability of water resources.

establishment of a target of halving the water and sewer service coverage deficit in each department by 2015, with respect to the deficit in 1990; (ii) the establishment of a viable wastewater treatment coverage target, consistent with the advances in water and sewer service coverage; and (iii) the overall quantification of investment needs in water and sewer service, and the determination of priority areas for investment in each department. It was further agreed to approve the guidelines for preparing Regional Sanitation Sector Plans (PSSR) by department, based on guidelines to be determined by the DNS, from a technical, financial, institutional, and environmental assessment of service delivery in each department and to develop actions and programs to achieve the coverage targets in a participatory process; and (b) to create a Water and Sanitation Information System for sector planning. This system will be administered by a single entity, but all sector entities will be able to access it, with the respective security protocols for confidential data processing by providers, as well as a system of reports to be prepared by the providers, subject to verification by the regulatory authority. For the second programmatic operation, two Regional Sanitation Plans must have been approved, and for the third three such plans must have been approved and two implemented. The Water and Sanitation Information System will be implemented during the second programmatic operation and functioning during the third. The expected development outcome is that the government will have sector planning by region and service, based on a needs analysis that prioritizes its interventions efficiently and equitably.

- 2.6 (ii) *Legislative framework for operators in small communities.* The objective of this activity is to create conditions for efficient, sustainable sanitation services in small communities and rural areas through the establishment of a system of regulation and supervision, rates, and minimum criteria for the hiring of SMEs. For this first programmatic operation, it was agreed that the regulatory system for operators in small communities and rural areas would cover: (i) the powers of the regulatory authority, the municipalities, and the community organizations, in order to make use of the comparative advantages of each body to achieve the regulatory objectives and the coordination mechanisms between these bodies; (ii) efficiency indicators for service delivery, provider management control, and a tariff structure based on criteria of efficiency and equity; and (iii) a regulatory system for contracting SMEs that would standardize provider selection criteria according to rate-based parameters, mandatory State contributions, or service quality and coverage targets. The second programmatic operation will need to apply: (i) these contracting systems to at least 50 providers; and (ii) the system for hiring specialized operators for small and medium-sized communities to 20 new operators. For the third programmatic operation, it was agreed: (i) to apply the contracting systems to 50 new operators, and (ii) to apply the specialized operator contracting system for small and medium-sized communities to 15 new operators. The expected development outcome is to improve the efficiency and sustainability of service delivery through a system of regulation and supervision, management and rates, and minimum criteria for SME contracting.

- 2.7 iii) *Institutional strengthening*. This activity would improve the regulatory authority's (DNS's) management capacity and the operational capacity of the regulator (SUNASS). For this first programmatic operation, it was agreed to develop a restructuring plan for the DNS and to create the Water for All (PAT) program and the SUNASS strengthening plan. The new DNS and PAT organizational structure and the SUNASS strengthening plan would need to be implemented for the second and third programmatic operations. One of the key aspects of the reform is that once it has been created the PAT will become an investment project executing unit with its own administrative management office. This will enable it to focus on and speed up the process of developing investment projects and the transfer of investment resources to regional localities. The DNS will concentrate on sector planning, policy development, investment program design, and tracking and monitoring. The scope of the DNS reform includes (a) the institutional restructuring, (b) strategic planning, and (c) preparation of regulations governing organization and functions and the corresponding manual. Enhancing the organizational structure envisages (i) strengthening the DNS with a definition of functions for information system management, capacity development, and the economic assessment; (ii) in the case of the Urban Sanitation Department with a definition of functions for promoting investment, private sector participation, and capacity development; and (iii) in the case of the Rural Sanitation Department, with a definition of functions for promoting investment and capacity development. The expected development outcome is for the DNS and SUNASS to have the structures and the resources to perform their functions efficiently.
- 2.8 **Component III - Financial policy.** This objective of the component is to establish objective criteria for allocation of public resources and to restructure the EPS financial liabilities. The component envisages the following activities:
- 2.9 (i) Investment financing. This activity would improve the public resource allocation and incentive system for operators, contributing to service efficiency and sustainability. For this first programmatic operation, it was agreed: (i) to establish eligibility requirements for allocation of investment resources. These requirements include: presenting projects accompanied by technical studies, an OMP commitment, restructuring debts with FONAVI, and signature of an operating contract; (ii) to establish an institutional framework for implementing the sector financial policy, and (iii) to prepare guidelines for: (a) setting out transparent resource allocation criteria (support thresholds, counterpart contribution, priority investment areas, and regional equity, among others) promoting efficiency and equity in service delivery (these allocation criteria will maximize the economic return on government investments); (b) developing operating tools for allocation of financing to investments (single government-supported resource allocation windows, operations manuals). On 21 June 2007, the Peruvian government issued a Supreme Decree setting out the following EPS allocation criteria: signing the operating contract, requesting SUNASS to draft the OMP, and presenting a proposal on activities actions to strengthen social and enterprise management. In rural areas and small towns, the allocation criteria are: presenting a proposal on

actions to strengthen operating and social management of sanitation services, and a commitment to apply the rates. The Sanitation Investment Fund (INVERSAN) was created on 7 July, as a vehicle whose main responsibility will be to channel sector resources as agreed in points “ii and iii” mentioned above. It was agreed that implementation of the public investment resource allocation system for investment financing would begin during the second programmatic operation and be completed during the third programmatic operation. The expected development outcome is to have a transparent, efficient, and equitable public resource allocation system that maximizes the economic return on government investments and helps operators to become efficient and provide sustainable services.

- 2.10 (ii) *EPS debt profile*. The objective of this activity is to improve EPS debt profiles so that they are able to provide quality service, properly operate and maintain their infrastructure, and become creditworthy. On the basis of the Sanitation Service Provider Management Optimization Act (approved under this reform program), one of whose objectives is to restructure EPS financial liabilities with FONAVI, debt-restructuring options will be explored (alternatives, procedures, incentives, and terms). For this first programmatic operation it was agreed to approve a legal framework for the restructuring of the FONAVI and SUNASS debt. It was agreed to initiate the debt restructuring process for two EPS during the second and third programmatic operations. It was agreed with the VMCS that, as part of the PSP program being financed with IDB and KfW resources under the Sanitation Sector Development Support program, to eliminate the financial liabilities of at least two EPS outside the Lima area. The clean up of FONAVI liabilities would be carried out in accordance with current legislation and IDB resources would be used to finance investment in rehabilitation and expansion, signature of operating contracts with the specialized operator, adoption of corporate governance measures, and implementation of a training plan. The expected development outcome is for the EPS to have better debt profiles so that they can become creditworthy.
- 2.11 **Component IV - Rate policy.** The objective of this component is to contribute to the rate and subsidy framework promoting cost recovery, efficiency and equity, and streamlined procedures. This component encompasses the following activities:
- 2.12 (i) *Rate structure and level*. This activity would enable companies to become financially self-sustaining in the long term with rates based on real costs that include environmental costs, and universal service delivery. For this first programmatic operation it was agreed: (a) to approve the regulations for inflation-based rate adjustments for EPS without rate formulas; this would allow the companies without regulated rate formulas to update rates in effect since the mid-1990s, through an increase of approximately 18%; (b) to restructure EPS rate structure in the following categories: residential, noncommercial, commercial, industrial, and government; (c) to approve regulatory accounting guidelines for segregating charges according the service provided: water, sewer, and wastewater treatment; and (d) to draft a proposal for regulations on the quality and quantity of industrial waste discharges for submission to the MVCS Department of

- Environmental Management. For the second programmatic operation, it was agreed: (a) to implement the regulations on inflation-based rate adjustments for EPS without rate formulas; (b) to apply the new EPS tariff structure to the five categories mentioned above; (c) to design a regulatory accounting system for segregating charges for different services; (d) to approve the regulations on the quality and quantity of industrial waste discharges into the sewer system and draft regulations on fees based on a pollution factor; and (e) to approve a water and sewer service rate calculation formula, that explicitly includes the concept of economic cost of water source use, environmental services, and pollution discharges. For the third programmatic operation, it was agreed to apply the subsidy system and regulatory accounting, and to introduce regulations governing fees for industrial discharges based on a pollution factor. The expected development outcome is to promote a universal service, with rates that reflect the cost of service.
- 2.13 (ii) Subsidies. The objective of this activity is to contribute to universal service delivery through targeted subsidies. For this first programmatic operation, it was agreed to approve the subsidy system guidelines. For the second programmatic operation, there would need to be approval to implement the action plan, and for the third programmatic operation implementation of the action plan would need to be in progress. Under the agreed subsidy system guidelines, subsidies will be granted to poor families for residential consumption. The subsidy will apply to subsistence consumption and to the fixed portion of the rate only. The subsidized rate would not be less than the variable cost. Only actual consumption will be billed, and the concept of minimum rates will be discontinued. To determine the best way to implement this policy, a study will be performed to analyze and compare the cross-subsidy and direct subsidy methodologies. For cross-subsidies, a contribution will be added to industrial, commercial, and nonpoor residential consumption to cover a subsidy to poor households for subsistence residential consumption. The additional cost must be less than any amount that creates an incentive for customers to leave the system (groundwater use). For the direct subsidy methodology, a study will be performed to determine which option is preferable: to subsidize the investment (discounting the investment portion from the rate) or to subsidize consumption from a subsidy fund. The minimum expected reform would be the structuring of a cross-subsidy system based on the guidelines previously outlined. The expected development outcome is to have a subsidy system that contributes to universal service.
- 2.14 (iii) Rate approval process: The purpose of this activity is to streamline the processing of the EPS Optimized master plans. For the first programmatic operation, it was agreed: to approve streamlined procedures for approval of optimized master plans and six OMPs. Tariff structures have now been approved for six service providers and studies have been completed for another eight, with only the public hearings for their approval pending. By December of this year, 14 service providers are expected to have approved rate structures. For the second programmatic operation, the parameters for the OMPs will be reviewed and 15 service providers will have approved plans, and for the third programmatic

- operation there will be 30 service providers with approved OMPs. The expected development outcome is to have service providers that are financially self-sustaining in the long term since rates will be based on actual costs, including environmental costs.
- 2.15 **Component V - Operator management.** This component would improve the institutional transparency and sustainability of water and sanitation operators. This component covers the following activities:
- 2.16 (i) Institutional strengthening: The objective of this subcomponent is to improve the management, operational, and administrative capacity of water and sanitation service through a National Water and Sanitation Capacity-building System (SFC). For this first programmatic operation, it was agreed to create the SFC as a functional operational entity. The system is being designed as an integrated network of institutions with knowledge, experience, and resources in water and sanitation, and its mission is to build up sector capacity, thus contributing to sustainable development of water and sanitation service in Peru. For the second programmatic operation, it was agreed that under the SFC framework 10 cooperation agreements would be entered into with training institutions, and an action plan for capacity development under the Water for All program and the “investment shock” would be implemented. For the third programmatic operation, it was agreed the Capacity-building System (SFC) would be operating. The expected development outcome is for the SFC to offer training to sector agents (DNS, EPS, operators and providers in small and medium-sized cities and in rural areas).
- 2.17 (ii) Management tools: The objective of this activity is to improve governance, accountability, and institutional sustainability in water and sanitation service management and operation, in order to ensure efficient service delivery based on the transparent allocation of responsibility and accountability, thus reducing EPS vulnerability to political interference. For the first programmatic operation, it was agreed: to approve the model operating contract, including targets, incentives, and penalties, accountability mechanisms, and a code of corporate governance, and to approve the guidelines for disseminating information on accountability and performance. For the second and third programmatic operations, it was agreed that for each operation at least five operating contracts would be signed, including targets, incentives, and penalties, accountability mechanisms, and a code of corporate governance. The expected development outcome is that companies would be less vulnerable to political change and EPS management and performance would be more transparent.
- 2.18 **Component VI - Private sector participation.** The objective of this component is to map out a national strategy for private sector participation and a process methodology that optimizes the use of preinvestment resources, processing time, and compliance with legal requirements by participating entities. This component covers the following activities:

- 2.19 (i) PSP promotion criteria and methodology: The objective of this activity is to promote the sanitation sector's national PSP strategy and to develop a methodology for promoting PSP processes that define the roles and responsibilities of participating entities. For this first programmatic operation, it was agreed that a national PSP strategy would be implemented in the sanitation sector, including government investment financing policies. The national strategy approved by the VMCS identifies the private sector as an essential agent in the different activities involved in sanitation service delivery under various arrangements, through contributions of financing and technical capacity. This strategy sets out mechanisms for promoting quickly ongoing participation by specialized operators with a view to increasing service coverage and quality in an effort to close the sector infrastructure gap. The strategy also establishes expected outcomes and targets, identifies the stakeholders, sets levels of coordination, allocates functions between stakeholders, defines selection criteria, and recognizes three PSP arrangements (management contracts, concession agreements, and integrated projects under build, operate, and transfer (BOT), build, own, operate, and transfer (BOOT), and licensing arrangements, etc.). For the second programmatic operation, it was agreed to complete three PSP processes for water and sanitation service, two outside Lima and one in Lima. For the third programmatic operation, it was agreed to complete two PSP processes for water and sanitation service, one outside Lima and one in Lima. The expected development outcome is to have private sector participation developed on the basis of a process methodology that optimizes compliance with current legal requirements.
- 2.20 (ii) PSP processes: The objective of this activity is to optimize PSP processing (streamlining and expediting), or say the processes for compliance with all legal requirements in the processing and approval of PSP arrangements. For the first programmatic operation, the operational and functional processes and procedures that are needed to streamline and expedite the processes, particularly those concerned with *diagnostic*, *integrated viability*, and *strategy and promotion* processes, will be identified. The integrated viability process, which includes the optimized master plan, SNIP feasibility, and PSP feasibility, produced a proposal that will harmonize certain shared processes, such as diagnostic assessments and viability, in order to avoid duplication of efforts. Also, it was agreed to approve regulations setting adjustment criteria for processing private initiatives to meet the objective of privately-sourced financing. For the second programmatic operation, the operational and functional processes and procedures necessary to optimize PSP processes during the promotion phase will be applied and regulations setting adjustment criteria for the processing of private initiatives will be introduced. The expected development objectives to have private sector participation based on a process methodology that optimizes compliance with current legal requirements.

C. Cost and financing

- 2.21 The present operation, designed as a programmatic policy-based loan, will be disbursed in a single tranche of US\$100 million, in principle in the first quarter of

2008.⁹ The Peruvian government has indicated that the amount of subsequent operations will be determined in conjunction with the Bank as the operations are processed. The amount proposed for the program is justified by the government's actions and reforms, the continuity of efforts between different levels of government to achieve the same objective, the institutional complexity of the proposed reforms, and the expected outcomes and benefits.

III. PROGRAM EXECUTION

A. Borrower and executing agency

- 3.1 The borrower is the Republic of Peru and the executing agency is the MEF, through the National Public Debt Department (DNEP), the agency responsible for negotiating the operation, and the Sector Loan Coordination Unit (UCPS), which is responsible for technical coordination in connection with program preparation and supervision. The MEF is part of the executive branch that regulates and harmonizes all activities concerned with economic and financial matters. Its purpose is to formulate, supervise, and evaluate sector policies and plans in line with overall government policy.
- 3.2 The present program supports the structural policy reforms to enhance the technical capacity of the MVCS, SUNASS, and the Private Investment Promotion Agency (PROINVERSION). Within the MVCS, the National Sanitation Department is responsible for all aspects of investment planning, financial policy, the regulatory framework for small communities, sector capacity-building, management tools, strategies, and criteria, and methodologies for promoting public sector participation in the sector. SUNASS is in charge of all aspects of tariff policy, concession agreement supervision, and future regulation of small communities. PROINVERSION is responsible for carrying out the PSP projects within its purview, in order to have specialized operators for efficient water and sanitation system management. These entities are essential to implement the program, and will receive the technical support of the MEF in order to meet the policy commitments.

B. Program execution and administration

- 3.3 The program would be complemented by parallel financing from the KfW (German Technical Cooperation Agency) in an amount of up to €39 million (approximately US\$50 million), to be disbursed in two tranches (€19.5 million for this first tranche) as specified in the preliminary agreements. The German government could allocate additional financing for the third programmatic operation. General program administration and supervision will fall to the MEF with the backing of public

⁹ The proposed amount is consistent with government and IMF projections on needs for programmed external resources for the coming years, and support 2007 financial requirements indicated in the Bank's programming report of November 2006. In principle, the Peruvian government plans to be able to meet the conditions for the program's second operation in September 2008 and the third in September 2009.

sector entities such as the MVCS, SUNASS, and PROINVERSION, which have designated officials to provide assistance in fulfilling program commitments.

- 3.4 The successful completion of the operation calls for coordinated, timely decision-making and performance of activities by different units within MEF, MVCS, SUNASS, and PROINVERSION. Although the technical coordination necessary for the success of the program is the responsibility of the MEF, the reforms and their implementation are the responsibility of the sector entities.
- 3.5 The DNEP is the unit in charge of financial matters, including the processing of disbursements, and the UCPS will be the technical unit within the MEF whose responsibilities cover: (i) coordinating efforts between with different units within the MEF and the public sector agencies responsible for adopting measures or technical execution of the activities; (ii) monitoring and promoting program activities to ensure successful completion; (iii) maintaining official communications with the Bank on technical matters; (iv) presenting reports of acceptable quality by the agreed deadlines; and (v) anticipating and satisfactorily addressing any risks and problems of a strategic or technical nature or relating to coordination that might arise during program execution.

C. Plan of program activities

- 3.6 The budget for fulfilling the commitments associated with the second and third programmatic operations is approximately US\$9.3 million, as follows: approximately US\$4.2 million to prepare the second programmatic operation and US\$5.1 million to prepare the third. Annex V gives a breakdown of expenditures and sources of financing in support of the policy based lending program. The financing consists of bilateral financing (KFW, GTZ, and others) in a total amount of US\$5 million, and a local counterpart contribution of US\$4.3 million. Both amounts will need to be budgeted.
- 3.7 The resources budgeted for the second and third programmatic operations will finance the following activities: (i) institutional regulatory framework component, a guide for formulation of regional plans, drafting of regional sanitation plans, information system design and implementation, establishment of a regulatory system, procurement for small communities, and implementation of the DNS and SUNASS organizational structure; (ii) investment and debt financing policy component, implementation of the public investment resources system, and support for debt restructuring; (iii) tariff policy component, application of the rate gap, subsidy system study and implementation, study of regulatory accounting and its implementation; regulations governing industrial waste discharges and their implementation; streamlining of the OMP approval process and approval of OMPs; (iv) EPS management component, implementation of the model operating contract and dissemination of information on accountability and performance, and implementation; and (v) private sector participation component, dissemination and implementation of the national private sector participation strategy and design and implementation of the optimization processes.

D. Disbursement schedule

- 3.8 As a programmatic policy-based loan, the financing will be disbursed in a single tranche once the loan agreement has been signed and the special and general conditions precedent to disbursement have been fulfilled, according to the means of verification presented in the Verification Matrix (Annex III).

E. Local currency

- 3.9 The Peruvian government has approached the Bank for use of the Local Currency Facility (LCF). Sanitation Sector Reform Program I would be financed with resources in United States dollars from the Single Currency Facility of the Bank's Ordinary Capital, and would be subject to the Operational framework for lending in local currency (document GN-2365-2). To minimize the exchange risk, under the provisions of the LCF, the Peruvian government would be entitled to convert the disbursements and amounts outstanding to Peruvian new soles. In order to increase the borrower's financing options, conversion of disbursements to local currency will be subject to two financial conditions in addition to those in the LCF: (i) the amortization profiles for local currency disbursements must be flexible, and (ii) price must be based on the Bank's effective funding cost should the Bank raise the financing through a bond issue. Justification for these two conditions as well as the waiver in respect of LCF conditions if the Interruption of Bank Access to Borrowing Clause was not applicable is provided in Annex VI and its appendices. As specified in paragraph 3.9 of document GN-2365-2, resources from the LCF may be used for up to five operations/transactions per year¹⁰. As five operations have already been approved this year, the Board of Executive Directors is being requested to authorize the use of the LCF in the present operation, to address the Peruvian government's expressed need to develop a public debt strategy with an increasing local currency component, with resources from the Single Currency Facility of the Bank's Ordinary Capital.

F. Monitoring and evaluation

- 3.10 While the operation was being prepared, the project team conducted an analysis of the medium-term framework for reforms for this operation. The general objective, together with indicators for each expected outcome, which have contributed to the program rationale, the cost, and method of intervention were determined on the basis of this analysis. The policy matrix also identifies the milestones and triggers that would guide an evaluation of the progress in implementing the reform program, making it possible to ascertain whether the two subsequent operations associated with the reform program should be processed and approved.
- 3.11 The MEF will coordinate efforts to fulfill the commitments relating to the first programmatic operation, as well as all other commitments and the progress of the reforms. The MEF will be responsible for providing information on the progress of

¹⁰ The five operations for which the Board of Executive Directors has authorized the use of the LCF are PR-3153 (Brazil); PR-3102-2 (Peru); PR-3167 (Peru); PR-3171 (Chile); and PR-3173 (Chile).

- the policy and output matrix, as well as for furnishing the means of verification to the Bank. Given the complexity of these reforms, the Bank's project team will monitor the project by means of missions to verify the progress of the reforms and to identify any problems that might have arisen. The output matrix, with medium-term indicators at completion of third programmatic operation (2008-2009) and long-term indicators (2011-2012), will be used to evaluate progress in implementing the program and making it possible to perform an evaluation upon completion of the last programmatic operation.
- 3.12 The borrower and the Bank have agreed to track the program by means of monitoring meetings to be on dates to be determined by the executing agency and the Bank. Based on this monitoring and the agreed triggers, the Bank and the executing agency will decide on an appropriate time for the second programmatic operation.
- 3.13 Since programmatic operations are designed to produce results in the medium and long terms, the Project Completion Report (PCR) will be completed at the end of the third operation and will evaluate the impact of the program and the extent to which the objectives envisaged for the three operations making up the program as a whole have been fulfilled, within six months after the reforms for the third operation have been carried out. The borrower previously reached agreement with the Bank on the indicators and baseline for this final evaluation (Annex II, Output Matrix).
- 3.14 The borrower will assemble all information necessary for tracking and evaluating the program and will collect, file, and make available to the Bank all information, indicators, and parameters used by the Bank to prepare the PCR. In particular, the borrower will present semiannual reports to the Bank for the duration of the program, including the advance of the reforms and especially the extent to which the triggers for the next programmatic operation have been fulfilled.

IV. VIABILITY AND RISKS

A. Institutional viability

- 4.1 The program's institutional viability is based on the MEF's commitment and execution capacity. The MEF has a highly qualified staff, effective and efficient management, coordination, and control procedures, proven leadership, and a clear strategic vision. The MEF has had considerable experience with similar projects, successfully implementing more than 23 policy based loans supporting policy reforms in a total estimated amount of US\$5.95 billion and 19 reimbursable technical-cooperation projects, through the UCPS, in an estimated amount of US\$115.3 million. The UCPS, the executing agency for the technical-cooperation projects, has the infrastructure and experience to manage these types of operations, including staff responsible for general coordination. The Bank has evaluated the UCPS performance in all these projects, and found that, in most of them, the UCPS: (i) maintained solid integration and connections with all relevant areas of project

- execution; (ii) satisfactorily administered disbursements and project finances; and (iii) had extremely well-designed strategic planning that could anticipate and address the risks and strategic, organizational, and technical problems associated with project execution.
- 4.2 The program currently has an ideal sector institutional framework. The functions of planning (DNS), regulation (SUNASS), and operation (EPS) are clearly defined and assigned to institutions that are legally independent under sanitation, decentralization, and municipality legislation. This program complements and strengthens the sector's current institutional framework and proposes adjustments that will lead to more dynamic and efficient sector development. The program preparation benefited from the sound technical backing of the DNS, SUNASS, PROINVERSION, and the MEF, an entity that struck a balance in coordinating efforts and setting priorities between the institutions linked to the program and between the international cooperation bodies.
- 4.3 For some years now, the government has accorded top priority to the water and sanitation sector, in the form of government programs to provide improved and sustainable service and to set clear rules governing eligibility and access. The PNS is complemented by the Water for All program, and a number of national laws to address the needs of the most vulnerable population groups. All the actions proposed hereunder are ensue logically from those already taken and adopted, and have been devised on the basis of the country's own experience, in light of its needs and capacities. The government's commitment to the reforms agreed for the present programmatic operation are largely evident from the government's efforts in each area associated with the program components. Moreover, the preparation and execution of all the actions and decisions necessary to implement the program have the financing and support of the entities linked to the program (MVCS, SUNASS, and ProInversión).
- 4.4 **Autonomy of the regulatory authority.** The Sector Loan Coordination Unit has taken part in coordinating efforts the development and execution of different activities with a number of sectors to ensure compliance with program matrixes, as part of the preliminaries to agreement on the external financing operation with the IDB. From the outset, SUNASS has been involved in all activities entailed in reaching an agreement, since one area the program would prioritize is "tariff policy". The preliminaries activities were coordinated, with due regard to each entity's area of expertise in the sanitation sector, without imposing any obligations that would jeopardize its functions or autonomy, all in keeping with the principle of autonomy established in the SUNASS Regulations on Organization and Functions, approved by Supreme Decree 017-2001-PCM. No mandate has been established with respect to SUNASS's area of expertise, since all activities have been coordinated, and moreover the activities SUNASS itself would carry out adhere strictly to the legal standards governing this entity and have no impact on other regulatory bodies.

B. Expected outcomes and benefits

- 4.5 The measures adopted with program support are expected to produce significant economic benefits, while improving the efficiency, equity, and sustainability of the water and sanitation service. The proposed program is expected to give service providers the institutional and financial framework to allocate resources based on objective criteria, to become self-sustaining and efficient in service delivery, and to invest in infrastructure. The gradual implementation of the structural reforms will change the system of incentives and assist service providers in implementing the governance and planning reforms, enabling them to offer quality service at the lowest possible cost, with the possibility of extending service to every one in their area. In addition, poor users will be assured of sufficient supply for proper hygiene at a price they are able and willing to pay. Transferring environmental costs to rates will encourage customers to use water more efficiently, thus enhancing the utilization of water resources in the watershed and maximizing the economic return.
- 4.6 The measures adopted are expected to increase water coverage from 76% to 80% by the year 2011, and sanitation coverage from 59% to 69%. This means that 2.8 million people will be receiving water service and 4.3 million sanitation service. The prioritization criteria adopted are expected to increase the efficiency of investments for the population at large by at least 33%, which in economic terms represents a coverage increase of US\$272 million and US\$29 million in net present value benefits. As to service providers offering financially sustainable, efficient delivery, the most significant expected outcomes will be a reduction in unmetered water from the current 43% to under 40% by 2011, and service provider operating margin (EBITDA) will rise from 17% to 25%. Service providers are expected to increase present value revenues by US\$220 million. Small cities are expected to have 100 specialized operators administering proper service by 2011, which is equivalent to providing good service to 700,000 residents.

C. Environmental and social impact

- 4.7 The operation's potential environmental impacts were evaluated as specified in the Bank's environmental policy (OP-703, B13). As a programmatic policy-based loan, the operation is not expected to have any direct adverse effects on the environment or natural resources, since physical investments are not being financed. The performance conditions envisaged are designed to produce more rational water and sanitation service management, while avoiding the negative impacts caused in the past by the absence of an overall vision. Moreover, given their nature, the program-supported actions will not have any direct or indirect adverse impacts on indigenous populations. When the second and third programmatic operations are being prepared, it will be verified that there have been no potential effects on indigenous populations as stipulated in the Bank's operational policy on indigenous peoples. As the improved subsidy allocation system will have a positive impact on water and sanitation service rates and more transparent and equitable rules for public resources allocation will be created, this operation qualifies as a social equity

enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment.

D. Risks and special considerations

- 4.8 The proper implementation of the proposed structural changes will take time and require timely allocation of resources. This program has been structured as three operations to ensure certain actions necessary to continue moving forward are fulfilled, and if necessary, to adopt corrective measures to achieve the proposed objectives. The commitments agreed for the first programmatic operation were exhaustively reviewed with the entities involved and they have reaffirmed their commitment. The means of verification were prepared with the help of consulting services financed by the Bank and the KfW. To mitigate any risk of commitments for subsequent programmatic operations not being fulfilled, the budgetary appropriation the Peruvian government would need to make good on its commitments has been estimated, and it was agreed to coordinate and request the necessary financing.
- 4.9 The success of the program depends largely on: (i) the strengthening of the governmental institutions responsible for policy-making, regulation, and training, (ii) regional investment needs, (iii) objective criteria for resource allocation, and (iv) the willingness of service providers and municipios to accept the proposed reforms. The proposed reforms may have an impact on the regulatory framework of other sector regulatory bodies and the viability of measures governing rate levels and structure and private sector participation. The absence of support from these autonomous entities could also impact actions that target subsidies at poor families and financing for the preparation and implementation of the policy measures for the second and third programmatic operations. These risks are mitigated insofar as the reforms proposed for the first programmatic operation would promote the development of regional investment plans, produce a sturdier regulatory and corporate governance framework, strengthen the training system, and create incentives for the reforms with resources for investment.
- 4.10 It is possible that a cross-subsidy system may not produce the expected social benefits or contribute to the companies' financial sustainability. Under the present programmatic operation, a study would be performed to design an appropriate subsidy matrix and assess the potential effects of the reform before it is approved and implemented. Also, the subsidy system would be gradually introduced and corrective measures taken to ensure the objectives are fulfilled. The DNS and the MEF will monitor the regulator as the subsidy policy is applied, support the reforms with parallel investment programs whenever necessary in order to improve service quality, efficiency, and coverage, and promote public information and education campaigns.
- 4.11 The success of the VMCS new organizational structure will depend largely on a proper level of communication and coordination between DNS and PAT. As part of the present programmatic operation, the new DNS structure will be monitored as it

is put in place, with strengthening being provided in those areas in charge of tracking and monitoring the investment programs.

- 4.12 The elimination of EPS financial obligations to FONAVI is essential for fostering long-term EPS sustainability, particularly their financial health. To this end, the MVCS plans to promote, at the same time as FONAVI liabilities are restructured, a series of comprehensive reforms in talks with the municipalities and the companies. These reforms introduced under Supreme Decree 021-2007 VIVIENDA mentioned earlier (paragraph 2.8) include: (i) support for the financing of investment in both rehabilitation and expansion, (ii) development and signature of operating contracts between service providers and concession grantors, (iii) adoption of corporate governance measures, and (iv) implementation of a training plan.

V. POLICY MATRIX

- 5.1 The Bank reached agreement with the Peruvian government on the Policy Letter (Annex IV) outlining the government's commitment to the objectives and actions of the entire series of programmatic loans and reaffirming the latter's commitment to the reforms and activities agreed with the Bank. In addition, the Bank agreed on the Policy Matrix (Annex I) describing the policy commitments for the present programmatic operation and the triggers for the second and third operations. Also attached are the outcomes matrix (Annex II) and the verification matrix (Annex III) for the first programmatic operation.

SANITATION SECTOR REFORM PROGRAM I (PE-L1025)
POLICY MATRIX

Objectives	Commitments: Programmatic I	Commitments: Programmatic II	Commitments: Programmatic III
I. General macroeconomic policy framework			
General macroeconomic policy framework	Macroeconomic framework consistent with program objectives and with the guidelines established in the sector policy letter.	Macroeconomic framework consistent with program objectives and with the guidelines established in the sector policy letter.	Macroeconomic framework consistent with program objectives and with the guidelines established in the sector policy letter.
II. Institutional framework of the sanitation sector			
Investment planning: To adopt a regional and local investment planning system based on coverage, efficiency, social, and environmental criteria.	a. The National Sanitation Plan's areas of service and guidelines for prioritizing investments for the overall quantification of viable regional targets and investment amounts are defined. b. The water and sanitation information system is created for sector planning.	a. Two regional sanitation plans are approved. b. The water and sanitation information system is being implemented.	a. Three new regional sanitation plans are approved and two regional sanitation plans are being implemented. b. The water and sanitation information system is operating.
Regulatory framework for small communities: To introduce a regulatory framework for small communities and rural areas, and to improve the transparency of management models for small and medium-sized enterprises.	A regulatory system for small cities and rural areas and a system for contracting specialized operators for small and medium-sized communities are defined and designed.	A regulatory system for small cities and rural areas is applied to 50 providers; and a system for contracting specialized operators for small and medium-sized districts is applied to 20 operators.	A regulatory system for small cities and rural areas is applied to 50 new providers; and a system for contracting specialized operators for small and medium-sized districts is applied to 15 new operators.

Objectives	Commitments: Programmatic I	Commitments: Programmatic II	Commitments: Programmatic III
Institutional strengthening: To improve the management capacity of the governing body and the operational capacity of the regulatory authority.	a. The reorganization plan for the National Directorate of Sanitation (DNS) and the Water for All (PAT) program are defined and created, respectively, in accordance with the new sector policies. b. The institutional strengthening plan for SUNASS is approved.	a. The new organizational structure for the DNS and PAT is being implemented. b. The institutional strengthening plan for SUNASS is being implemented.	a. The organizational structure for the DNS and PAT is implemented. b. The institutional strengthening plan for SUNASS is implemented.
III. Sector financial policy			
Investment financing: To improve the public investment resource allocation system to generate efficient investments and sustainable services. EPS debt profile: To improve the EPS debt profile.	Regulations are approved for the allocation of investment resources in sanitation projects. The legal framework for restructuring the debt of FONAVI and SUNASS is approved.	The public investment resource allocation system for financing investments is being implemented. Two service providers begin the process of restructuring their debt.	The public investment resource allocation system for financing investments is implemented. Two additional service providers begin the process of restructuring their debt.
IV. Sector rate policy			
Rate structure and level: To allow enterprises to become financially self-sustaining in the long term, by having a rate based on actual costs, including environmental costs.	a. Regulations are approved for inflation rate adjustments for service providers without rate formulas. b. Reorganization of the rate structure for EPSs into the following categories: residential, social, commercial, industrial, and government, approved.	a. Regulations are introduced for inflation rate adjustments for service providers without rate formulas. b. Reorganization of the rate structure for EPSs into the following categories: residential, social, commercial, industrial, and government, being implemented.	

Objectives	Commitments: Programmatic I	Commitments: Programmatic II	Commitments: Programmatic III
	c. Guidelines for the subsidy system are approved.	c. The action plan for the subsidy system, consistent with the guidelines for Programmatic I, approved.	c. The action plan for the subsidy system, consistent with the guidelines for Programmatic I, is being implemented.
	d. Regulatory accounting guidelines to segregate charges for water, sewer, and wastewater treatment services are approved. e. Regulations on the quality and quantity of industrial waste discharges are developed.	d. Regulatory accounting system to segregate charges for water, sewer, and wastewater treatment services is designed. e. Regulations on the quality and quantity of industrial waste discharges are approved. f. Regulations on charges for industrial discharges based on a pollution factor are developed. g. Formula for calculating water and sewer rates, explicitly including the concept ¹ of economic cost for use of water sources, environmental services, and polluting discharges, approved.	d. Regulatory accounting system to separate collections for water, sewer, and wastewater treatment services is being implemented. e. Regulations on payment for industrial discharges with a contamination factor are approved.
Rate approval process: To improve the rate approval process by adapting the OMP to the type of EPS and increased EPS capacity.	a. Simplification of the OMP approval procedure, approved. b. Six EPSs with approved OMPs.	a. Revised parameters for the preparation of OMPs are being applied (including historical information for diagnostics, function of costs, master plan, profile and project content). b. Fifteen service providers with approved OMPs.	Thirty EPSs with approved OMPs.

¹ The concept of cost does not mean a determination of the cost.

Objectives	Commitments: Programmatic I	Commitments: Programmatic II	Commitments: Programmatic III
V. Management of service providers			
Institutional strengthening: To improve the management, operational, and administrative capacity of water and sanitation services.	Capacity-building system (SFC) is being implemented.	a. Ten cooperation agreements, under the SFC framework, are signed with training institutions. b. Action plan to build capacity under the “Water for All” program and the investment shock are implemented.	Capacity-building system (SFC) is in operation.
Management instruments: To improve governance, reporting, and institutional sustainability in water and sanitation service management and operation.	Model operating contract, including targets, incentives and penalties, reporting mechanisms, and a corporate governance code, approved.	a. Guidelines are approved for dissemination of service delivery reporting and performance by local and regional governments. b. Five operating contracts are signed, including targets, incentives and penalties, reporting mechanisms, and a corporate governance code.	Five new operation contracts are signed, including targets, incentives and penalties, reporting mechanisms, and a good corporate governance code.
VI. Private sector participation			
Promotion criteria and methodology: To promote the sanitation sector’s PSP strategy nationally. PSP processes: To optimize PSP processing.	National PSP strategy in the sanitation sector, including financing policies for State investments, is being implemented. a. The operational and functional processes and procedures necessary to optimize PSP processes in its promotional stage are defined. b. Regulations establishing adjustment criteria for processing private initiatives are being implemented.	PSP for water and sanitation services is completed in two EPSs outside of Lima and one in Lima. a. The operational and functional processes and procedures necessary to optimize PSP processes in its promotional stage are being implemented. b. Regulations for establishing adjustment criteria for processing private initiatives are being implemented.	PSP for water and sanitation services is completed in one new EPS outside of Lima and one new EPS in Lima.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/07

Peru. Loan ____/OC-PE to the Republic of Peru
Sanitation Sector Reform Program I

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 sanitation sector reform program I. Such financing will be for an amount of up to US\$100,000,000 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.

LEG/SGO/PE-1192689-07
PE-L1025