Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 24-Oct-2022 | Report No: PIDA34846

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Peru	P178591	Peru Sustainable Growth and Finance DPF-DDO (P178591)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
LATIN AMERICA AND CARIBBEAN	15-Dec-2022	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Republic of Peru	Ministry of Economy and Finance		

Proposed Development Objective(s)

The Program Development Objective is to support Government reforms to (i) strengthen fiscal resilience and efficiency, (ii) foster a more inclusive and competitive financial sector, and (iii) promote greener production

Financing (in US$, Millions)

SUMMARY

Total Financing	500.00

DETAILS

Total World Bank Group Financing	500.00
World Bank Lending	500.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

Peru achieved remarkable economic growth and poverty reduction over the two decades prior to the COVID-19 pandemic, but progress has slowed in recent years. Between 2002 and 2013, Peru grew at an average annual rate of 6.1 percent. Peru's comparative advantage in commodities coupled with solid macroeconomic management and well-targeted programs fostered inclusive economic growth, and the poverty rate fell from 59 percent in 2004 to 21 percent in 2019. In the years prior to the pandemic (2013-2019), average growth rates declined to half of what they were in the 2002-2013 period, as productivity and job growth slowed. Between 2020 and 2021 during the COVID-19 crisis, accumulated growth has been less than one percent, despite rising export prices. The momentum to pursue important reforms for the country also stalled.

Peru's GDP is expected to expand by about 2.7 percent in 2022, remaining below its pre-pandemic trend. GDP growth this year will be mainly driven by higher export volumes, while domestic demand will gradually decelerate. GDP is expected to remain around 7 percent below its pre-pandemic trend, and long-term effects of the pandemic could be significant, through the impacts of school closures on future labor productivity. The fiscal deficit is expected to slightly increase next year, mainly due to an anticipated reduction in fiscal revenues, given the recent correction in mining prices. However, the fiscal deficit is projected to remain in line with fiscal rules next year and thereafter. Over the medium term, the current account deficit is expected to decline, mainly due to higher exports and the normalization of mining companies' profits. The economic outlook is subject to significant uncertainty and some risks, but important mitigation factors exist. Overall, Peru's macroeconomic policy framework is deemed adequate and sustainable over the medium term.

Relationship to CPF

The proposed operation is aligned with the forthcoming Peru Country Partnership Framework (CPF) FY23–FY27 and the Performance and Learning Review FY17-FY21 (Report No. 135267-PE, discussed by the Board of Executive Directors on April 25, 2019). The proposed operation is aligned with the three High Level Outcomes (HLOs) that are presented in the forthcoming CPF and the recently completed SCD Update: increased quality economic opportunities for workers and entrepreneurs (HLO1); improved access to quality public services across the territory (HLO2); and increased resilience to shocks (HLO3). It reflects broad policy consensus with the government on the criticality of supporting a more sustainable growth model in Peru and is aligned with the Government's Strategic Plan for National Development (PEDN). It is also closely aligned with the World Bank's strategic framework to move "From Crisis Response towards Green, Resilient and Inclusive Development" (GRID) and the World Bank Group 2021-2025 Climate Change Action in aligning climate and development goals while boosting growth. Moreover, it complements the Bank's ongoing and pipeline program to promote a sustainable growth model for Peru and builds on the Bank's longstanding policy dialogue in these areas.

C. Proposed Development Objective(s)

The Program Development Objective is to support Government reforms to (i) strengthen fiscal resilience and efficiency, (ii) foster a more inclusive and competitive financial sector, and (iii) promote greener production.

Key Results

Examples of expected results include:

- A more sustainable fiscal deficit
- Higher impact and more efficient investments in regional infrastructure
- PPP projects in the National Infrastructure Plan for Sustainability and Competitiveness have been prioritized and awarded following the climate-informed environmental sustainability criteria
- Increased number of men and women with an account at a financial institution or mobile money provider
- Increased registration and confirmation of electronic invoices, to facilitate financing for small and medium enterprises through factoring
- Clean production agreements signed between industrial firms and the government
- Degraded public land mapped and validated for the development of commercial forest plantations
- Increased number of farmers that receive technical assistance about climate smart and productivity enhancing agriculture practices

D. Project Description

The proposed stand-alone Sustainable Growth and Finance Development Policy Financing with a Deferred Drawdown Option (DPF-DDO) for US$500 million is composed of three pillars. As part of the World Bank Group's broader program of support to Peru, it has benefited from close coordination with development partners, and the operation has been prepared under the overall guidance of the Ministry of Economy and Finance. Some of the prior actions supported by this program are informed by long-standing technical assistance by the Bank and other international partners.

The first pillar of the operation supports reforms that strengthen fiscal resilience and efficiency. Fiscal resilience and efficiency at the national and subnational levels are required to fund public infrastructure and service delivery throughout the country, while providing adequate fiscal buffers to respond to future shocks, including climate-induced natural disasters. More efficient leveraging of public and private financing for infrastructure is needed to fund public low-carbon and climate resilient infrastructure and close Peru's large gaps in infrastructure. This pillar includes policy actions to: (i) approve a viable fiscal rule for 2023-2026 that allows the country to have solid public finances to respond to climate-induced shocks; (ii) increase the impact of subnational investments, and improve the efficiency of public investment in infrastructure by expanding the sources of funding and types of investments that are eligible for private financing and execution under the "Works for Taxes" modality; and (iii) foster low-carbon and climate resilient infrastructure projects through public-private partnerships.

The second pillar of the operation supports reforms to foster a more inclusive and competitive financial sector. A more competitive and inclusive financial sector expands access to finance for underserved households and makes it easier for firms to access funding for green and growth-enhancing investments. The pillar includes policy actions to: (i) improve financial inclusion and promote competition in the financial system by enabling the market entry of 100 percent digital financial service providers, implementing a simplified and risk-based framework for credit-only providers, and improving competition in the cash transportation sector; and (ii) improve firms' access to finance by establishing a regulatory framework and registry for the confirmation of electronic invoices to facilitate factoring.

The third pillar of the operation supports reforms to promote greener production, including in industry, forestry, and agriculture, which together represent the bulk of the country's emissions. Greener production is essential for the industry, forestry, and agriculture sectors to remain competitive, reduce emissions, and become more resilient to observed and anticipated climate change impacts. The pillar includes policy actions to: (i) incentivize clean industrial production by regulating the formulation, subscription, and execution of clean production agreements between manufacturing firms and the Ministry of Production; (ii) develop a sustainable forest industry through commercial forest plantations; and (iii) promote climate-smart agriculture by strengthening the agricultural extension system and regulating land use classifications to avoid deforestation from agriculture.

E. Implementation

Institutional and Implementation Arrangements

As the implementing entity, the Ministry of Economy and Finance (MEF) is responsible for monitoring information related to program implementation and progress towards the achievement of the results indicators. The MEF is further responsible for coordinating necessary actions among the other agencies involved in the reform program, which include the Ministry of Environment (MINAM), National Forest and Wildlife Service (SERFOR), Ministry of Production (PRODUCE), Ministry of Agrarian Development and Irrigation (MIDAGRI), National Superintendency of Customs and Tax Administration (SUNAT), and others. The World Bank has worked closely with MEF and relevant sectoral entities to define results indicators that are clear and measurable and have realistic targets. The Bank will focus on monitoring progress towards the expected results, including through ongoing policy dialogue, the preparation of any subsequent operations, and related technical assistance activities.

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

Poverty and Social Impacts

This program is expected to have positive impacts on poverty reduction through the promotion of sustainable and efficient expenditures and fostering competitiveness and green growth. The reforms under the first pillar, aimed at supporting fiscal consolidation and better leveraging public and private financing to close Peru's large gaps in infrastructure, are expected to have positive economic and social impacts through macroeconomic stability and reducing income volatility. Prior actions in the second pillar aiming at fostering a more inclusive and competitive financial sector are expected to have both direct and indirect positive impacts on poverty reduction efforts. For example, increasing competition in the financial sector and allowing new entrants into the market are expected to reduce prices of financial service and expand the use of these services, particularly for women and the rural population. As of 2021, 58 percent of adults had a bank account while 22 percent borrowed from a financial institution. The gender financing gap in Peru is estimated at US$ 500 million, with 11 percent of women-owned smaller enterprises facing financing constraints.

Policies corresponding to the third pillar seeking to promote greener production are expected to have welfare-enhancing direct and indirect effects. Prior actions in this pillar are expected to reduce pollution, mitigate climate change risks, and spur a sustainable and socially inclusive commercial forest plantation industry. The promotion of climate-smart agriculture through the agricultural extension system is expected to have positive economic and social effects among Peru's 2.2 million farmers by means of higher productivity and climate resilience.

Environmental, Forests, and Other Natural Resource Aspects

The prior actions supported by this operation are not expected to have any significant negative effects on the country's environment, forests and other natural resources. Rather, several prior actions are expected to have positive environmental effects, including through environmentally sustainable PPP projects, cleaner industrial production, reforestation through commercial forest plantations, climate-smart agriculture extension services, and updated land use regulations to prevent deforestation. Even though the implementation of two prior actions—on PPPs and forestry—have the potential to lead to negative environmental effects, the national legal framework incorporates the necessary mitigation measures for their adequate management.

G. Risks and Mitigation

The overall risk rating for the proposed operation is assessed as Substantial. The substantial risks identified include: (i) political and governance and (ii) institutional capacity for implementation and sustainability. *Political and Governance risk*: Over the past years, there has been a frequent turnover of high-level government officials at both the executive and ministerial levels. There is a risk of future turnover leading to slower implementation of reforms, and/or a lack of continuity of government programs due to shifts in priorities. The mitigation measures put in place for the operation include: (i) ensuring a high-level of commitment of the administration to the proposed reforms; and (ii) closely monitoring potential political and governance risks related to the operation throughout implementation. Since political turnover cannot be foreseen or fully mitigated, its impact on achieving the operation's development outcome is considered Substantial (residual risk). *Institutional Capacity for Implementation and Sustainability* risk is rated substantial, particularly as the operation involves multiple agencies. To succeed, some of the proposed reforms will require coordination among line ministries and with regional and local governments. Coordination between agencies in Peru is weak, and consensus building usually takes time which could lead to delays in implementation. To mitigate these risks, the operation is largely focusing on supporting reforms benefiting from long-standing policy dialogue and technical assistance by the World Bank and other donors.

CONTACT POINT

World Bank

Bledi Celiku, Daniel Francisco Barco Rondan, Thomas Edward Haven
Senior Economist

Borrower/Client/Recipient

Republic of Peru

Implementing Agencies

Ministry of Economy and Finance
Valentín Cobeñas
Director de la Dirección de Créditos de la Dirección General
vcobenas@mef.gob.pe

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leader(s):	Bledi Celiku, Daniel Francisco Barco Rondan, Thomas Edward Haven

Approved By

Country Director:	Pilar Maisterra	28-Sep-2022