



Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 24-Aug-2022 | Report No: PIDC34324



BASIC INFORMATION

A. Basic Project Data

Country Ecuador	Project ID P178636	Project Name Ecuador Second Green and Resilient Recovery DPF (EGARR DPF-2) (P178636)	Parent Project ID (if any) P176983
Region LATIN AMERICA AND CARIBBEAN	Estimated Board Date Nov 10, 2022	Practice Area (Lead) Energy & Extractives	Financing Instrument Development Policy Financing
Borrower(s) Ministry of Economy and Finance	Implementing Agency Ministry of Economy and Finance		

Proposed Development Objective(s)

The Program's Development Objective (PDO) is to assist the government of Ecuador in its agenda to tackle selected structural challenges to foster growth, inclusion, job creation, and climate resilience, strengthen low-carbon development and help realize its commitment to become carbon neutral by 2050.

Financing (in US\$, Millions)

SUMMARY

Total Financing	500.00
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DETAILS

Total World Bank Group Financing	500.00
World Bank Lending	500.00

Decision

The review did authorize the preparation to continue



B. Introduction and Context

Country Context

The proposed Second Green and Resilient Recovery Development Policy Financing (DPF), for US\$500 million, is the second operation in a programmatic series of three. The series seeks to assist the Government of Ecuador (GoE) in its agenda to tackle selected structural challenges to foster growth, inclusion, job creation, and climate resilience, strengthen low-carbon development, and help realize its commitment to become carbon neutral by 2050. The first operation, for US\$700 million, was approved by the WB's Board of Executive Directors in February 2022. This programmatic series is fully aligned with the National Development Plan 2021-2025 (*Plan de Creación de Oportunidades 2021-2025*, NDP) and the Country Partnership Framework (CPF) FY2019-2023. The series seeks to support critical structural growth-enhancing reforms, builds on the reform agenda initiated with the Inclusive and Sustainable Growth DPF series and complements the ongoing Social Safety Net Additional Finance Project. In addition, this operation significantly expands WB's support for the GoE's climate change mitigation and adaptation efforts.

Despite the recent recovery and high oil prices, Ecuador still needs to address long-lasting structural challenges to reach fiscal sustainability, achieve inclusive growth, and protect vulnerable people. After dropping 7.8 percent in 2020, Gross Domestic Products (GDP) grew by 4.2 percent in 2021, thanks to a successful vaccination campaign and a favorable external context. Moreover, despite its negative effect on banana, flower, and shrimp exports, the Russia-Ukraine conflict has increased oil exports and fiscal revenues. Yet, Ecuador still needs to undertake significant reforms to achieve strong, inclusive, green, and resilient growth. With a fully dollarized economy and limited macroeconomic buffers, the GoE aims to implement a progressive, inclusive, and resilient fiscal framework that sustains fiscal consolidation while protecting the vulnerable, advancing the implementation of its climate commitments and goal, and regaining access to the international capital markets under favorable financial conditions. After decades of negligible productivity gains, Ecuador needs to enhance its productivity not only as a critical element to improving competitiveness in a dollarized economy but also to generate new engines of growth and employment to facilitate the economy to move away from the oil sector in a decarbonizing world. High informality and limited economic diversification result from an underdeveloped private sector linked, at less partially, to the prevalence of protectionist, rigid labor markets, and distortive market regulation.

Moreover, Ecuador's high exposure to climate change and climate-related disasters calls for enhanced efforts to foster green and resilient growth. Ecuador is among the ten countries with the highest natural disaster risk globally, being particularly exposed to earthquakes, recurrent floods, and intensifying droughts, which have reduced development gains in the last decades. Vulnerability to phenomena like El Niño Southern Oscillation (ENSO) and related disasters such as floods and landslides is exacerbated by the fact that 96 percent of the urban population lives in the coastal and mountainous region. Every year, Ecuadorian firms lose US\$1 billion due to infrastructure disruptions, most of which are due to transport and power disruptions.¹ Ecuador has much to gain from global efforts to combat climate change and is committed to decoupling economic growth from greenhouse gas (GHG) emissions.

The GoE remains committed to laying the foundations for fiscal consolidation, inclusion, and a greener and more resilient medium-term growth. After amendments in 2021, the medium-term International Monetary Fund (IMF) program is on track as the GoE is committed to continuing the ongoing reform process to support a growth-friendly and inclusive fiscal consolidation, strengthen governance, and foster private investment. The GoE not only passed a tax reform increasing the tax burden on the better-off firms and people and setting incentives for investment in closing the digital

¹ IADB. 2021. Políticas climáticas en América Latina y el Caribe: casos exitosos y desafíos en la lucha contra el cambio climático at <https://publications.iadb.org/publications/spanish/document/Politicas-climaticas-en-America-Latina-y-el-Caribe-casos-exitosos-y-desafios-en-la-lucha-contra-el-cambio-climatico.pdf>.



divide but is also applying measures to make public procurement more efficient and sustainable and enhancing the institutional set-up to integrate climate-change-related challenges and disaster risk into budget planning. The GoE is also taking steps to enhance competitiveness by reducing trade barriers, negotiating trade agreements, improving the labor market outcomes by strengthening its vocational training, and enhancing financial inclusion through the management of environmental, social and governance, and reducing climate-related risks. On the social front, while building on previous efforts to continue improving and expanding the social safety net to reach the most vulnerable and ease migrants' integration, the GoE has prioritized dealing with malnutrition, which affects one-quarter of children under five years. Climate change (in part because of its impacts on agriculture productivity) could increase undernutrition and severe stunting among children. Several of these reforms are supported by this DPF series.

Relationship to CPF

The proposed operation is closely aligned with the Country Partnership Strategy FY2019-2023 and includes reforms related to the ongoing Social Safety Net Project. The operation supports a more inclusive and resilient fiscal management by increasing tax collection in an inclusive, transparent, and green way to support the ongoing fiscal consolidation and strengthen the institutional framework to deal with climate-related challenges and improve the achievement of Ecuador's Nationally Determined Contributions (NDCs). It also fosters growth and labor opportunities by reducing trade barriers and promoting private investment in reducing geographical divides in access to digital technologies. The operation strengthens mechanisms to support the most vulnerable groups, such as people at the bottom of the income distributions, those exposed to malnutrition, and migrants. The project aims to strengthen low-carbon development to support the country's ecological transition to a greener and resilient energy sector by improving the measurement and reporting of GHG emissions and developing carbon trading mechanisms.

The proposed operation is also aligned with Ecuador's National Development Plan 2021-2025 (*Plan de Creación de Oportunidades 2021-2025, NDP*), which focuses on the country's medium and long-term development goals to reduce poverty and increase shared prosperity. The NDP aims at attracting investment to foster economic recovery and job creation, improving the social protection system and access to public services, improving security, advancing an ecological transition, and strengthening governance and institutions. Although the program with the IMF has been changed to reflect the new government priorities, it has ratified the Government's commitment to continue the ongoing fiscal consolidation process, foster private investment, and strengthen governance.

C. Proposed Development Objective(s)

The Program's Development Objective (PDO) is to assist the government of Ecuador in its agenda to tackle selected structural challenges to foster growth, inclusion, job creation, and climate resilience, strengthen low-carbon development and help realize its commitment to become carbon neutral by 2050.

Key Results

The expected results of this operation include Ecuador's macro-fiscal policies and practices aligning with its climate goals and adopting a budgeting approach that prioritizes climate-responsive investments and moves from greening projects to greening the economy. These structural changes are expected to foster growth and protect the vulnerable population, while the structural reforms can bolster private investment as they reduce the cost of imported capital goods such as machinery and mechanical appliances, increase the participation of the private sector in the provision of non-conventional renewable energy (NCRE), , and reduce GHG emissions generated from gas flaring and by improving



sustainable forest management.

D. Concept Description

The first pillar of the second operation tackles selected structural challenges to foster equitable growth, social inclusion, and climate resilience. This first pillar aims to support selected measures to: (i) make fiscal management more inclusive and resilient by increasing tax collection in a fair, progressive, transparent, and green manner and strengthening the institutional framework for more strategic management of climate financing and risks and integration of climate considerations in long and medium development planning; (ii) foster growth by reducing trade barriers and supporting inclusive financing with an environmental, social and governance approach; and (iii) strengthen social protection mechanisms to support the most vulnerable groups such as people at the bottom of the income distribution and those exposed to malnutrition and increased poverty due to climate risks.

The second pillar of the proposed operation aims to strengthen low-carbon development. It does so by: (i) promoting a greener and more resilient energy sector by fostering private investment in developing NCRE generation, fostering gas flaring reduction, and promoting sustainable forest management to reduce deforestation and enhance forest carbon sinks, as part of the implementation of Ecuador's NDC; and (ii) help develop voluntary markets by enhancing measurement and reporting of GHG mitigation initiatives to better monitor decarbonization progress.

The proposed operation will provide significant climate co-benefits that will help Ecuador to become more resilient, including to climate changes, and reach its climate commitments. On the adaptation side, the proposed operation acknowledges the GoE's efforts to reduce the dependency on oil revenues, reduce public debt, and build some fiscal buffers, which are critical to improve resilience and attract private investment, including in areas to deal with climate change. Adaptation is also favored by the GoE's effort to improve the institutional setup to enhance its capacity to handle climate disasters and integrate environmental and social considerations in development planning through risk evaluation and disclosure of the financial cooperatives. A broadened safety net and ramped-up action on reduction of malnutrition due to increasing impacts from climate risks on food security will help the resilience of the most vulnerable populations to climate disasters. On the mitigation side, it includes actions to enhance the decarbonization of the energy sector by promoting more NCRE, reduce gas flaring to help reduce emissions from oil extraction, and promote sustainable forest management. The latter aims to reduce deforestation and increase conservation and restoration of forests, hitting critical mitigation levers identified by the Intergovernmental Panel on Climate Change (IPCC). In this context, the proposed operation is broadly aligned with the Green, Resilient, and Inclusive Development (GRID) framework, adopted by the World Bank Group to tackle rising poverty and deepening inequality while addressing the immediate devastation brought by COVID-19 and the longer-term challenges of climate change.

E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

The prior actions supported by the proposed operation are expected to have positive or neutral impacts on poor households and vulnerable groups in the short term. In the medium and long term, the expected effects are overall positive. The tax reform will be progressive and will not impact the poor or the bottom 40 and reduce inequality. It will mainly affect the upper deciles of the income distribution. The measures to improve monitoring and managing climate-change-related expenditures, strengthen public finances by promoting the prevention, mitigation, and management of fiscal risks, and streamline procurement processes will not impact households in the short run, but these might have



positive impacts, in the long run, depending on how resources will be allocated. The measures to reduce trade barriers will likely have no significant welfare effects in the short run. However, these policies might indirectly positively impact welfare in the medium-long run through growth, higher labor incomes, and lower consumer prices. The enhancement of labor market inclusion policies such as training, and job search assistance will help youth and women workers by increasing their employment opportunities and integrating them into the formal sector. The immediate expansion of social programs in the event of natural disasters, the Social Registry's coverage increased, and policies for increasing the efficiency of resources allocated to malnutrition are expected to have positive effects on vulnerable populations' welfare. The migration regularization policies will help Venezuelan refugees and migrants by integrating them into society, improving people's employability while lowering pressure on mover vulnerable low-skilled workers in host communities, and enabling their access to public services and social protection. However, complementary actions are needed to materialize these opportunities that come with migration.

Policies under pillar 2 are expected to have neutral impacts on poverty and the bottom 40 at least in the short run. Incentives to promote the participation of private sector investments in renewable and clean energy projects are not expected to impact welfare directly in the short run. Yet, increased private investment may contribute in the medium and long run to reducing generation costs, increasing environmental benefits, and creating more jobs. Neutral impacts on poverty and shared prosperity are expected by requiring public and private firms operating oil fields to reduce associated gas flaring. However, these measures might impact living conditions in other dimensions. Enhancing transparency and the country's access to national and international financial resources would not impact poverty or inequality reduction. Impacts depend on the proper implementation of this program and the compensation mechanisms to counter potential negative effects.

Environmental, Forests, and Other Natural Resource Aspects

The Prior Actions supported through the EGARR DPF are likely, in aggregate, to have a positive impact on Ecuador's environment, forests, or other natural resources:

- Pillar 1 – Tackle structural challenges to foster growth, inclusion, job creation, and climate resilience—deals largely with implementing a more progressive tax system, more transparent and climate-oriented public finance and procurement, reducing trade barriers, facilitating the flow of private and public capital to integrate environmental, social and climate considerations, strengthened climate and disaster risk management, labor opportunities, the inclusion of vulnerable groups in labor markets. These are expected to be environmentally neutral. A positive environmental impact is expected from the measure proposed by PA#1 of eliminating the special consumption tax for electric and hybrid vehicles. PA#7 aims to integrate environmental and social considerations in risk evaluation and disclosure of the cooperative sector; through requirements issued by the SEPS. With these requirements proposed by the Prior Action, there may be potentially positive environmental impacts resulting from the better management of environmental and social risks related to credit operations in the financial sector and disclosure of Environmental, Social and Governance (ESG).
- Pillar 2- Strengthen low-carbon development— environment, forests, and natural resources. PA#11 support the enactment of regulation to support the tracking of GHG emission reduction in the contribution of Ecuador's NDC and the development of a carbon finance market. This is expected to reduce GHG emissions and has positive spillover impacts on the natural environment locally and as a global public good more broadly. Similarly, PA#10— introducing energy efficiency legislation in productive sectors— is expected to support mitigation efforts and reduce pressure on the natural environment. PA#12, the enactment of the Ministerial agreements to set a regulatory framework for the establishment of sustainable Forest Management, including a tracking and



good practices certification and incentives for deforestation-free products, will support reduced emissions in the forest sector and disincentivize deforestation.

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APPROVAL

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