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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A

PROPOSED LOAN

IN THE AMOUNT OF US$750 MILLION

REPUBLIC OF PERU
FOR THE

Peru Sustainable Growth and Finance DPF-DDO

November 16, 2022

Macroeconomics, Trade and Investment Global Practice
Finance, Competitiveness and Innovation Global Practice
Latin America And Caribbean Region

Republic of Peru

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of November 16, 2022)

Currency Unit

Peruvian Soles (PEN) 3.84 = US$1.00

ABBREVIATIONS AND ACRONYMS

AM	Accountability Mechanism	MAPS	Methodology of Assessing Procurement Systems
ASA	Advisory Services and Analytics	MEF	Ministry of Economy and Finance
BCRP	Central Reserve Bank of Peru	MIDAGRI	Ministry of Agrarian Development and Irrigation
CAF	Development Bank of Latin America	MINAM	Ministry of Environment
CCDR	Country Climate and Development Report	MMM	Multi-year Macroeconomic Framework
CGR	National Comptroller's Office	MSMEs	Micro, Small and Medium Enterprises
CIT	Cash-in-transit	NDC	Nationally Determined Contributions
CO2	Carbon Dioxide	NIPC	National Infrastructure Plan for Competitiveness
COVID-19	Coronavirus disease that emerged in 2019	NIPSC	National Plan for Competitiveness
CPF	Country Partnership Framework	NPL	Non-Performing Loan
CPI	Consumer Price Index	OECD	Organization for Economic Co-operation and Development
DDO	Deferred Drawdown Option	PA	Prior Action
NI	National Identity Card	PDO	Program Development Objective
DPF	Development Policy Financing	PEDN	Strategic Plan for National Development
ENAHO	National Household Survey	PER	Public Expenditure Review
ETCAN	Empresa de Transporte, Custodia y Administración de Numerario	PFM	Public Financial Management
FCL	Flexible Credit Line	PMO	Project Management Offices
FOCAM	Fondo de Desarrollo Socioeconómico de Camisea	PNIF	National Financial Inclusion Policy
FONCOMUN	Municipal Compensation Fund	PPG	Public and Publicly-Guaranteed
FONCOR	Regional Compensation Fund	PPP	Public Private Partnerships
FOREX	Foreign Exchange	PROINNOVATE	National Program for Technology Development and Innovation

FSAP	Financial Sector Assessment Program
GBD	Global Burden of Diseases
GCRF	Global Crisis Response Framework
GDP	Gross Domestic Product
GHG	Greenhouse Gases
GIZ	German Agency for International Cooperation
GoP	Government of Peru
GRID	Green Resilient and Inclusive Development
GRS	Grievance Redress Service
HLO	High-level Objectives
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
ILO	International Labour Organization
IMF	International Monetary Fund
IMIAP	Informe Multianual de Inversiones en Asociaciones Publico
INIA	National Institute of Agrarian Innovation
IOARR	Investments for Optimization, Marginal Expansion, Rehabilitation and Replacement
IPF	Investment Project Financing
IPSAS	International Public Sector Accounting Standards
J-CAP	Joint Capital Market Program
LAC	Latin America and the Caribbean
REDD+	Reducing Emissions from Deforestation and Forest Degradation Plus
RENIEC	National Registry of Identification and Civil Status
REPO-AFP	Scheme for Rescheduling the Payment of Social Security Contributions of the Pension Funds
RII	Regional Impact Investments
ROA	Return on Assets
SBS	Banking and Insurance Supervisor
SCD	Systematic Country Diagnostic
SDR	Special Drawing Rights
SEACE	Electronic Procurement System
SECO	Swiss State Secretariat for Economic Affairs
SERFOR	National Forest and Wildlife Service
SIAF	Integrated Financial Management System
SIDEA	Scheme for the repayment of debts with other public entities
SME	Small and Medium-sized Enterprises
SUNAT	National Superintendency of Customs and Tax Administration
UIT	Taxable Units
ULE	Local Enrollment Units
UNFCCC	United Nations Framework Convention on Climate Change
USAID	United States Agency for International Development
WB	World Bank
WBG	World Bank Group

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REPUBLIC OF PERU

PERU SUSTAINABLE GROWTH AND FINANCE DPF-DDO

TABLE OF CONTENTS

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic
P178591	No

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

Organizations

Borrower:	REPUBLIC OF PERU
Implementing Agency:	Ministry of Economy and Finance

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**750.00**

DETAILS

International Bank for Reconstruction and Development (IBRD)	750.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

Substantial

Results

Indicator Name	Baseline	Target
Pillar A: Strengthen fiscal resilience and efficiency		
Results Indicator 1: Fiscal deficit (% GDP)	2.6% (2021)	2% (2024)
Results Indicator 2A: Percentage of FONCOR committed to finance Regional Impact Investments	0% (2022)	45% (2024)
Results Indicator 2B: Increase in financing provided by private companies for public investments at the subnational level through the modality of Works for Taxes (percent)	0 % (2019)	80 % (2024)
Results Indicator 3: PPP projects that are included in the National Infrastructure Plan for Competitiveness (NIPC) are prioritized and awarded following the climate informed environmental sustainability criteria	No (2022)	Yes (2024)
Pillar B: Foster a more inclusive and competitive financial sector		
Results Indicator 4a: Percentage of adults with an account at a financial institution or mobile money provider	57% (2021)	65% (2024)
Results Indicator 4b: Gender gap in percentage of adults with an account at a financial institution or mobile money provider (percentage points)	9 (2021)	4 (2024)
Results Indicator 5: Registry for the confirmation of electronic invoices is operational	No (2021)	Yes (2024)
Pillar C: Promote greener production		
Results Indicator 6: Number of clean production agreements signed	0 (2021)	7 (2024)
Results Indicator 7: Area of degraded public land mapped and validated by SERFOR for the development of commercial forest plantations (hectares)	0 (2022)	800,000 (2024)
Results Indicator 8: Increase in farmers that receive technical assistance about climate smart and productivity enhancing agriculture practices (percent)	0% (2019)	34% (2024)

IBRD PROGRAM DOCUMENT FOR A PROPOSED LOAN TO THE REPUBLIC OF PERU

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Sustainable Growth and Finance Development Policy Financing with a Deferred Drawdown Option (DPF-DDO) for US$750 million** seeks to support the Government of Peru (GoP)'s reforms to (i) strengthen fiscal resilience and efficiency, (ii) foster a more inclusive and competitive financial sector, and (iii) promote greener production.[1] The proposed operation is aligned with the forthcoming Peru Country Partnership Framework (CPF) FY23–FY27 and the Performance and Learning Review FY17-FY21. The proposed operation is aligned with the three High Level Outcomes (HLOs) that are presented in the forthcoming CPF and the recently completed Systematic Country Diagnostic (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). 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.

2. **Following over a decade of fast economic growth and significant progress in reducing poverty, GDP growth and poverty reduction in Peru slowed markedly after the end of the commodity boom (Box 1).** Driven by its comparative advantage in commodities coupled with solid macroeconomic management and well-targeted programs, Peru experienced inclusive growth in the 2004-2013 period. Economic growth averaged 6.4 percent annually, while 1 million people escaped poverty every year. In the years prior to the pandemic (2013-2019), average growth rates declined to half of the previous decade as productivity and job growth slowed, and poverty reduction slowed down significantly. 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.[2]

3. **Climate risk and natural hazards, expose Peru to severe economic and welfare losses and threaten Peru's development path.** The country already suffers earthquakes, landslides, droughts, and floods, which together cause average annual asset losses of 2 percent of GDP and welfare losses equivalent to 5.2 percent of GDP. It is the world's third largest fish producer and has become a leading exporter of fruits and vegetables, and these sectors are particularly vulnerable to climate change impacts. Water supply from glacier melts is likely to reduce significantly as early as 2030, and the increased frequency of droughts, floods, frost, and cold waves will heavily impact the agriculture sector. In addition, natural disasters and extreme weather events, negatively affect the tax and productive structure of the economy. Building resilience in public finances is critical to allow for timely and efficient policy responses in the wake of climate shocks, mitigating social and economic costs. The negative impacts of climate change on agriculture will affect the poor disproportionately, since the sector provides employment to the majority (56 percent) of employed household heads living in poverty.

4. **While the COVID-19 pandemic led Peru to have one of the deepest recessions in Latin America, the economy rebounded in 2021 recovering pre-pandemic levels.** GDP contracted 11.1 percent in 2020, one of the highest drops among

[1] The use of "greener" in pillar C refers to low carbon and climate resilient.

[2] The country has been governed by 5 different presidents in the last six years. In addition, Congress was dissolved in 2019 and it was necessary to elect a new one in 2020 to end the government period that lasted until July 2021. In the last decade, increasing fragmentation has made it difficult to reach consensus on policies and implementing difficult reforms.

the major economies of Latin America. The national poverty rate increased 10 percentage points, reaching 30.1 percent in 2020.[3] The COVID-19 pandemic also had a devastating impact on lives and livelihoods, as Peruvian families experienced one of the largest employment and income losses in the region. The GoP actively responded to the COVID-19 pandemic through a package of policies aimed at addressing the health emergency and providing economic relief to vulnerable firms and households.[4] Vaccines have been readily available and by June 2022 around 27.5 million people (84 percent of the target population) were fully vaccinated, and 18.1 million people (64 percent of the target population) had received three doses. The economy grew 13.3 percent in 2021, yet the labor market recovery has been uneven.[5]

5. **The country has embarked on a path to economic recovery, with growth and social inclusion and equity at the center of its policy agenda.** The GoP's program has a strong emphasis on supporting vulnerable populations, overcoming social exclusion, and promoting equity across regions, particularly in Peru's lagging regions and rural areas. The Ministry of Economy and Finance (MEF) presented the "Impulse Peru" Plan with measures that seek to promote economic growth in September 2022. The Plan includes a set of 36 measures to unlock private investment and streamline public investment. The measures also include support to the vulnerable population, such as the distribution of a one-time cash transfer and subsidies for LPG for domestic use, the electricity rate and urban transport. The Bank is supporting the government's efforts to enhance social inclusion through a series of proposed policy and investment lending, including pipeline operations to support basic service delivery improvements and productive development in rural areas, social protection, and economic inclusion.

6. **The proposed DPF-DDO supports the government's reform agenda for sustainable growth, provides a buffer against shocks, and builds on longstanding policy dialogue.** The proposed operation supports critical reforms to strengthen fiscal resilience and efficiency, foster a more inclusive and competitive financial sector, and promote greener production. It builds on a string of successful DPOs in the country that have helped Peru weather key crises, including the impact of "*El Niño Costero*" in 2017 and the COVID-19 pandemic in 2020-2021. The financial buffers offered by DDOs were instrumental during the pandemic in allowing the rapid deployment of social transfers. In the context of high uncertainty and financial market volatility, the authorities also see the DPF-DDO as an important hedge against increasing global interest rates and international capital markets volatility. The reform agenda supported by this DPF-DDO prioritizes policy actions with political consensus for their implementation. The agenda also: (i) benefited from previous Advisory Services and Analytics (ASA), which enabled the identification of key policy bottlenecks that need to be addressed, (ii) is well aligned with the administration's sustainable growth efforts, and (iii) has synergies with the World Bank's program in Peru, such as *Enabling a Green and Resilient Development DPF (EGRD, P177765), Investing in Human Capital DPF II (P176387),* and *Strengthening Foundations for Post COVID-19 Recovery DPF (P174440)* (see paragraph 65 for more details), as well as synergies with support provided by development partners such as IMF, Inter-American Development Bank (IADB), Development Bank of Latin America (CAF), United States Agency for International Development (USAID), the Swiss State Secretariat for Economic Affairs (SECO), and GIZ.

7. **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

[3] Poverty is estimated to have declined to 25.9 percent in 2021, however still above pre-pandemic levels, hampered by the lower quality of employment. Despite the rebound in economic activity, the poverty rate is still closer to the levels observed one decade ago.

[4] According to the World Bank simulations, in the absence of emergency social transfers, the poverty rate would have risen by an additional 4pp in 2020. Similarly, *Reactiva Peru Program* helped to avoid a deeper economic contraction, *BCRP, Moneda No. 184, December 2020.*

[5] As of end-2021, employment levels have almost returned to the pre-crisis levels. However, this was largely driven by low quality jobs in the informal sector. In fact, formal employment in urban areas is still more than 20 percent below pre-pandemic levels. Lower quality of employment has led to a reduction of household income, and by the end of the year, the average wage was still 13 percent below that registered in 2019.

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 sustainable public finances, including 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 Public-Private Partnership (PPP) projects.

8. **The second pillar of the operation supports reforms to foster a more inclusive and competitive financial sector.** A more inclusive and competitive financial sector expands access to finance for underserved households and makes it easier for firms of all sizes 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.

9. **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.

10. **This operation is aligned with the Green, Resilient and Inclusive Development (GRID) framework and the Global Crisis Response Framework (GCRF).** It promotes green growth through more impactful and efficient public investment at national and subnational levels, climate informed PPP projects, cleaner production, and promotion of commercial forest plantations. The operation supports inclusive development by improving financial inclusion and strengthening the agricultural extension system. Finally, the operation supports a resilient development by providing adequate fiscal buffers to respond to future shocks, including climate-induced natural disasters. Under the GCRF, the operation is especially aligned with the "Strengthening Resilience" and "Strengthening Policies, Institutions, and Investments for Rebuilding Better" pillars (see paragraph 29 for more detail).

Box 1: Peru's challenges and opportunities to accelerating economic growth

Between 2002 and 2019, Peru grew at an annual 5.1 percent rate on average, well above the 2.7 percent average in Latin America. During this period, GDP per capita as a percentage of that of US went from 12.7 percent to 20.5 percent, recovering part of the losses occurred during the 70s and 80s. General economic progress coupled with well targeted social programs translated into significant poverty reduction, which went from 52.5 percent in 2005 to 20.6 percent in 2019. Particularly, between 2002 and 2013, GDP growth was stellar, averaging 6.1 percent annually, driven by good economic reforms and favorable external conditions. Peru's macro-fiscal reforms initiated during the 90s were consolidated in the 2000s, improving macroeconomic stability, strengthening trade openness, and enhancing investor confidence. Capital accumulation, mainly linked to the mining sector, was the main source of growth during this period, representing 60 percent of total growth between 2002 and 2013. The export-oriented growth model also spurred the development of modern agriculture, which was benefitted by the conjunction of trade agreements, new irrigation infrastructure, a more flexible labor regime and good prices. In this context, agricultural exports increased in value from $758 million in 2000 to more than $8.8 billion in 2021, growing at an average annual rate of 12.4 percent.

Economic growth more than halved between 2014 and 2019, to 3.0 percent, reflecting a less benign external environment, characterized by lower commodity prices and higher volatility in global financial markets. On the other hand, the impact generated by previous reforms vastly diminished. The less favorable external environment during this period also brought to light the more profound structural challenges of Peru's growth model. As identified in Peru's SCD Update (2022), productivity continues to be low, attenuating economic growth. More than 70 percent of labor is either self-employed or working in firms with 10 employees or less, with an estimated labor productivity that is just around 10 percent that of firms with more than 50 workers. Also, territorial disparities are sizable, and exports are highly concentrated in mining and other extractive activities, rendering the economy vulnerable to terms of trade shocks and climate change impacts. The limited progress in addressing these challenges is correlated with the weak capacity of public institutions. Institutional instability has substantially increased since 2016, further weakening the capacity of the state to design and implement needed reforms and deliver quality services across the territory. In this challenging context, Peru needs to look for new drivers of growth for the following decades. One of the sectors with more potential is forestry. According to the Peru CCDR (forthcoming), investing $6 billion dollars between 2023 and 2050 in forest landscape interventions could create close to 85,000 jobs a year over the same period, multiply the sector's contribution to the economy seven-fold, and raise its contribution to GDP from 1.9 percent in 2023 to 5.5 percent in 2050. More broadly, accelerating long-term economic growth requires improving connecting infrastructure and public services, raising human capital, and streamlining rigidities in markets for factors and products. Accomplishing these goals requires increasing State capacity to regulate and enforce the law effectively, provide quality services, and cope with diverse shocks.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

11. **After decades of strong growth, fueled by the commodity super cycle, Peru's growth decelerated to an average of 3.1 percent per year from 2014 to 2019.** Between 2002 and 2013, Peru's real Gross Domestic Product (GDP) grew at an average rate of 6.1 percent, far exceeding the Latin America and Caribbean's (LAC) 3.4 percent growth rate. High growth rates enabled Peru to double its per capita income and reach upper-middle-income status in 2008. Macroeconomic stability, coupled with open financial and capital markets and a sustained trade liberalization policy, amid a favorable external environment for commodity exporters, were the key factors behind Peru's success. The prolonged period of high growth was equitable and conducive to poverty reduction. Poverty fell from 59 percent in 2004 to 21 percent in 2019, and inequality fell substantially. The Gini index declined from 0.50 to 0.44 over that period, and the middle class expanded from 15 to 34 percent of the population. However, growth slowed down significantly after 2014, hampered by worsening terms of trade, the severe El Niño weather event in 2017, and spillovers of the *"Lava Jato"* corruption investigation.

12. **Economic activity was halted in late March 2020 when the COVID-19 pandemic led to a national lockdown, harsher than in other LAC countries.** Real GDP fell by 11.0 percent in 2020 as strict and prolonged quarantine measures and supply-side constraints led to a collapse in production, including in the mining and labor-intensive services sector. This was exacerbated by weak state capacity, especially in the health sector, low digitalization, and limited teleworking opportunities. Total employment fell 40.1 percent (7.1 million workers) by June 2020, while earnings and hours worked declined substantially for those who remained employed.

13. **Output bounced back to its pre-pandemic level in 2021, but the labor market has not yet completed the recovery and real wages remain below the 2019 level.** GDP grew 13.5 percent in 2021, driven by the easing of mobility restrictions, an accelerated execution of public works, and the resumption of private investment projects. The rebound in economic activity was reflected in all spending accounts, with a higher intensity in public and private domestic spending.

GDP grew by 3.5 percent y-o-y in the first half of 2022, led by higher activity in manufacturing, construction, and services, and supported by considerable fewer restrictions than the previous year's first semester. However, the labor market recovery has been slow. Real wages are still 12 percent below their 2019 level and the average quality of jobs is lower, with underemployment and informality rates higher by 4 p.p. compared to their pre-pandemic levels.

14. **The current account deficit increased in 2021, mainly reflecting increased profits by foreign mining companies.** Although the trade balance recorded a record surplus, the current account marked a 2.3 percent deficit in 2021, interrupting the previous decreasing trend. On the external side, the deficit reflected the effect of higher commodity prices on foreign mining firms' profits and their impact on income payments abroad. On the domestic side, it reflected the recovery of domestic demand, in particular consumption and investment, generating higher demand of foreign capital. The external deficit has been completely financed with long-term capitals that have met the public and private sector financial requirements. Long -term capital income also partially compensated for a short -term capitals exit greater than 7 percent of GDP. In this context, international reserves climbed to US$78.5 billion by the end of 2021, equivalent to 35 percent of GDP and more than eight times its short-term external debt. To further shield the economy against external risks, in May 2020, Peru was granted access to a Flexible Credit Line (FCL) with the International Monetary Fund (IMF) for about US$11 billion, which expired after two years.[6] In May 2022, a new FCL for an amount of US$5.4 billion was granted, for an additional two years.

15. **Inflation accelerated since mid-2021, mainly reflecting the global rise in commodity prices and the domestic demand stimulus to support the recovery after the COVID-19 crisis.** Between 2015 and 2020 inflation averaged 2.3 percent backed by independent and prudent monetary management. During 2020, expansionary monetary stimulus, in the form of interest rate reductions and unprecedented liquidity support, including under the *Reactiva Peru* Program, was effective in supporting private sector activity during the initial months of the pandemic. However, inflation picked up since June 2021. By September 2022, it reached 8.5 percent y-o-y, largely driven by the global increase in food and energy prices, and the domestic demand stimulus. In particular, prices of food have shown a strong upward trend this year, reaching an annual variation of 11.7 percent in September, mainly due to external factors, such as the war in Ukraine, weather events that have affected harvests worldwide, and difficulties in global transport. Rising prices led to higher food insecurity among the poor, as they spend on it a higher percentage of their budget. To curb inflation, the Central Bank tightened its monetary policy by elevating the reference policy rate by 675 basis points since August 2021, to 7.0 percent currently. To counteract food insecurity, the Government launched a one-time cash transfer to be distributed by end-2022. The local currency appreciated almost 10 percent in the last twelve months to September, mainly due to the anti-inflationary response of the Central Bank. In addition, although the perception of political risk remains high, it is somewhat lower than a year ago.

16. **Fiscal policy stabilized quickly, after the sizable response that was implemented in the wake of the COVID-19 crisis.** In response to the pandemic, the GoP implemented a countercyclical response ascending to 22 percent of GDP.[7] Revenues sharply declined, and the Non-Financial Public Sector deficit increased to 8.9 percent of GDP in 2020.[8] The fiscal

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[6] FCL is a contingent financing to prevent the effects of crunches in balance of payment flows. The authorities' intention is to treat the arrangement as precautionary.

[7] The response included the provision of liquidity to enterprises through guaranteed loans, fiscal transfers to vulnerable population groups and firms, increased expenditures on goods and services, and relaxing access to unemployment and private retirement accounts.

[8] By Legislative Decree 1276 of December 2016, the fiscal rules were defined as a limit of 1 percent of GDP for the public deficit and a ceiling of 30 percent of GDP for public debt. Compliance with fiscal rules was suspended in 2020-2021 by Legislative Decree 1457. Subsequently, fiscal rules were established just for 2022 at 3.7 percent for the fiscal deficit and a public debt ceiling of 38 percent of GDP, by DU (emergency decree) 079-2021. In August 2022, Law 31541 established the new fiscal deficit rules for the years 2023, 2024, 2025 and 2026 at 2.4 percent, 2.0 percent, 1.5 percent and

deficit narrowed sharply to 2.6 percent of GDP in 2021, mainly driven by a 40 percent real increase in public revenues. Increased revenues were the result of higher tax collection from mining companies, the prepayment of some tax fines, and some administrative measures, such as the adoption of the electronic invoicing. Public debt reached 36 percent of GDP in 2021, just slightly above its 2020 level. However, mainly due to the increased political uncertainty, Moody's and Fitch to downgrade Peru's sovereign risk rating for long-term external debt.[9] The Ministry of Finance (MEF) estimated that the maximum exposure of the Non-Financial Public Sector to explicit contingencies amounted to 12.0 percent of GDP by end 2021, with the expected materialization of 0.9 percent of GDP in 2022.[10] In addition, the government maintains explicit guarantees for 3.3 percent of GDP related to *Reactiva Peru* and other financing programs to face the COVID-19 crisis, with an expected total materialization of 0.6 percent of GDP.

17. **The financial sector has remained resilient to the impacts of the COVID-19 pandemic and credit provision has risen above pre-pandemic levels.** As of July 2022, capital adequacy levels (14.7 percent) remain well above minimum regulatory thresholds (8 percent) and liquidity stresses have not materialized. The non-performing loan (NPL) ratio in the banking sector is moderate at 3.8 percent; and the profitability of the sector is continuing to rebound though it remains below pre-pandemic levels, with a ROE at 17.5 percent as of July 2022. The credit growth rate was 6.3 percent y-o-y last August, with an expansion of 17.2 percent in personal credit. However, credit to companies grew only 0.9 percent y-o-y, which together with the persistently low business confidence suggest a slow performance of private investment. Recent stress testing exercises conducted by the banking supervisor (SBS) indicate that capital adequacy levels would remain above 12.5 percent through 2023, and that most financial institutions are well-placed to endure liquidity shocks. Finally, while the financial system as a whole has been resilient to the impacts of the COVID-19 pandemic, some smaller financial institutions face greater solvency stress in part due to their exposures to SMEs experiencing credit repayment challenges.

Table 1. Key Macroeconomic Indicators 2019-2025

	2019	2020	2021	2022P	2023P	2024P	2025P
Real economy	Annual percentage change, unless otherwise indicated						
GDP (nominal--local currency)	761,984	704,939	866,342	941,426	987,615	1,048,863	1,103,801
Real GDP	2.2	-11.0	13.4	2.7	2.6	2.6	2.6
Per Capita GDP (In US$ Atlas Method)	6,615	5,808	6,507	6,617	6,721	6,830	6,939
Contributions:							
Consumption	2.5	-5.2	8.6	2.4	2.1	2.1	2.0
Investment	0.1	-5.0	7.1	0.0	0.1	0.2	0.2
Net exports	-0.4	-0.7	-2.3	0.3	0.3	0.3	0.3
Imports	0.5	-4.3	6.6	1.3	1.2	1.2	1.2
Exports	0.1	-4.9	4.3	1.6	1.5	1.5	1.5
Unemployment rate (ILO definition)	3.3	5.1	4.5	4.0	3.8	3.8	3.8
GDP deflator	1.9	3.9	8.4	5.8	2.3	3.5	2.6
CPI (average)	2.1	1.8	4.0	7.4	4.3	2.5	2.3
Fiscal Accounts	Percent of GDP, unless otherwise indicated						
Expenditures	21.4	26.7	23.6	23.9	23.4	22.9	22.3
Revenues	19.8	17.8	21.0	21.8	21.0	21.0	20.8

1.0 percent, respectively. In addition, it established that public debt should not exceed 38 percent of GDP in the following ten years and 30 percent in subsequent years.

[9] Moody´s downgraded Peru´s risk rating from A3 to Baa1 in September 2021 and Fitch downgraded it from BBB+ to BBB in October 2021. Notwithstanding, Peru retains the investment grade and still possesses the second-highest rating in Latin America, behind Chile.

[10] The identified contingent liabilities included: i) judicial processes in national and international courts, and national arbitrations (7.1 percent of GDP), ii) international controversies in investment matters (3.2 percent of GDP), and iii) guarantees granted with the signing of Public-Private Partnerships contracts (1.8 percent of GDP). The government estimates that the expected realization of the explicit contingent liabilities would generate a higher public debt path of 1.4 p.p. of GDP on average during the period 2022-2030 with respect to the path of the base scenario.

Non-financial public sector balance	-1.6	-8.9	-2.5	-2.1	-2.4	-2.0	-1.5
PPG gross debt (eop)	26.8	34.7	35.9	35.2	35.9	35.8	35.6
Selected Monetary Accounts	Annual percentage change, unless otherwise indicated						
Base Money	2.8	31.2	12.3	2.5	2.0	2.0	2.0
Credit to non-government	7.1	11.0	4.4	4.5	5.0	5.3	5.3
Interest (key policy interest rate)	2.6	0.7	0.8	5.3	5.0	3.3	2.0
Balance of Payments	Percent of GDP, unless otherwise indicated						
Current Account Balance	-0.7	1.2	-2.3	-3.5	-2.5	-0.8	-0.2
Imports	22.2	20.4	25.6	27.1	26.4	25.2	24.8
Exports	23.7	22.3	28.8	28.7	26.8	26.9	27.1
Foreign Direct Investment	2.9	0.4	2.5	2.7	2.3	2.2	2.1
Gross Reserves (in million US$, eop)	68,370	74,909	78,539	80,521	82,123	83,540	83,540
In months of next years' imports	20.0	15.7	14.1	13.7	--	--	--
As % of short-term external debt	498.0	540.0	430.0	438.0	--	--	--
External Debt	34.8	44.3	45.2	41.5	40.0	37.5	34.9
Terms of Trade	-1.1	4.3	11.2	-7.3	-6.0	3.7	1.0
Exchange Rate (average)	3.3	3.5	3.9	3.8	3.7	3.7	3.7
Other memo items							
GDP nominal (in million US$)	228,404	201,408	223,212	247,744	266,923	283,477	298,325
Net Public Debt	12.9	22.2	21.8	--	--	--	--

Source: World Bank staff based on the Central Bank, Ministry of Finance and the IMF data.

Table 2. Balance of Payments Financing Requirements and Sources, 2016-2024 (USD million)

	2019	2020	2021	2022P	2023P	2024P	2025P
BOP financing requirements and Sources							
Financing requirements (US$)	**-9,710**	**-3,445**	**-8,740**	**-15,776**	**-13,856**	**-9,634**	**-7,789**
Current account deficit	-1,651	2,349	-5,216	-8,737	-6,726	-2,263	-629
Medium and long-term debt amortization	-8,059	-5,795	-3,524	-7,038	-7,129	-7,370	-7,160
Financing Sources (US$)	**9,710**	**3,445**	**8,740**	**15,776**	**13,856**	**9,634**	**7,789**
FDI and portfolio investments (net)	4,727	536	17,283	8,895	4,237	4,109	4,026
Capital grants	0	0	0	0	0	0	0
Medium and long-term debt disbursements (excl. IMF)	13,177	9,300	-4,913	8,863	11,220	6,942	4,956
Change in reserves (+ decrease)	-8,195	-6,391	-3,631	-1,982	-1,602	-1,417	-1,193

Source: World Bank staff based on the Central Bank's data.

Table 3. Key Fiscal Indicators for the Public Sector, 2019-2025 (% of GDP)

	2019	2020	2021	2022P	2023P	2024P	2025P
Overall Balance	-1.6	-8.9	-2.5	-2.1	-2.4	-2.0	-1.5
Primary balance	-0.2	-7.3	-1.0	-0.3	-0.5	-0.3	0.1
Total Revenues (and grants)	19.8	17.8	21.0	21.8	21.1	21.1	21.0
Tax revenues	14.7	13.3	16.3	17.0	16.4	16.4	16.4
Taxes on goods and services	6.9	6.3	7.7	7.6	7.5	7.5	7.5
Direct Taxes	5.7	5.3	6.3	6.7	6.6	6.6	6.6
Taxes on international trade	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other taxes	1.9	1.5	2.2	2.5	2.1	2.1	2.1
Non-tax revenues	2.7	2.3	2.6	2.7	2.6	2.6	2.5
Social insurance contributions	2.2	2.2	2.1	2.0	2.0	2.0	2.0
Capital revenues	0.2	0.1	0.1	0.1	0.1	0.1	0.1

Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditures	21.4	26.7	23.6	23.9	23.5	23.0	22.5
Current expenditures	16.9	22.2	18.5	18.8	18.4	18.0	17.4
Wages and compensation	6.3	7.4	6.2	6.3	6.3	6.3	6.3
Goods and services	5.8	7.0	6.8	6.8	6.8	6.8	6.8
Interest payments	1.4	1.6	1.5	1.8	1.9	1.7	1.6
Current transfers **	3.3	6.3	4.0	3.9	3.4	3.2	2.7
Capital expenditures	4.5	4.5	5.0	5.1	5.1	5.1	5.1
Capital investments	3.9	3.8	4.2	4.3	4.2	4.3	4.3
Capital transfers **	0.6	0.7	0.8	0.8	0.9	0.8	0.8
Non-Financial Public Sector Financing	1.6	8.9	2.5	2.1	2.4	2.0	1.5
External (net)	0.6	4.8	6.1	0.6	0.3	-0.1	-0.8
Domestic (net)	1.0	4.1	-3.6	1.5	2.1	2.1	2.3
of which: privatization	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: World Bank staff based on the Central Bank and Ministry of Finance data.
Notes : * Non-financial public sector. ** Current transfers include spending on pensions, social benefits and social programs. Capital transfers include deferred payments (APPs), capital contributions, expropriations, transfers to funds and advances for works.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

18. **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. Exports will be supported by the entry into operation of important copper mines, such as Quellaveco, Mina Justa and Toromocho enlargement. Capital spending on mining will continue to drive private investment, partially offsetting the effect of low business confidence. In addition, the recovery of high-quality jobs, more dependent on private investment, will be slow, limiting both workers' income and productivity gains. Over the medium term, output is expected to expand at an annual rate of around 2.6 percent. GDP growth would continue to be supported by higher exports, as the new mines reach their maximum production capability. Private spending would continue expanding slowly in a context of low business confidence, lower expected growth for trading partners and volatility in the price of energy. Expansion of public spending will be restricted by the fiscal consolidation mandated by fiscal rules. 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.

19. **The external deficit is expected to peak this year but should gradually decline afterwards.** In 2022, higher factor payments abroad and the recovery of imports will be only partially attenuated by the effect of favorable mineral prices on the value of exports. Over the medium term, the current account deficit is expected to decline, mainly due to higher exports and the normalization of mining companies' profits. Although copper prices are expected to place below those recorded in the first half of 2022, they are still expected to be considerably higher than those in 2015-2020, in the context of the energy transition. The deficits are expected to be financed by long-term capital, as in previous years. FDI is expected to continue financing the external deficit by the finalization of some projects (Toromocho expansion, Quellaveco) and the initiation of others (Corani, Magistral, Río Seco), in a context of relatively high mining profits. However, FDI might stay short of the levels of the previous commodity boom due to global risk factors and domestic political uncertainty.[11] Also,

[11] Newmont Corporation announced in September that it will postpone the US$ 2.5 billion investment in Yanacocha Sulfuros.

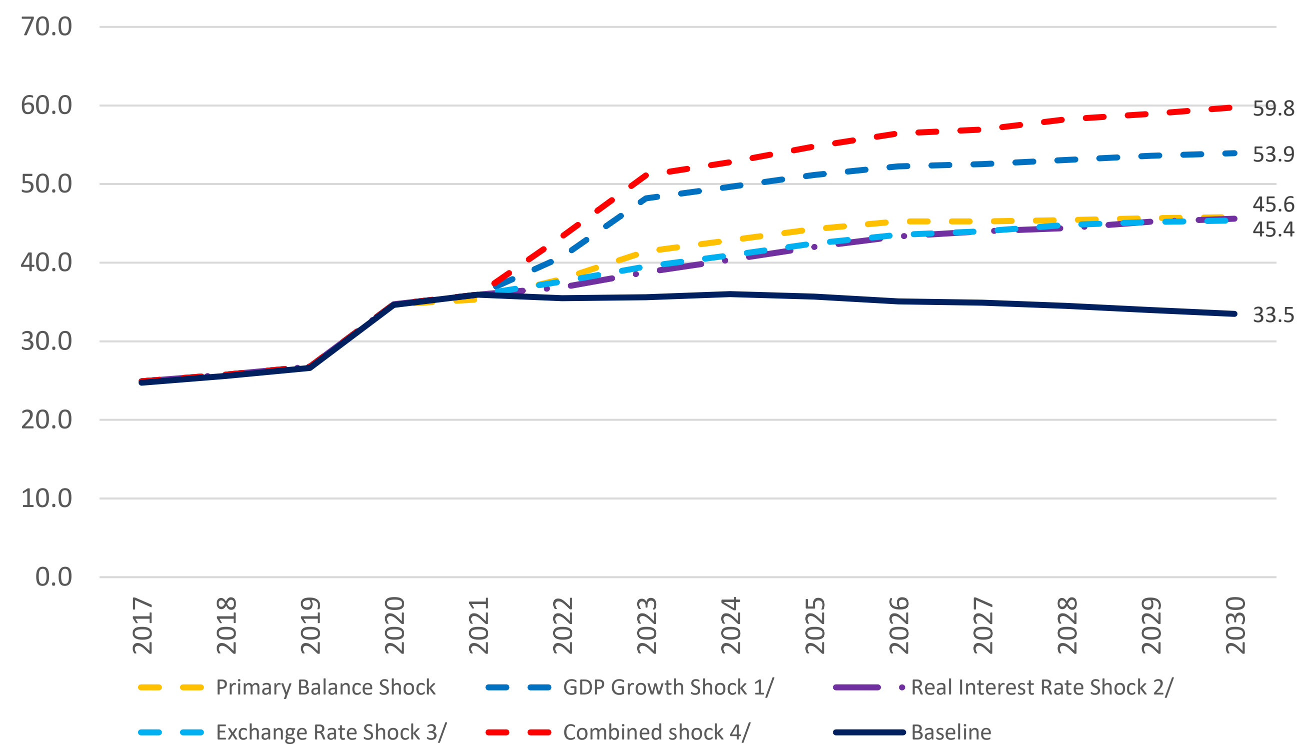
this uncertainty and higher international interest rates might trigger outflows of portfolio investments, exerting some pressure on international reserves and the exchange rate. Inflation is expected to gradually reverse to the target range by end 2023, as the driving factors are temporary.

20. **The fiscal deficit is projected to continue narrowing along the projection period, while public debt is expected to stabilize.** 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.[12] Tax revenues would be around 16 percent of GDP, supported by the entry into operation of new mines, elevated mineral prices (even after the recent correction), and the effect of administrative measures taken in recent years.[13] These factors will mainly increase collection of corporate taxes, but they will also have some positive effect on indirect taxes. Also, extraordinary spending linked to containing the effects of the pandemic and reducing the effects of the rise in food and energy prices will gradually dissipate. Thus, the subsidies and tax expenses associated with confronting the recent increase in inflation is estimated to amount to approximately 0.9 percent of GDP in 2022. Their withdrawal between 2023 and 2024 would support fiscal consolidation, reducing the pressure to cut other current or investment expenses. In line with a gradual reduction of the deficit, public debt is projected to remain stable in 2022-24, slightly below 36 percent of GDP. The GoP is committed to a declining path of the fiscal deficit, but there are also important demands for the provision of quality public services. Therefore, attaining the fiscal target of 1 percent of GDP deficit by 2026, as the GoP is currently foreseeing, may require additional measures on the revenue side.

21. **Peru's public sector debt is assessed to be sustainable and resilient to a range of different shocks.** The public debt-to-GDP ratio is likely to remain above the public debt ceiling of 30 percent of GDP throughout the projection period, mainly due to a large one-off increase in 2020.[14] Also, the debt-to-GDP ratio is expected to remain stable, around 36 percent of GDP until 2024, and is expected to decline gradually thereafter as the primary deficit falls below the debt-stabilizing primary deficit. Higher GDP growth than the 3 percent average expected for 2022-25 in our projections would prompt a faster decline of debt ratios. Public debt risks arise from a high share of public bonds held by non-residents (69.6 percent of total) and the currency composition (55.4 percent denominated in foreign currency), while the interest rate structure is favorable. Public debt remains at manageable levels under the standardized shocks, and it stays well below the 70 percent of GDP benchmark for emerging markets (Figure 1). The results of the debt sustainability analysis shock scenarios show that the authorities have sufficient buffers to accommodate a gradual fiscal consolidation path.

[12] Marco Macroeconómico Multianual 2023-2026 and Law No. 31541, approved on August 4th, 2022.
[13] Since 2017, The GoP took administrative measures to reduce tax evasion and avoidance, through the digitalization of the tax system, the adaptation of the Tax Code to the best international practices and the implementation of a non-compliance risk management model in Sunat. Thus, in 2021, new risk indicators were incorporated to refine the risk profile assigned to taxpayers and establish different treatments. Also, the overcrowding of the electronic invoicing culminated in June 2022 with the incorporation of the last group of micro and small enterprises (MYPE). The coverage of sales supported through electronic documents increased from 70.4 percent in 2018 to around 96 percent in June 2022. Regarding international taxation, the automatic exchange of information allowed that in 2021 Sunat receives the Country-by-Country Report of 24 countries, which contains tax information on the transactions carried out by taxpayers with their related parties abroad during the 2019 fiscal year.
[14] Law No. 31541 approved a change to the public debt ceiling to 38 percent of GDP until 2031.

Figure 1. Public Debt Sustainability



Source: World Bank staff calculations.

Notes: 1/Real GDP shock consists of a reduction of one standard deviation (5.2 percent) in GDP growth for two years. This also increases primary balance and the interest rate on debt. 2/Real interest rate shock consists of a permanent shock of an increase of 200 basis points in the interest rate paid on debt. 3/ Real exchange rate shock consists of a one-off depreciation of 19 percent leading to a real exchange depreciation of around 14 percent. 4/Combined shock consists in the worst scenario combining the size and duration of other shocks under 1/, 2/ and 3/.

22. The economic outlook is subject to significant uncertainty and some risks, but important mitigation factors exist. Domestic risks include higher inflation, low citizen confidence in national institutions and political uncertainty. If any of these risks materialize, it might imply higher uncertainty, increased fiscal tensions, and eventually social unrest. Therefore, they would directly affect the pace of recovery of the domestic economy. If higher inflation translates into a more aggressive monetary tightening by the Central bank, the pace of output recovery could also be compromised. Also, low citizen support for Congress and the Executive Branch could eventually translate into greater government spending, compromising fiscal objectives. An eventual misalignment of fiscal and monetary policies might also pose a risk to inflation reduction. Political volatility might continue introducing uncertainty around the future policy agenda, undermining business confidence and investment prospects. Also, some institutional setbacks are already materializing, generating higher rigidity in the labor market and affecting the functionality of the State. External risks include a further slowdown in global economic activity, commodity price declines, higher international food and energy prices, a faster than expected monetary tightening in the US, as well as higher frequency and intensity of climate-related disasters due to climate change. On the domestic side, the fiscal position remains a strong mitigating factor. Higher tax collection as a result of increasing mining extraction, higher commodity prices and administrative measures has provided Peru the fiscal space to rebuild its fiscal buffers, pursue countercyclical fiscal policy and support the economic recovery. However, in the event of adverse external shocks, further escalation of the pandemic, or disasters, international financial institutions financing in the form of budget support operations and contingent credit lines would play an important role. On the external side, increased exchange rate flexibility and large international reserves offer comfortable policy margin to withstand external shocks, given the country's modest dollarization ratio. Another positive development is that the ongoing global energy transition is expected to provide support to the long-term price of copper, Peru´s main export product. The financial sector entered the crisis well-capitalized but will require continued monitoring. While some small financial institutions could be affected by the slowness in the recovery of output and labor markets, leading to some consolidation in the sector, a systemic disruption is not expected. Recent stress testing exercises conducted by the banking supervisor (SBS) indicate that capital adequacy levels would remain above 13 percent through 2022, and that most financial institutions are well-placed to endure liquidity shocks. Also, capitalization ratios are considered adequate, and the banking supervisory agency is expected to continue closely monitoring the soundness of the banking system.

23. **Overall, Peru's macroeconomic policy framework is deemed adequate and sustainable over the medium term.** The macroeconomic policy mix is appropriate in the current circumstances. The central bank (BCRP) took an active stance in anchoring inflation expectations and curbing inflation by opportunely and gradually reducing its monetary policy flexibility. Thus, its reference interest rate went from -2 percent in mid-2021 to 2.1 percent in real terms by October 2022, around to its neutral rate. Also, the GoP has redefined the fiscal rules for the years 2023 to 2026, offering a guide for the pace of fiscal consolidation in the following years. In this context, the combination of extraordinary and permanent higher revenues of the GoP are allowing for a slow withdrawal of the extraordinary fiscal stimulus, while allowing for an inclusive fiscal consolidation. In line with the expected gradual reduction of the deficit, public debt is assessed to remain sustainable.

2.3. IMF RELATIONS

24. **The GoP maintains an ongoing dialogue and systematic engagement with the IMF on macroeconomic policy.** On May 28, 2020, the Executive Board of the International Monetary Fund (IMF) approved a two-year precautionary Flexible Credit Line (FCL)[15] arrangement for SDR 8.007 billion (about US$11 billion). On May 27, 2022, the IMF approved a successor two-year Flexible FCL, of about US$5.4 billion. On April 29, 2022, the IMF concluded its Article IV consultation with Peru. The IMF Board noted that Peru's very strong economic fundamentals and policy frameworks—anchored by a credible inflation targeting framework, a flexible exchange rate, effective financial sector supervision and regulation, and a solid medium-term fiscal framework—have allowed the authorities to deliver a comprehensive and timely response to the COVID-19 pandemic and promote growth. They also noted that the Peruvian economy remains exposed to elevated risks, including from renewed waves of the COVID-19 pandemic, slowing economic activity in key trade partner countries, the war in Ukraine, tighter global financial conditions, and political uncertainty. According to the IMF, a renewed structural reform agenda in the context of the OECD accession process will be critical to mitigate scarring from the pandemic and support a green and inclusive recovery. They stressed the importance of addressing informality in the labor market, especially among women. More effective public services and greater transparency, including through civil service reform and anti-corruption measures, as well as a stable and predictable legal and regulatory environment, will be key to these efforts. Steps will also be needed to reduce risks from climate change, ease the transition to a low-emission economy, and contribute to global mitigation efforts. The IMF and WB maintain close collaboration on macroeconomic and structural issues.

[15] Peru qualifies for the FCL by virtue of its very strong economic fundamentals and institutional policy frameworks, a track record of implementing very strong policies, and commitment to maintaining such policies.

3. GOVERNMENT PROGRAM

25. **The GoP recently updated its Strategic Plan for National Development (PEDN), which has a 2050 horizon.** The PEDN 2050 was approved through Supreme Decree No. 095-2022-PCM in July 2022. The plan's four national objectives are to: i) achieve the full development of people's capabilities without leaving anyone behind; ii) manage the territory in a sustainable manner to prevent and reduce risks and threats that affect people and their livelihoods, through the use of knowledge and communications, recognizing geographical and cultural diversity, in a context of climate change; iii) raise competitiveness and productivity levels with decent employment and based on the sustainable use of resources, human capital, use of science and technology, and digital transformation of the country; iv) guarantee a just, democratic, peaceful society and an effective State at the service of the people, based on dialogue, national agreement and strengthening of institutions. The proposed operation is aligned with priorities under all four of the plan's objectives. The proposed operation is also aligned with the Peru 2050 Vision, in particular three of its principles that seek: (i) the sustainable management of natural resources and putting in place measures to mitigate and adapt to climate change, (ii) sustainable development with dignified employment and in harmony with nature, and (ii) the development of a modern, efficient, transparent and decentralized state that guarantees a just and inclusive society without corruption and leaving no one behind.

26. **The proposed operation is also closely aligned with the National Competitiveness and Productivity Plan and the *Plan Impulso Peru.*** The National Competitiveness Plan was approved through decree N° 345-2018-EF in December 2018, and this operation supports reforms related to the following plan objectives: provide the country with quality economic and social infrastructure by improving public infrastructure planning (objective 1); promote mechanisms for local and external financing (objective 4); and support environmental sustainability in undertaking economic activities (objective 9). The *Plan Impulso Peru* was launched in September 2022 and aims to generate sustainable economic growth and employment generation, while supporting the most vulnerable and maintaining fiscal responsibility. This operation contributes to all three pillars of the plan, including 1) improving conditions for private investment; 2) accelerating public investment; and 3) recovery of confidence (for instance in agriculture and forestry).

27. **The operation is also closely aligned with Peru's commitments on climate change, including the recently updated Nationally Determined Contributions (NDCs).** In the latest update of the NDCs (December 2020), Peru committed to achieve an overall emissions reduction of 30 percent by 2030. It also committed to reduce current and future losses due to impacts of climate change related hazards and to benefit from the opportunities that climate change offers for sustainable and climate responsible development.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

28. **The Program Development Objective (PDO) of this operation is to support Government policies to (i) strengthen fiscal resilience and efficiency, (ii) foster a more inclusive and competitive financial sector, and (iii) promote greener production.** Pillar A supports reforms aimed at strengthening fiscal resilience to climate shocks, enhancing fiscal efficiency and better leveraging public and private financing to close Peru's large gaps in infrastructure. Pillar B supports reforms to build a more inclusive and competitive financial sector that expands access to finance for underserved households and

makes it easier for firms of all sizes to access funding for green and growth-enhancing investments. Pillar C reforms target greener and more sustainable production in industry, forestry, and agriculture, which is essential for those sectors to remain competitive while improving the country's resilience to climate change risks and vulnerabilities.

29. This operation is aligned with the WBG's Global Crisis Response Framework (GCRF), especially pillars 3-4 on "Strengthening Resilience" and "Strengthening Policies, Institutions, and Investments for Rebuilding Better". Prior actions 1-3 are aligned with GCRF Pillar 3 given their focus on macro-fiscal sustainability, and fiscal and climate resilience. Prior actions 4-8 are aligned with GCRF Pillar 4 (through green & sustainable growth) given the financial sector reforms for a more inclusive and competitive financial sector and key reforms on green and more sustainable production in industry, forestry, and agriculture.

30. This operation incorporates lessons learned from the Bank's previous engagements in Peru and other upper-middle-income countries. Three main lessons from prior DPFs are relevant and have been incorporated into the design of this operation:

- Strong analytical underpinnings provide the foundation for a well-designed operation. Critical Analytical and Advisory Services (ASAs) contributed to the design of this DPF and helped shape some of the prior actions.

- Strong links to other WBG technical assistance and investment operations are critical for the program's implementation. The operation is linked to areas where the Bank has ongoing or recent engagement, such as on financial sector/capital markets and agriculture innovation / extension.

- Strengthening governance and institutions and mainstreaming climate action in the development agenda of key sectors are long-term processes. The design of the operation takes this into account by supporting the foundational building blocks of improved institutional structures and regulations to promote low carbon and climate resilient growth.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar A: Strengthen fiscal resilience and efficiency

Pillar A of the operation supports more sustainable and efficient public spending through a medium-term fiscal framework, more efficient public and private investment in infrastructure and climate resilient PPPs. A more resilient fiscal performance at the national and subnational levels is required to fund public low-carbon and climate resilient infrastructure, while providing adequate fiscal buffers to respond to future shocks. More efficient leveraging of public and private financing, including enhanced climate resilience for infrastructure is needed to close Peru's large infrastructure gaps, benefitting firms and citizens across the country.

Prior Action 1: To support fiscal consolidation, the Borrower has approved caps for the non-financial public sector on total gross debt of 38 percent of GDP starting in fiscal year 2023 and 30 percent within 10 years, and on the annual deficit of 2.4 percent in 2023 to 1.0 percent in 2026, respectively, as evidenced by Law No. 31541 published in the Official Gazette on August 4th, 2022.

31. Rationale: For two decades, stable macro-fiscal management has underpinned Peru's steady economic growth and enabled it to face shocks, including the substantial climate change risks and natural hazards the country is exposed to.[16] To accommodate the large fiscal response, the authorities suspended the fiscal rules for 2020 and 2021. As the economy rebounds from the COVID-19 pandemic, a resumption of growth requires a credible medium-term macroeconomic framework that cements investor confidence and reduces uncertainty. In addition, Peru suffers from substantial climate change risks and natural hazards which also have significant fiscal impacts. Climate change risks and extreme events have direct and indirect impacts on fiscal accounts, generating a decrease in tax revenues and increasing public spending. A fast and efficient government response will mitigate the cascading effects of any climate shock and significantly reduce its economic and social costs. On the revenue side, climate change induced natural disasters and extreme weather events, which are already affecting Peru and are only expected to intensify in the future, will negatively affect the tax and productive structure of the country as a result of the lower economic dynamism associated with them. On the spending side, the increase in frequency and severity of climate induced disasters and extreme weather events will be accompanied with greater damage and post-disaster needs, as well as rehabilitation and reconstruction efforts and costs.[17] In the absence of adequate fiscal buffers, attending to the emergency could displace productive public spending, which may have negative implications in the potential growth of GDP (due to lower spending on education, health, among others). Hence, maintaining appropriate fiscal buffers is key to responding quickly and efficiently to climate change shocks.

32. Substance of the Prior Action: Law No. 31541 establishes that the annual fiscal deficit of the Non-Financial Public Sector must not exceed 2.4 percent of GDP for the fiscal year 2023, decreasing further to a maximum of 1.0 percent by 2026. The bill marks a return to a viable fiscal path and renews the Government of Peru's commitment to fiscal responsibility. The law is based on the analysis and publication of the Multiyear Macroeconomic Framework (MMM), which was published in August 2022. It contains the official multi-year macroeconomic projections (2023-2026) that are used to prepare the public sector budget bill for the fiscal year 2023. The framework is explicit about the need for adequate management of fiscal accounts and a multi-year approach to tackle climate change. In addition, it includes climate-driven disasters as an implicit contingent liability and quantifies both the economic and fiscal impact on the economy.

33. Expected results: The main result will be to stabilize debt and bring deficits back to a lower level, aiming at 2 percent by 2024 as measured by the results indicator, and subsequently to 1 percent by 2025-2026, thereby restoring Peru's ability to respond to shocks and maintain the kind of healthy macroeconomic management that investors favor. The decree, and the accompanying Multiyear Macroeconomic Framework show clear commitment towards fiscal consolidation and a sustainable debt path. This will in turn allow the country to have enough fiscal buffers to react in the face of future shocks, including climate-induced natural disasters, without compromising its macroeconomic stability, fiscal sustainability, and growth, and leading to long-term scarring effects which are likely to disproportionally affect the poor.

Prior Action 2: To improve the targeting, efficiency and scale of public investment in infrastructure, the Borrower has: (a) mandated an increase in the minimum percentage of FONCOR funds that Regional Governments are required to allocate to Regional Impact Investments from 35 percent in 2023 to 100 percent by 2027, as evidenced by Supreme Decree No 038-2022-EF, published in the Official Gazette on March 18, 2022; and (b) expanded the sources of funding and types of investments that are eligible for private financing and execution under the Works for Taxes modality, as evidenced by Legislative Decree No. 1534 published in the Official Gazette on March 19, 2022.

[16] Peru suffers earthquakes, landslides, droughts, and floods, which together cause average annual asset losses of 2 percent of GDP and welfare losses equivalent to 5.2 percent of GDP. The 2017 El Niño event caused US$6–9 billion in monetary losses, affected 1.7 million inhabitants, generated 370,000 new poor, and damaged or destroyed crops, roads, bridges, homes, schools, and health posts (IPCC 2022). These impacts are expected to intensify in the future.

[17] Considering that reconstruction usually demands greater public expenditure and for a relatively long period.

34. Rationale: Public investment is a key driver of economic growth in Peru. In 2021, 23 percent of total executed non-financial public expenditure corresponded to investment and other capital expenditures. Capital expenditures have increased during the last five years, from US$8.1 billion in 2016 to US$9.5 billion in 2021. Of this amount, US$3.6 billion was channeled through the national government (38 percent) and US$5.9 billion (62 percent) through regional and local governments. According to the National Infrastructure Plan for Competitiveness (2019), Peru has a gap in basic services and infrastructure of US$100 billion (S/. 363 billion soles) when compared to developed countries. Improving public investment at subnational level, and as a result, increasing levels of investment is key to closing this gap. The Bank has developed analysis that identified bottlenecks in Public Investment Project Execution in Peru (especially on infrastructure investment). The IADB, among other development partners, has also been supporting the GoP in improving public investment management. Subnational investment in infrastructure also has critical implication for local resilience to climate change. The National Adaptation Plan lists several risks such as changes in precipitation and changes in the patterns of El Niño/La Niña that could affect the availability and quality of water resources. Investments in water and sanitation infrastructure, including the proper operation and maintenance of the systems, are increasingly important to ensure access and quality of water and sanitation services.

35. The current predominance of small investment projects at the subnational level does not allow governments to take advantage of economies of scale in the administration and execution of projects and diminishes their impact. According to Peru's investment project bank, as of May 2021, 86 percent of viable projects had an investment amount of less than S/5 million (US$1.3 million), with 7 percent of these investment projects implemented by regional governments and 73 percent by local governments. The high number and small scale of the projects impairs the efficiency of their administration and makes their supervision very difficult. This inefficiency, together with the low quality of the technical files, contributes to the fact that many projects at the subnational level end up paralyzed. Currently, there are projects for a budget amount of US$5.1 billion paralyzed. Law 31069 of the year 2020 increased the total amount distributed for capital expenditures to regional governments through the Regional Compensation Fund (FONCOR), in such a way that by 2024 they amount to two percentage points of the value added tax rate (IGV).[18] With this, it was sought to provide resources to regional governments to execute projects of regional scope, also facilitating their supervision. The reform included in this prior action complements the previous law, assigning a minimum budgeted investment amount to projects financed through FONCOR and establishing that they must be used to close the infrastructure gaps defined as priorities.

36. Works for Taxes is a modality of public works created in 2008 to finance and execute public investment. Created as a mechanism to overcome the substantial delays in the public investment and the constraints in financing, Works for Taxes enables private companies, individually or in a consortium, to finance, execute, and maintain public investment projects covering up to 50 percent of their income tax liability in the following year[19]. It typically results in lower execution times vis-à-vis traditional public works. According to statistics from *Proinversión*, since the creation of the Works for Taxes mechanism until April 2022, US$1.7 billion have been committed to 465 projects involving 137 private companies and benefiting close to 21 million people. Despite these encouraging results, a 2022 World Bank Group and UNICEF note on Works for Taxes highlights that this mechanism has been underutilized relative to its potential.

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[18] Since its inception in 2002 and until 2021, FONCOR had only S/690 million (US$184 million) annually to be distributed among 25 regional governments. Resources are distributed proportionally among the regional governments according to a formula approved by the MEF. Criteria include population, unsatisfied basic needs, territorial extension, rural population, execution of investment spending, border location, and resources (canon) received from the exploitation of natural resources and customs revenues. In 2021, two percentage points of the collection of IGV represented about 120 percent of total capital expenditures of regional governments.

[19] A project could be financed through this modality in two ways: 1) choosing from the existing investment pipeline (projects that have been declared viable) prioritized by the public entity, or 2) a private firm presents a proposal. In the case of the latter, the public entity needs to validate the alignment of the proposal with national and local priorities, following which the firm is required to formulate the project in accordance with the Public Investment regulations.

37. Substance of the Prior Action: Supreme Decree No 038-2022-EF requires that FONCOR transfers to regional governments be better targeted toward larger and higher impact infrastructure and service delivery investments. The regulation mandates regional governments to increasingly use the resources from FONCOR in Regional Impact Investments (RII). RIIs are defined as those that can help close priority territorial gaps and have a minimum total investment amount of 2,400 UIT (taxable units, or *Unidad Impositiva Tributaria*), or close to US$3 million.[20] The regulation also eliminates a previous requirement that investments that are considered RII must have a scope of at least two or more provinces. According to the decree, by 2027, 100 percent of the funds should be used for RII projects that can help close infrastructure and service delivery gap in the beneficiary regions.

38. Legislative Decree No. 1534 modifies the legal framework of Works for Taxes by expanding its scope and sources of funding and allowing it to be used for rehabilitation or operations and maintenance rather than just new construction.[21] It modifies Article 2 of Law No. 29230 to include smaller activities known as Investments for Optimization, Marginal Expansion, Rehabilitation and Replacement (IOARRs) and Emergency IOARRs in the event of a state emergency. By allowing the government to quickly carry out IOARR investment projects to respond to an imminent danger or after a climate related disaster has occurred, this modification strengthens the government's overall Disaster Risk Management capacity. The decree also expanded the eligible source of funding for the Works for Taxes mechanism. Before this mechanism was only available to Regional and Local Governments that received revenue from canon,[22] royalties, and customs revenue received by the respective regional and/or local government. With the reform, regional and local governments can now use other sources of funding, including resources from funds such as the Regional Compensation Fund (FONCOR), Municipal Compensation Fund (FONCOMUN) and *Camisea* Socioeconomic Development Fund (FOCAM); resources from taxes received by the local government; resources directly collected; and ordinary resources for the execution of investment projects and IOARRs. On September 14, 2022, the Government issued Supreme Decree No. 210-2022-EF that regulates the implementation of this Legislative Decree, including i) mechanisms to ensure that projects are aligned with national and local priorities, ii) controls exercised by the *Contraloría General de la República* (CGR) during firm selection and project implementation, and iii) the participation of a supervisory firm to monitor the implementation progress and assess the quality upon project completion.[23]

39. Expected Results: The improved targeting of FONCOR is expected to result in larger and higher impact regional investments, reducing the atomization of projects at the regional level. It is also expected to help government better prepare for climate and disaster risks, by investing more in the prevention and response to flooding and other extreme

[20] RII were first defined in Supreme Decree 084-2021-EF of April 2021 as "investments that contribute to the closing of priority gaps based on a diagnosis of gaps with a territorial approach, whose total viable or approved investment amount at market prices is equal to or greater than 2,400 UIT, with a minimum scope of two provinces." It also mandated the use of FONCOR on those investments. However, this regulation could not be applied immediately because there were not enough projects with these characteristics. Supreme Decree 038-2022-EF redefines RII by taking out the previous restriction of having a minimum scope of two provinces and also provides for a gradual increase in the share of RII projects in the uses of FONCOR, up to 100 percent in 2027.

[21] Prior to enactment of the legislative decree, Works for Taxes could be used exclusively to execute investment projects in the framework of the National Public Investment System, now known as the National System of Multiannual Programming of Investments, Invierte.pe.

[22] Canon refers to the share that corresponds to local and regional governments from the total revenue and income obtained by the state for the exploitation of natural resources. In Peru, this includes minerals, water resources in electric power generation, hydrocarbons (oil and gas), fisheries, and forestry.

[23] Once a project is selected, the head of the public entity designates a committee to select a firm. Before the committee publishes the notice, it needs to submit all the information to the CGR for approval (*informe previo*). The selection will not only include selecting the firm to execute the project, but also a supervisory firm responsible for monitoring and quality control. After the agreement is signed by the public entity and the private firms, the firm starts project execution. The firm is responsible for reporting monthly progress (with favorable opinion by the supervisory firm) to the public entity. When the project is finished, the supervisory firm and the public entity need to check the quality of the work before tax credit can be issued.

climate-induced weather events. Also, by concentrating in bigger projects, it will reduce the chance of overlapping with projects executed by local governments. The new provisions also allow for a large number of projects that surpass the US$3 million investment threshold but are contained within a single province to be financed. Over 4,000 projects with an initial formulation in Peru's public investment system meet these criteria of investment amount and coverage. These higher impact investments will ultimately contribute to increased climate resilience, stronger and more inclusive growth and closing infrastructure and service delivery gap. The results indicator target is to increase the percentage of FONCOR committed to Regional Impact Investments from 0 to 45 percent by 2024.

40. The modifications of Works for Taxes enable more subnational governments to use private sector resources to finance and execute investment. As a result, financing provided by private companies for public investments at the subnational level through this modality is expected to increase from US$30.7 million annually in 2019 to US$55.3 million by 2024[24], which would represent an increase of 80 percent. Moreover, allowing this modality to finance operation and maintenance of the investment will contribute to the proper functioning of the infrastructure, hence increasing climate resilience. Enabling government entities to use Works for Taxes to respond to natural disasters is expected to shorten government response time in extreme climate-induced natural disaster events. The reform is also expected to increase the amount and coverage of investment in water and sanitation which facilitate the measurement and subsequent mitigation of sanitation-related emissions.[25]

Prior Action 3: To foster low-carbon and climate resilient Public-Private Partnership (PPP) Projects, the Borrower has added environmental sustainability, including climate resilience, to the criteria that are required to be applied to all phases of the development of projects published within the National Infrastructure Plan for Competitiveness, as evidenced by Legislative Decree 1543 published in the Official Gazette on March 26, 2022 and the Supplementary Modifying Provisions of the Supreme Decree No. 211-2022-EF published in the Official Gazette on September 14, 2022.

Rationale: The World Bank supported the government of Peru through the WB DPF-DDO: Public Expenditure and Fiscal Management (P154981), where significant progress was made in improving the legal and institutional framework for PPP projects. Namely, the Government enacted a new PPP framework to incorporate these projects into the budget process and ensure spending units (contracting authorities for PPPs) prioritize their budget allocations for PPPs in a way that is consistent with their existing fiscal framework. A report titled A 'Roadmap to Relaunch PPPs and Infrastructure Financing in Peru' looked at the state of the PPP Program with the aim of outlining an agenda for further improving the results obtained via PPP procurement method. This was further complemented by a technical assistance engagement where the World Bank conducted a portfolio review of Peru's public-private partnership (PPP) projects from 2010 to 2020 and noted the need to mainstream climate considerations within these projects. Hence, it is necessary to integrate climate mitigation, adaptation and resilience criteria as part of the methodology for prioritizing projects in the National Infrastructure Plan, which the IADB has aided the government with. It is also imperative that capacity be built within

[24] Data indicates that investment amounts through Works for Taxes in the first two years of a subnational administration tend to be low, followed by substantial increases in the third and fourth years of the administration. This is mainly because subnational administration need time to familiarize with the modality and engage with private sector before reaching a final agreement. The current subnational administrations started in 2019 and will end in 2022. New administrations will start in 2023 and end in 2026. The target year 2024 is the second year of the new administrations. It would not be appropriate to compare the performance of 2024 with 2022, which is the fourth and last year of the administration. And because the value of 2020 was exceptionally low due to COVID-19 pandemic, 2019 is chosen as the baseline year.

[25] The discharge of untreated waste into the environment and the use of on-site technologies, such as septic systems and pit latrines, are sources of emissions but remain poorly quantified. Sanitation and wastewater systems contribute to GHG emissions both directly through breakdown of excreta discharged into the environment or during treatment processes, and indirectly through the energy required for treatment steps. While there are GHG emissions either way (with or without investments in sanitation services), these are easier to quantify when homes and businesses are connected to a sewer system. To the extent possible, mitigation measures should be incorporated into the projects to reduce emissions.

contracting authorities/project owners (Ministries and other grantors) to develop low-carbon and climate resilient projects. More generally, the strengthening of institutional capacities for PPPs is critical to help Peru deliver on its ambitious infrastructure plan in the next five years and beyond. This is especially true in the current context of climate change impacts, which require improved infrastructure that can withstand climate-induced weather events over longer project lifespans. By strengthening these capacities and making sure project design incorporates climate change considerations, Peru would move closer to more mature PPP programs such as those of the United Kingdom, Canada, Chile, and Colombia.

41. Substance of the Prior Action: Legislative Decree 1543, which was approved on March 26, 2022, mandated the adoption of climate-informed measures, following environmental sustainability criteria in PPPs. The decree establishes, for the first time in the country's history, the legal mandate to ensure climate considerations are embedded in the design and execution of PPP projects developed within the National Infrastructure Plan for Competitiveness (NIPC), a governance tool that is updated every few years[26]. The decree requires that climate informed and environmental sustainability principles, particularly related to adaptation and mitigation, be considered in all phases of the project lifecycle. Legislative Decree 1543 is operationalized by the Supreme Decree No. 211-2022-EF, approved September 14, 2022, which modifies existing regulation to require all relevant contracting authority of PPPs to indicate the consistency of proposed projects with the new "Principle of Sustainability" (including environmental and climate resilience sustainability) in their Multi-Annual PPP investment plans (*Informe Multianual de Inversiones en Asociaciones Público Privadas* or *IMIAPP*, acronym in Spanish). Projects are then prioritized and included in the NIPC, to be published later in 2022, to the degree that they abide by and contribute to: i) quantification and measurement of reduction of GHG emissions as they contribute to the state's NDCs, and ii) the conservation of ecosystems and the incorporation of methods that restore or protect biodiversity of the ecosystem including through the use of nature-based solutions to increase climate resilience.[27] Furthermore, the regulatory modifications introduced by Supreme Decree also require projects under consideration for procurement in the PPP modality to include in their project description and evaluation documents (*Informe de Evaluacion* or *IE*, acronym in Spanish) an assessment of the project's consistency with the Principle of Sustainability, including its environmental and climate resilience criteria. The vehicle by which project design will be climate informed is also mandated in Legislative Decree 1543 and the Supreme Decree No. 211-2022-EF, stipulates the use of Special Projects Offices—for projects or programs over UIT 1.380 million—whose technical assistance will provide the necessary resources to evaluate and incorporate climate considerations in the prioritized PPP projects within the National Infrastructure Plan for Competitiveness.

42. Expected Results: Within two years, all PPP projects included in the NIPC should adhere to the climate informed environmental sustainability criteria. As such, the expected result is (i) the mainstreaming of climate informed project design in PPPs, and (ii) increased mobilization of private capital for climate finance. Further, this reform will enhance the capacity of line ministries and contracting authorities to inform both technical evaluations and project design with climate criteria, a capacity that they currently typically lack. Contracting authorities are therefore highly incentivized to design projects that reduce GHG emissions or promote ecosystem conservation (preserving their carbon capture capacity). The results indicator target is that all PPP projects that are included in the NIPC are prioritized and awarded following the climate informed environmental sustainability criteria.

[26] The National Infrastructure Plan for Competitiveness is expected to be published in 2022 under the name National Infrastructure Plan for Sustainability and Competitiveness.
[27] Plan Nacional de Infraestructura para la Competitividad 2022.

Pillar B: Foster a more inclusive and competitive financial sector

43. Pillar B supports reforms to foster a more inclusive and competitive financial sector. By lowering costs and encouraging the entry of new financial service providers, households and micro, small, and medium enterprises will gain access to better financial services, thus making it easier to save and invest (PA 4). Small and medium sized firms will also have better access to working capital through reforms to facilitate factoring (PA 5), which allows business owners to collect invoice payments upfront without having to wait to receive payment from a client.

Prior Action 4: To improve financial inclusion and promote competition in the financial system, the Borrower has: (a) facilitated the market entry of 100 percent digital financial service providers by eliminating requirements to have a physical headquarters or principal office, and permitting them to perform digitally all operations that they are licensed to perform, (b) facilitated the market entry of non-deposit-taking credit providers by introducing a new license for such providers with a simplified regulatory and supervisory framework; and (c) facilitated competition in the cash transportation sector by reducing minimum capital requirements for licensed providers, as evidenced by Legislative Decree No. 1531 published in the Official Gazette on March 19, 2022.

44. Rationale: Access to basic financial services is critical for poverty reduction and inclusive economic growth. Inclusive financial systems increase the resilience of vulnerable populations by enabling them to access financial support during economic shocks—including as a result of climate change—from social networks and governments (via digital payments), as well as their own savings.[28] Access to credit also allows micro, small, and medium enterprises (MSMEs) to make investments and purchase working capital, thereby enhancing their productivity and employment potential. International evidence has demonstrated that reforms to enhance digital financial inclusion can have a disproportionately positive impact on women's financial resilience, savings, and labor market outcomes.[29] Despite recent progress, nearly half of Peruvian adults remain unbanked: only 57 percent of Peruvian adults (ages 15+) have a transaction account with a financial institution, below the regional average of 73 percent (2021 Global Findex data). Firms are also constrained in their access to affordable and appropriate financial services: IFC estimates that 45 percent of MSMEs are fully or partially credit constrained. Digital financial services can help to overcome obstacles to financial inclusion by shifting financial transactions to digital or low-cost delivery channels, improving customer-centric product design, and leveraging digital data sources to reduce informational asymmetries. According to 2021 Global Findex data, Peru has a significant financial inclusion gender gap with men 9 percentage points more likely than women to own an account.[30] Studies have found that women's financial inclusion in Peru is constrained by inequalities in labor market outcomes and differences in the level of education, but is also exacerbated by poor product design, high costs, lower trust in financial institutions, and limited opportunities for financial education.[31,32]

45. Financial sector frameworks that promote competition and the adoption of digital technologies can facilitate financial inclusion, as recognized by Peruvian authorities in their 2022 Multisectoral Strategic Plan under the National

[28] For example, evidence from Kenya has shown that access to digital financial services strengthened the adaptive capacity of households to negative shocks (including droughts and floods) by enabling them to receive timely and affordable remittances from their social networks.
[29] See for example, Suri, T. and W. Jack. 2016. "The long-run poverty and gender impacts of mobile money." *Science*, Vol 354. https://www.science.org/doi/10.1126/science.aah5309.
[30] However, Peru's 2021 national household survey does not find a statistically significant gender gap in the ownership of transaction accounts.
[31] See, for example, a recent study by Peru's financial sector regulator on gender differences in financial inclusion: https://www.sbs.gob.pe/Portals/4/jer/PUB-ESTUDIOS-INVESTIGACIONES/Genero_e_Inclusion%20.pdf
[32] For example, unbanked women are more likely than unbanked men to report "accounts are too expensive" as their sole barrier to financial inclusion.

Financial Inclusion Policy (PNIF).[33] Peru's financial sector has historically been dominated by banks and has demonstrated persistently high levels of concentration and low levels of competition. Despite recent growth in e-wallets, there is significant scope to further develop Peru's ecosystem for digital financial services. Limited competition in the cash-in-transit (CIT) sector has also contributed to elevated operational costs of financial service providers, which are subsequently passed on to consumers.[34,35] The CIT market in Peru is made up of just two companies. A 2015 World Bank study found that high capital requirements for CIT firms was a driver of low competition in the sector and recommended a review of these requirements, a recommendation that has been taken up by Peruvian authorities. The World Bank is currently providing a range of complementary technical assistance to financial sector authorities in Peru, including related to competition and innovation in the retail payments market, open banking, and fintech.

46. Substance of the Prior Action: Legislative Decree No. 1531 supports a range of measures to improve financial inclusion and enhance competition in Peru's financial sector. First, it supports measures to facilitate the market entry and growth of digital financial service providers, in particular those with a 100 percent digital operational model (i.e., no physical branches or access points). The reform eliminates the requirement for a financial service provider to have a physical headquarters or offices and authorizes, by law, financial service providers to perform all of their operations in a 100 percent digital manner. Second, the decree supports reforms to apply a risk-based framework to credit-only financial service providers. The reform establishes a new license for "Credit Firms" (replacing the former license of "*Empresa de Desarrollo de Pequeña y Microempresa*") to attract new market entrants that serve the credit needs of a broad range of consumers including medium-size firms and individuals. The reform also establishes a risk-based regulatory and supervisory framework for Credit Firms in line with their limited scope of activities (i.e., no deposit-taking from the public) and non-systemic role in the market, which will facilitate market exit and lower resolution costs. Third, the reform reduces the minimum capital requirement for cash transportation companies (*Empresa de Transporte, Custodia y Administración de Numerario*, ETCAN) to promote greater competition in the sector and thus reduce operational costs for financial service providers.

47. Expected Results: The measures supported under the Prior Action are expected to improve financial inclusion, household resiliency, and competition in Peru's financial sector. Specifically, the measures are expected to facilitate the market entry and growth of a range of financial service providers, including 100 percent digital providers, credit-only providers, and cash transportation companies. New, innovative providers can leverage technology and customer-centric design thinking to better meet the needs of unserved and underserved populations, including women.[36] Greater competition in the CIT market is expected to drive down operational costs for financial service providers—particularly those in rural areas—and improve the affordability of basic financial services for consumers, thereby facilitating greater financial inclusion. Women's financial inclusion is expected to benefit, as new providers can address cost, product design, and trust barriers that currently constrain women's access and use of financial products and services. Thanks to increased access to digital financial services and transactions accounts, the financial resiliency of households to climate-induced shocks is expected to improve. The results indicator is a commonly used proxy for financial inclusion: the share of adults (age 15+) with an account at a financial institution or mobile money provider, from a baseline of 57 in 2021 to a target of 65 by 2024. The contribution of the prior action to narrowing the gender differential in financial inclusion in Peru will be

[33] For example, Priority Objective #3 of the PNIF seeks to "foster a regulatory framework appropriate to the evolution of trends of innovation in the financial sector, while preserving stability" and "promote the development of the financial sector within a context of market competition".
[34] The CIT sector refers to firms that transport cash and other valuables of behalf of financial institution, e.g., to supply bank branches and ATMs with cash notes.
[35] Previous studies have indicated that the cost of handling cash can make up between 20 and 60 percent of total bank branch costs in Peru. See Khiaonarong, 2013. "Payment Systems Pricing Policy – Peru", IMF.
[36] Digital-only financial service providers are becoming increasingly common in Latin America, for example Brubank in Argentina and Nequi in Colombia.

measured via the gender gap in the aforementioned indicator, from a baseline of 9 percentage points in 2021 to 4 percentage points by 2024.

Prior Action 5: To improve the enabling environment for factoring, the Borrower, through SUNAT, has established a regulatory framework and a registry for the confirmation of electronic invoices, as evidenced by Superintendency Resolution No. 00165-2021/SUNAT published in the Official Gazette on November 18, 2021.

48. Rationale: Factoring is a critical tool to address the financing needs of Peruvian small and medium enterprises (SMEs) and mend supply chains disrupted by the pandemic, by increasing working capital and cash flow optimization, which can in turn boost production and sales capacity. Factoring consists of a financial institution providing financing or liquidity to a firm through the purchase of its credit invoices.[37] The financier relies on the creditworthiness of the payor of the invoice (often a larger firm), rather than that of the beneficiary (normally an SME). Peru has taken a series of steps to regulate and incentivize factoring, including under the General Law of the Financial and Insurance System, the Organic Law of the Superintendence of Banking and Insurance (Law No. 26702 in 1996), and Law No. 30308 of 2015, which promotes the financing of firms using factoring. Peru has also made significant efforts to develop the electronic invoice for tax purposes and in 2015, became the sixth Latin American country to establish a gradually mandatory electronic invoicing system—which connects the tax elements of the invoice to SME financing, following international best practice with a technologically advanced foundation in terms of the XML files for e-invoices. Furthermore, in 2020 Peru adopted Emergency Decree No. 013-2020 to promotes access to financing by MSMEs by allowing factoring with electronic invoices. Given this extensive legislative and regulatory work, the use of factoring in Peru has grown since 2020.[38] A method to electronically verify and register payment confirmation by the buyer—a risk reduction measure required by financing entities—is important for continued growth.

49. Substance of the prior action: The prior action addresses this missing element as National Superintendency of Customs and Tax Administration (SUNAT) Resolution No. 00165 establishes a regulatory framework and registry for the confirmation of electronic invoices. The electronic registry records the invoice and the buyer's confirmation of the obligation, thereby providing the public record needed to validate the buyer's obligation to pay the e-invoice at maturity. The new registry records three types of information: express confirmation of the payment obligation, tacit confirmation of the obligation, and express rejection of the obligation. The express confirmation is recorded directly when the buyer confirms receipt of the goods or services represented by the e-invoice and its intention to pay. The tacit confirmation is recorded automatically by the registry system itself, after an eight-day validation period prescribed in the factoring act, so long as the buyer has not registered a rejection of the obligation during that time. In this latter case, the factoring act provides a limited set of circumstances in which a rejection can be recorded, which must be noted and evidenced in the rejection itself, thereby limiting the ability of a payor of an invoice to arbitrarily impede its negotiability. Upon recording of the express or tacit confirmation in the registry, the e-invoice becomes a payable instrument available for factoring by the SME. This reform builds on recommendations from past IFC analytical work regarding developing factoring in Peru. The IFC is also exploring future technical support to the government on factoring.

[37] In factoring operations, the factor provides an initial advance rate (typically between 75 to 85 percent) of the face value of the invoices to the customer, and the debtor is instructed to pay the invoices to the financing institution at maturity. When the debtor pays full amount of the invoice to the financing institution, it then applies payment to the outstanding balance of the advance or facility provided and forwards any remainder (after covering any pending interest or fees) to the customer.
[38] According to a Report of the General Office of Impact Assessment and Economic Studies of the Ministry of Production (*Oficina General de Evaluación de Impacto y Estudios Económicos del Ministerio de la Producción, PRODUCE*), 613,300 invoices were negotiated, between January and July 2022, for an amount of S/15,629 million, an increase of 30 percent in relation to the same period in 2021.

50. **Expected results:** The use of e-invoices has enormous potential to facilitate access to finance for Peruvian SMEs through factoring. Confirmed e-invoices give SMEs electronically tradable and financeable assets, which contain all supply chain, financing and transfer information embedded in an XML file (including delivery, confirmation, payment, and endorsement data). This is also expected to facilitate financial product innovations by fintechs and other platforms. Factoring with electronic invoices will help SMEs improve their resilience to climate change impacts. Quick and easy access to financing online through factoring will help SMEs, particularly in the agribusiness sector, adapt to climate-induced shocks and disruptions to production and supply chains, thus maintaining business continuity. The results indicator is the registry for the confirmation of electronic invoices is operational, from “no” in 2021 to “yes” in 2024.

Pillar C: Promote greener production

51. **Pillar C supports reforms to promote greener production, including in industry, forestry, and agriculture.** Low carbon and climate resilient production in industry, forestry, and agriculture is essential for those sectors to remain competitive and reduce emissions, while enhancing Peru’s resilience to observed and anticipated climate change impacts. Clean production agreements between manufacturing firms and the government incentivize firms to use less energy and other inputs, both reducing costs and protecting the environment (PA6). Commercial forest plantations will allow Peru to meet domestic and international demand for wood products, while helping reforest degraded public land (PA7). Promoting climate-smart agriculture through better extension services and land-use regulations will simultaneously increase productivity, enhance resilience, and reduce emissions (PA8).

Prior Action 6: To incentivize clean industrial production, the Borrower has approved a directive that regulates the expression of interest, evaluation, formulation, subscription, execution, follow-up and final evaluation of clean production agreements between industrial manufacturing or domestic trade firms and the Ministry of Production, as evidenced by Ministerial Resolution Nº 00146-2022-PRODUCE published in the Official Gazette on April 20, 2022.

52. **Rationale:** Clean production agreements have become an attractive instrument to encourage clean production and address climate change through the private sector around the world. The agreements promote productive and environmental improvements, as well as encourage better coordination among government agencies responsible for the formulation of public policies on environmental and health issues within the framework of clean production in industry. The mechanism is also better received by the industrial sector than regulations or taxes.[39] Reducing industrial emissions is central to climate change mitigation, as manufacturing and industry are the fifth largest source of greenhouse gas emissions in Peru.[40] The Peruvian government defines cleaner production as the continuous application of a preventive and integrated environmental strategy for processes, products and services, aiming to increase efficiency, rationally manage resources, and reduce risks to the human population and the environment, to achieve sustainable development.[41] In practice, this means reducing the use of water, electricity, fuels, and other inputs. Chile’s successful experience using clean production agreements to reduce emissions is described in Box 2. Clean industrial production in Peru is being

[39] Rezessy, S., Bertoldi, P. (2011). Voluntary agreements in the field of energy efficiency and emission reduction. Review and analysis of experiences in the European Union 39, 7121e7129.

[40] The largest sources of greenhouse gas emissions by sector in descending order of importance are 1) land-use change and forestry; 2) agriculture; 3) transport; 4) electricity and heat; and 5) manufacturing, construction, and industry. Source: Our World in Data based on Climate Analysis Indicators Tool (CAIT), https://ourworldindata.org/grapher/ghg-emissions-by-sector?time=latest&country=~PER.

[41] Cleaner production measures that the owner of operations can adopt include, as applicable, a) control of inventories and the flow of raw materials and supplies, as well as their substitution; b) review, maintenance and replacement of equipment and applied technology; c) control or substitution of fuels and other energy sources; d) the reengineering of production processes, methods and practices; e) the restructuring or redesign of the goods and services it provides; and, f) the recovery of waste, among others.

supported by the WB and other development partners. Examples include circular economy research and technology transfer to the private sector through the recently approved WB Strengthening Peru's National Science, Technology, and Innovation System IPF (P176297), technical assistance on clean production agreements from UNIDO and GIZ, and support to transitioning to a green industrial sector from the Partnership for Action on Green Economy (PAGE, a multi-stakeholder UN initiative).

Box 2: Chile's experience with clean production agreements to reduce greenhouse gas emissions

Chile has successfully used voluntary clean production agreements to lower industrial emissions, according to a recent ex-post evaluation of the program.[42] The agreements are between firms, groups of firms, or an association of firms that represent a productive sector and the government. During the 2001-2014 period of study, 8 of 23 industrial sectors in Chile had a clean production agreement. 52 percent of the agreements were associated with the food industry, followed by the metallurgical industry with 12 percent. These same sectors are those with the highest consumption of water, electricity and fuels. The evaluation found a reduction of 47 percent in average fuel oil consumption, a reduction of 16 percent in liquefied petroleum gas consumption, and a reduction of 11 percent in CO_2 emissions for sectors with clean production agreements. As a result, the evaluation concluded that clean production agreements are an effective tool in Chile.

A separate report analyzed 156 clean production agreements signed in Chile with 37 sectors and subsectors between 1999 and 2019. The agreements cover more than 8,000 private companies and more than 13,000 facilities such as restaurants, workshops, foundries, bakeries, university campuses, etc. The analysis estimated a reduction of 535,693 tons CO_2 equivalent between 2012-2018. This is equivalent to about 2 percent of Chile's GHG emissions from industry over that period or removing over 115,000 cars from the road.

Sources: Mardones, C.; Bienzobas, R. (2019) Ex-post evaluation of clean production agreements in the Chilean industrial sectors. Journal of Cleaner Production 213 (2019) 808e818 *https://doi.org/10.1016/j.jclepro.2018.12.228*. AND Consejo de Producción Limpia (2019). Carbon Equivalent Emissions derived from the implementation of the Clean Production Agreements carried out in Chile. https://ledslac.org/wp-content/uploads/2019/09/EdC-APL-Chile-30.07.19-vf.pdf

53. Substance of the Prior Action. General Directive Nº 00002-2022-PRODUCE of the Ministry of Production, approved on April 18, 2022, creates Clean Production Agreements as an instrument to incentivize firms to produce in ways that promote low carbon and climate resilient growth.[43] The directive regulates the expression of interest, formulation, subscription, execution, monitoring, and evaluation of Clean Production Agreements to be signed between the Ministry of Production (PRODUCE) and a firm or group of firms (known as the activity owner) involved in manufacturing or internal trade activities. Clean production actions to be implemented by the activity owner must exceed environmental standards required by current legislation. Subscription to the agreements is voluntary between the government and the activity owner, and agreements must have a duration of at least one year. The activity owner must determine targets, which should improve annually, and accomplish goals related to the use of technologies for mitigation or adaptation to climate change, adoption of productive processes and activities that use clean technologies and supplies, circular economy actions, eco-efficiency, energy efficiency, and others.[44] For monitoring and evaluation of compliance with the agreements, the parties must agree on how the activity owner will share the evidence on fulfillment of the goals with PRODUCE.

[42] The study used an ex-post evaluation methodology known as a pseudo-panel regression to estimate the effect of clean production agreements on water consumption, electric power consumption, fuels consumption and CO2 emissions in different industrial sectors in Chile using data reported in the Annual National Industrial Survey (ENIA) between the years 2001 and 2014. The pseudo-panel methodology is used to construct a counterfactual scenario representing what the situation of the group of participants would be if they had not participated in the program.
[43] Acuerdos de Producción Más Limpia (AP+L).
[44] At a minimum, goals should include information on feasibility; exceeding existing regulatory requirements; environmental, productive and economic benefits; and key performance indicators.

PRODUCE then coordinates with other relevant public entities for periodic and final evaluations. Incentives for firms to participate are currently related to reputational benefits—from PRODUCE and the firms publicizing the agreements and results achieved—and reduction of costs through eco-efficiency measures. The directive is a vital piece of implementing the government's Roadmap Towards a Circular Economy in the Industry Sector, approved by Supreme Decree No. 003-2020-PRODUCE on February 17, 2020 (action a.3).

54. **Expected results:** Firms participating in clean production agreements are expected to reduce the use of electricity and fuels, water, and other inputs used for the production and transportation of inputs, contributing to low-carbon development and increasing climate resilience of the sector, as droughts become more prevalent in Peru due to climate change. In line with Chile's experience, these measures are expected to result in a reduction in greenhouse gas emissions from industry in Peru. PRODUCE is working on strengthening the incentives for firms to participate with support from UNIDO, including developing a clean production seal (which could be linked to private sector green certifications that are beneficial for exports) and possible better access to public services (e.g., innovation and technology centers, innovation grants) and public procurement. The first agreement is currently being negotiated with a large textile firm. Additional agreements are currently being discussed with industrial parks and large firms in the cement, chemicals, plastics, food, metal-mechanic, and textile industries. The mechanism is expected to catalyze increasing numbers of agreements in the coming years (as was seen in Chile) and provide Peruvian firms with a critical tool to meet increasing global demand for climate-friendly production. The results indicator target is to have 7 agreements signed between PRODUCE and firms (or groups of firms) by 2024, compared to a baseline of zero in 2021.

Prior Action 7: To develop a sustainable forest industry, the Borrower, through the National Forest and Wildlife Service, has approved the "Strategy for Promoting Commercial Forest Plantations 2021-2050", kick-starting a short-, medium-, and long-term series of concrete proposed actions (such as the mapping and classification of areas for potential plantations) by all key public and private stakeholders for developing the investment enabling conditions, production, transformation, and commercialization of new and existing commercial forest plantations in strategic geographic corridors, as evidenced by Resolution of the Executive Director No. D000190-2021-MIDAGRI-SERFOR-DE published in the Official Gazette on October 12, 2021.

55. **Rationale:** Although more than 50 percent of its landscape is covered by Amazon forests, Peru's forest sector contributes only about one percent of the country's GDP and supplies only about half of domestic demand for wood and wood products. At the same time, unsustainable exploitation of forest resources, coupled with climate change impacts, has led to high rates of deforestation and thus high GHG emission from the Amazon regions.[45] Evidence shows that climate change has profound impacts on the distribution and abundance of biodiversity of Peru's forest ecosystems, in particular its tropical montane ecosystems.[46] Recognizing the importance of the forest sector to the country's climate actions and sustainable economic development of forest-rich but economically less developed Amazon regions, Peru, with technical and financial support from multiple development partners, has been seeking to enhance the competitiveness of its forest sector through various policy actions.[47] As part of the Bank's Country Climate and Development Report (CCDR), the WBG has completed a deep dive on the forestry sector underlying challenges and opportunities for reform in the sector. In

[45] According to *Tercera comunicación nacional del Perú a la Convención Marco de las Naciones Unidas* (MINAM, 2016), Land-Use, Land-Use Change and Forestry (LULUCF) accounted for 65.8 percent of Peru's GHG emission. The Peru Climate Change and Development Report (World Bank, forthcoming) highlighted that between 2001 and 2019, Peru lost more than four million hectares of tree cover, representing four percent of its forest cover.

[46] Bax, Vincent, Augusto Castro-Nunez, and Wendy Francesconi. 2021. "Assessment of Potential Climate Change Impacts on Montane Forests in the Peruvian Andes: Implications for Conservation Prioritization" Forests 12, no. 3: 375.

[47] Among others, Norway and Germany have been implementing a REDD+ program since 2014 with recent participation of the UK and the USA in 2021 to reduce deforestation in the Amazon.

addition, for the CPF FY23-FY27 currently under preparation, the WBG will seek opportunities to include potential investment operations in the forest sector.

56. On the government side, Peru developed its 2013 National Forest and Wildlife Policy and called for the creation of favorable conditions and incentives to promote private sector investments in the forest sector. The Ministry of Agriculture in 2015 issued guidelines for public investments in forest development (*Lineamientos de Política de Inversión Pública en Desarrollo Forestal 2015-2021 – Resolución Ministerial Nº 0344-2015-MINAGRI*) and proposed investment priorities in commercial forest plantations. Yet, existing barriers, such as the lack of well-mapped land areas that are legally validated and clearly defined regulations for the contracting and operations of commercial forest plantations, are limiting the private sector's interest in forest investments.

57. **Substance of the Prior Action:** Based on a detailed analysis and extensive stakeholder consultations, SERFOR approved a strategy to promote private investments in sustainable commercial forest plantations. The strategy kick-starts concrete proposed actions by all key public and private stakeholders for developing the investment enabling conditions, production, transformation, and commercialization of new and existing commercial forest plantations in strategic geographic corridors, with a view to meeting significant unmet national demand for primary and value-added lumber products nationally rather than by importation, generating job and economic opportunities, and contributing to national climate and environmental commitments. As one of the initial key actions stipulated in the strategy, SERFOR has completed the identification, classification, and mapping of degraded land areas at the national level and developed a validation methodology to confirm the suitability of such land areas for commercial forest plantations on the ground, with support from GIZ.[48] Currently, SERFOR is implementing a pilot project to validate degraded public land areas in two Amazon regions—San Martin and Ucayali. Along with this pilot, SERFOR has been updating and developing detailed administrative guidelines and procedures to regulate the development and operation of such plantations. As part of this effort, the draft administrative guidelines that will regulate the public contracting process of commercial forest plantations has been disclosed for public consultation. In addition, the strategy includes a comprehensive set of complementary measures such as technical assistance and capacity building to support private investments in commercial forest plantations.

58. **Expected Results:** The implementation of the strategy is expected to remove regulatory and technical barriers and create the enabling conditions for the private sector to invest in commercial forest plantations in an environmentally sustainable and socially inclusive manner. The mapping and validation of the degraded public lands, in conjunction with the updated regulatory framework and other actions under the strategy will enable the two pilot regions to contract commercial forest plantations on degraded public lands by 2025. Private investments to be contracted on these land areas will improve the environmental and economic performance of Peru's forest industry, contribute to climate mitigation through increased forest coverage, and benefit economically less developed Amazon regions that are highly vulnerable to deforestation and forest degradation. The proposed results indicator is the area of degraded public land that has been mapped and validated by SERFOR for the development of commercial forest plantations, with a target of 800,000 hectare by 2024, compared to a baseline of zero in 2022.

Prior Action 8: To promote climate-smart agriculture, the Borrower has: (a) enacted the Law Regulating the Agriculture Extension Service, which provides for the establishment of a national registry, accreditation system, and supervision of agriculture extension service providers, as evidenced by Law Nº 31368 published in the Official Gazette on December 7, 2021; and (b) approved an updated regulation on the land use classification, which includes forest cover as an integral

[48] For afforestation and reforestation purposes, degraded land is defined as land areas with less than 30 percent of tree coverage.

part, as evidenced by Supreme Decree N° 005-2022-MIDAGRI published in the Official Gazette on April 24, 2022.

59. **Rationale:** Climate-smart agriculture simultaneously aims to increase productivity, enhance resilience, and reduce emissions. Increasing productivity can improve food security and boost incomes, especially for people in rural areas in Peru. Enhancing resilience means reducing Peruvian farmers' vulnerability and capacity to adapt to drought, pests, diseases, erratic weather patterns, and other climate-related risks and shocks. There are many agriculture technologies and farming practices available in Peru that could improve productivity and resilience.[49] The National Agricultural Innovation IPF (P131013), which ended in February 2021, supported new climate-smart technologies and practices related to protected environment agriculture (e.g. greenhouses), pest and disease management, fertilization, and irrigation, among others. However, adoption by farmers has been slow.[50] Agriculture extension plays a crucial role in overcoming farmer information constraints and encouraging the adoption of climate-smart technologies and practices.[51] Access, affordability, and quality are the heart of reforms to successfully enhance agriculture extension and advisory services coverage. Peru has over 2.26 million farmers, of which only 5.2 percent have indicated having access to agricultural extension and advisory services.[52] In addition to the low access, agriculture extension challenges include: i) lack of coordination; ii) low quality control in the delivery of services; iii) poor accountability due to lack of planning and monitoring of results; and iv) unclear financing mechanisms to support the expansion of access as well as continuous quality improvements.[53]

60. A critical way to reduce emissions is by avoiding deforestation. It is estimated that land-use change from forest to agriculture and cattle ranching accounts for 76 percent of the annual deforestation in Peru. Currently, the annual rate of deforestation is about 145,000 hectares. Land-use change due to deforestation accounts for 51 percent of the total emissions of greenhouse gas in Peru, making it the largest source of emissions.[54] The government has pursued a series of legislative and institutional reforms to tackle this issue, including the Forestry and Wild Fauna Act (Law No. 27308 of 2000), which governs sustainable use and conservation of forest resources and wildlife. Law No. 27308, among other things, established the need for the Ministry of Agriculture Development and Irrigation (MIDAGRI) to update regulations related to land use suitability. Regulating land use suitability classifications was also identified as one of the most critical actions to address climate change in the January 2022 Supreme Decree declaring the climate change emergency as a national concern (*Decreto Supremo N° 003-2022-MINAM*). The purpose of the land use suitability classification is to identify the relative suitability of soils for a given use while considering economic, social, and environmental values.[55] The absence of regulations regarding land use limits control of agriculture expansion into forest areas with low suitability for agriculture and cattle ranching.[56]

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[49] World Bank. (2021). Implementation Completion and Results Report (ICR): National Agricultural Innovation System Support Project. Report No: ICR00005483. Washington, DC.

[50] Tambet, Heleene, and Yaniv Stopnitzky. "Climate adaptation and conservation agriculture among peruvian farmers." American Journal of Agricultural Economics 103, no. 3 (2021): 900-922.

[51] World Bank. (2017). Gaining Momentum in Peruvian Agriculture: Opportunities to Increase Productivity and Enhance Competitiveness. World Bank, Lima.

[52] Instituto Nacional de Estadísticas e Informática. 2019. Encuesta Nacional Agropecuaria (ENA).

[53] Instituto Interamericano de Cooperación para la Agricultura (IICA). 2020. Análisis del mercado de los servicios de extensión agraria en el Perú y propuesta de estrategia para su desarrollo en el marco del Sistema Nacional de Innovación Agraria. Instituto Nacional de Innovación Agraria (INIA). Lima, Perú, 171 pp.

[54] Peru's Third National Communication to the UNFCCC. AND https://ourworldindata.org/grapher/ghg-emissions-by-sector?time=latest&country=~PER

[55] The suitability establishes five categories of use: (i) lands suitable for agriculture (annual crops); (ii) lands suitable for agriculture (perennial crops); (iii) lands suitable for pasture; (iv) lands suitable for forest management; and (v) lands suitable for forest protection.

[56] Organization for Economic Co-operation and Development (OECD). 2017. Environmental Performance Reviews: Peru 2017, OECD Environmental Performance Reviews, OECD Publishing, Paris.

61. **Substance of the Prior Action.** The prior action contributes to all three dimensions of climate-smart agriculture: productivity, resilience, and emissions. Law Nº 31368 *(Ley que Regula el Servicio de Extension Agropecuaria)* is designed to: i) improve the governance of agriculture extension services by defining more clearly the roles and responsibilities among providers, users, and regulators of the services at the national and subnational government levels and in the private sector; ii) improve quality of agriculture extension and advisory services by establishing a national registry and accreditation process for agriculture extension services providers, under the responsibility of the National Institute of Agrarian Innovation (INIA), which is also charged with supervision of the sector; iii) charge INIA with monitoring and evaluation responsibility to assess the delivery of agriculture extension to farmers; and iv) empower INIA to impose administrative sanctions on service providers who violate registration, accreditation, and information requirements or provide deficient advisory services. All of these improvements should lead to extension services quality and coverage improvements while directly and indirectly contributing to climate resilience of the agriculture sector. In the short and medium term, the primary focus of agriculture extension services is the delivery of climate-smart technologies and farming practices developed by the National Agriculture Innovation Program (PNIA), a US$100 million program implemented through two projects co-financed by the World Bank between 2013-2021.

62. As called for by the Forestry and Wildlife Act (Law No. 27308), Supreme Decree N° 005-2022-MIDAGRI approves an updated Regulation on the Classification of Land by its Major Use Capacity (*Reglamento de Clasificación de Tierras por Su Capacidad de Uso Mayor*). This regulation defines land suitability classification standards, which will be used to identify areas suitable for agriculture, cattle ranching, forest management, and forest protection. The updated regulation will help the government to reduce illegal deforestation by providing that land classified as suitable for forest management and protection cannot be issued the permits needed to change land-use from forest to agriculture and ranching, which are directly related to land-use change through deforestation. In addition, the updated regulation provides that land classified as suitable for forest management and protection cannot be issued land titles. Compared to the previous regulation issued in 2009, the updated land-use regulation (2022), among other things, includes forest cover assessment as one of the key measures in determining the land-use suitability. Also, it simplified technical procedures for the classification of land suitability for indigenous people, therefore, streamlining the process of issuing land rights to them.

63. **Expected results**: The agriculture extension law is expected to improve the quality of national agriculture extension services. Better quality should lead to increased coverage of extension services through both increased demand from farmers and higher capacity of the extension providers to meet the demand. This in turn should increase the adoption of climate-smart technologies and practices by farmers. Farmers should then be better equipped to adapt to climate-induced shocks. Agriculture extension improvements are expected to be complemented by an IADB project under preparation that supports public agricultural science, technology, technological innovation, and information services for the development of small family farming. The updated land use suitability classification will strengthen the capacity of the government to control the expansion of the agriculture frontier into forest areas unsuitable for agriculture and cattle ranching development, therefore, reducing GHG emissions associated with land-use change caused by deforestation. The results indicator target is a 34 percent increase in the percentage of farmers that receive technical assistance about climate smart and productivity between 2019 and 2014.

Table 4: DPF Prior Actions and Analytical Underpinnings

Pillar A: Strengthen fiscal resilience and efficiency	
Prior Action 1. Support fiscal consolidation	• World Bank (2017) Public Expenditure Review. • International Monetary Fund (IMF) (2018) Raising revenue. • World Bank (2020) Climate-Smart Fiscal Policy Can Foster a Lasting Economic Recovery.

	• Banco Mundial (2021) Repensar el futuro del Perú. Notas de política para transformar al Estado en un gestor del bienestar y el desarrollo. • World Bank (2021) Financing for Green, Resilient and Inclusive Development (GRID) Towards A Post-Pandemic Approach.
Prior Action 2. Improve the targeting and efficiency of government spending in public infrastructure	• World Bank (2017) Policy Note Local Government Infrastructure Planning and Investment in Peru • World Bank; Blanco, Martinez-Vazquez, (2017). Peru: Building a more Efficient and Equitable Fiscal Decentralization System. • *Ministerio de Economía y Finanzas* (2021) *Exposición de Motivos*, *Proyecto de Ley de Reestructuración Fiscal de Municipalidades en Riesgo de Insolvencia* (official use only). • World Bank Technical Note (2021) Analyzing the Bottlenecks in Public Investment Project Execution in Peru with focus on Infrastructure investments, Macro level Analysis of Public Investment Management in Peru. • World Bank (2021) Macro Level Analysis of Public Investment Management in Peru. Washington, DC: World Bank. • World Bank and UNICEF (2022) Improvement of the Management of Investments in Educational Infrastructure Under the Works for Taxes Mechanism. • ROSSELLÓ Attorneys at Law (2022). *Importantes modificaciones a la Ley Obras por Impuestos*. Lima: ROSSELLÓ Attorneys at Law. Available at *https://es.linkedin.com/pulse/importantes-modificaciones-la-ley-de-obras-por-impuestos-?trk=pulse-article_more-articles_related-content-card*
Prior Action 3. Foster low-carbon and climate resilient PPPs	• World Bank (2020) Policy Note on Attracting Private Investment to Infrastructure in Peru: Achievements, Challenges and a Way Forward. • World Bank (2021). PPP Support to *Proinversión*: Diagnosis and Recommendations Report to improve project preparation by addressing timelines, competitive selection, and the contracting process, thereby improving the value for money of PPPs. As per the findings in an ex-post portfolio review conducted by the World Bank that analyzed 54 projects that *Proinversion* had structured during 2010-2020, there is a need to integrate climate resilience criteria in the technical design of PPPs. WBG's Joint Capital Market Program (J-CAP) Sustainable Long-Term Finance Facility to support PPPs—including greening the PPP portfolio—in Peru.
	Pillar B: Foster a more inclusive and competitive financial sector
Prior Action 4. Improve financial inclusion and promote competition in the financial system	Several World Bank studies, and assessments have highlighted the need to enhance competition in Peru's financial sector, promote digital financial services, and address the duopoly structure in the CIT market, including: • World Bank (2015) Policy Note on Competition and Efficiency in Payment Systems and Services • World Bank (2018) Financial Sector Assessment Program (FSAP), including the Technical Note on Payment Systems • World Bank (2021) *Policy Note on Digital Financial Services*
Prior Action 5. Improve small and medium firms' access to finance	Factoring is a growing source of external financing for SMEs, given that credit provided by a lender is explicitly linked to the value of a supplier's accounts receivable and not the supplier's overall creditworthiness. The digitization of invoices reduces legal, financial, and operational risks associated with factoring, automating customer onboarding, underwriting, due diligence, as well as lowering regulatory compliance, thereby incentivizing the use of factoring for SMEs as well as the development of Fintech platforms to finance and trade electronic invoices. • World Bank (2010) The role of factoring for financing small and medium enterprises. Policy Research working paper series; no. WPS 3593. • World Bank (2019) Knowledge Guide on Secured Transactions, Collateral Registries and Movable

	Asset-Based Financing. • World Bank (2020): Digital Financial Services (Finance, Competitiveness and Innovation). • World Bank (2021) Fintech and SME Finance: Expanding Responsible Access, Fintech, and the Future of Finance Flagship Technical Note. • IFC (2018): Factoring Framework Diagnostic for Peru (Latin American Financial Infrastructure Program - SECO) • IFC (2020) Market analysis for factoring and supply chain financing in Peru (Latin American Financial Infrastructure Program - SECO). • IFC (2021): Guidebook on Supply Chain Financing by Development Banks and Public Entities.
Pillar C: Promote greener production	
Prior Action 6. Incentivize clean industrial production	Examples of analyses of mechanisms to incentivize cleaner industrial production include: • Oliveira Neto, G. C. de, Tucci, H. N. P., Correia, J. M. F., da Silva, P. C., da Silva, V. H. C., & Ganga, G. M. D. (2020). Assessing the implementation of Cleaner Production and company sizes: Survey in textile companies. *Journal of Engineered Fibers and Fabrics*. • *Consejo de Producción Limpia* (2019). Carbon Equivalent Emissions derived from the implementation of the Clean Production Agreements carried out in Chile. • Cleaner Production Agreements as Public Policy (2017). Universidad de Chile. • Mardones, C.; Bienzobas, R. (2019) Ex-post evaluation of clean production agreements in the Chilean industrial sectors. *Journal of Cleaner Production* 213 (2019) 808e818 • Ashton, W.S., Panero, M.A., Izquierdo Cruz, C. et al. (2018) Financing resource efficiency and cleaner production in Central America. *Clean Technologies and Environmental Policy*.
Prior Action 7. Develop a sustainable forest industry and address deforestation	Given the significance of Peru's forest sector in both mitigation and adaptation, many donors, including the Bank, have supported capacity building and pilot investments in the sector as part of, and/or along with, the development and implementation of Peru's NDCs. These engagements have clearly identified commercial forest plantations, if managed properly, could help alleviate the increasing wood demand on natural forests and restore degraded forest areas. The Bank's CCDR has highlighted the importance of mobilizing private sector investments in the forest sector. • Forest Investment Program Project on Sustainable Forest Management • Center for International Forestry Research (2018), Farm-forestry in the Peruvian Amazon and the feasibility of its regulation through forest policy reform • Forest Trend (2020), Peeling back the bark: Timber tracking and regulations controlling the Peruvian forest supply chain • La Cámara Nacional Forestal (2022), *Una nueva Política Nacional para los Bosques del Perú*. • World Bank (forthcoming), Country Climate and Development Report.
Prior Action 8. Promote climate-smart agriculture	• Chavas, J. P., & Nauges, C. (2020). Uncertainty, learning, and technology adoption in agriculture. Applied Economic Perspectives and Policy, 42(1), 42-53. • Takahashi, K., Muraoka, R., & Otsuka, K. (2020). Technology adoption, impact, and extension in developing countries' agriculture: A review of the recent literature. Agricultural Economics, 51(1), 31-45. • Kondylis, F., Mueller, V. and J. Zhu, 2015. Measuring agricultural knowledge and adoption. Agricultural Economics 46 (3): 449-462. • Davis, Kristin E., Suresh Chandra Babu, and Catherine Ragasa. 2020. Agricultural extension: Global status and performance in selected countries. Intl Food Policy Res Inst. • Organization for Economic Co-operation and Development (OECD). 2017. Environmental Performance Reviews: Peru 2017, OECD Environmental Performance Reviews, OECD Publishing, Paris.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

64. **This operation is aligned with key Bank strategies and the current CPF.** An example is the Bank's COVID-19 Crisis Response to Resilient Recovery paper, which lays out a broad framework and integrated approach to promote recovery and growth through green, resilient, and inclusive development (GRID).[57] Another is the WBG Climate Change Action Plan 2021-2025, which represents a shift from "green" projects to greening entire economies, and from focusing on inputs to impacts.[58] The proposed operation is aligned with the forthcoming Peru Country Partnership Framework (CPF) FY23–FY27 under preparation, with 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 aligned with the Government's Strategic Plan for National Development (PEDN).

65. **The objectives of this operation are complemented by other projects under implementation.** Similar to the proposed operation, the Peru Enabling a Green and Resilient Development DPF (EGRD, P177765) supports green finance and public and private investment framework in Peru through complementary instruments. In addition, the EGRD DPF supports the transition to a greener economy in complementary sectors. The proposed operation supports green production in industry, forestry and agriculture while the EGRD DPF supports reforms on urban development, transport, and energy. In addition, two other DPFs are currently in implementation: Investing in Human Capital DPF II (P176387), with the objective of improving delivery of social protection and teacher management systems; and Peru: Strengthening Foundations for Post COVID-19 Recovery DPF (P174440), which focuses on reinforcing structural foundations for an inclusive and climate smart economic recovery.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

66. **The objectives, pillars, policy actions and expected results of the operation have been defined in collaboration with the Government's key sectoral entities through a consultation process led by the MEF**, which is the implementing agency for the DPF operation. The operation's task team maintained a close dialogue with representatives from key line ministries, agencies, and sectoral entities, including MEF, MINAM, SERFOR, PRODUCE, MIDAGRI, SUNAT, *ProInversión* and others. Through an iterative process of sectoral consultations, a multidisciplinary World Bank Group team has worked with an array of counterparts in the above-mentioned entities to define policy reform priorities, identify prior actions that would promote these reforms, and determine the most impactful results indicators.

67. **Consultations**. According to article 14 of Supreme Decree No. º 001-2009-JUS, public agencies must publish the draft bills in the official gazette, in their electronic portals (websites) or by any other means, within a period of no less than thirty days before the date scheduled for the bill's entry into force, except in exceptional cases, to enable citizens to comment on the proposed measures. In addition, regarding bills of law, the No. 9 2012 2013 / COUNCIL-CR Agreement of

[57] WBG (2021) From COVID-19 Crisis Response to Resilient Recovery: Saving Lives and Livelihoods while Supporting Green, Resilient and Inclusive Development (GRID).
[58] World Bank Group. 2021. World Bank Group Climate Change Action Plan 2021–2025: Supporting Green, Resilient, and Inclusive Development. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35799.

the National Congress' Directive Board establishes that all bills of law that are presented and published, are entered in the Congress' Virtual Legislative Forums. The objective of this provision is to promote the participation of citizens and civil society in the analysis and debate of bills, through relevant contributions, comments, and opinions, during the legislative process. In some cases, the reforms supported under this operation went above and beyond the required consultations. For instance, the development of the regulatory framework for promoting commercial forest plantations went through six national and thirteen regional consultation events, and solicited written inputs from government officials, business owners, international donors, NGOs and national experts.

68. **Collaboration with other development partners.** The operation, as part of the WBG's broader program of support to Peru has benefited from close coordination with development partners. These include the IMF, Inter-American Development Bank (IADB), Development Bank of Latin America (CAF), United States Agency for International Development (USAID), the Swiss State Secretariat for Economic Affairs (SECO), GIZ, and others under the overall guidance of MEF. Some of the prior actions supported by this program are informed by long-standing technical assistance by the Bank and other international partners. Bank staff have met regularly with staff of other international institutions to coordinate efforts and align messages. One example is collaboration with the IADB on support to the innovation agenda.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

69. **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** (See Annex 4 for complete assessment). Specifically, the reforms under Pillar A, 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 Action 1,* on fiscal consolidation is expected to foster economic growth and decrease income variability, although the effect on poverty and household incomes will ultimately depend on the categories of public expenditures that may be reduced in the short run versus the potential gains in revenues of higher investment due to lower macro-fiscal risks. *Prior Action 2* which supports the targeting and efficiency of government spending in public infrastructure is expected to have indirect positive effects on poverty reduction by creating new jobs due to higher infrastructure investments and improving access to basic services. Policies aiming at improving procurement processes, accountability and project management for infrastructure investments under *Prior Action 3* are expected to indirectly improve household welfare by releasing public funds that could be reoriented to social infrastructure and other productive investments.

70. **Prior actions in pillar B aiming at fostering a more inclusive and competitive financial sector are expected to have both direct and indirect positive impacts in poverty reduction efforts.** *Prior action 4* aiming at increasing competition in the financial sector and allowing new entrants into the market is expected to reduce prices of financial service and expand the use of these services, particularly for women and the rural population.[59] As of 2021, 57.5 percent of adults had a bank account while 22.1 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. *Prior action 5,* which aims to improve firms' access to finance through factoring, is expected to have indirect positive poverty effects through the creation of jobs from higher investments by MSMEs which face significant barriers to access financing.

[59] Burguess and Pande (2005); Karlan and Zinman (2010); Dupas and Robinson (2013); Kast and Pomenraz (2014); and Brune et. al (2016), Trivelli et al (2008) and Trivelli et al (2011).

Only 39 percent of MSMEs have access to the regulated financial system, and just 8 percent of MSMEs had access to a loan product.

71. **Policies corresponding to pillar C seeking to promote greener and more sustainable production industry, are expected to have welfare enhancing direct and indirect effects.** Prior actions in this pillar are expected to reduce pollution and mitigate climate change risks, spurring a sustainable and social inclusive commercial forest plantation industry. More specifically, *Prior action 6* is expected to have indirect impacts on welfare by reducing pollution and mitigating climate change, as air pollution is among the fifth highest health risks in the country, causing more than 11,000 deaths per year, and negatively affecting labor supply.[60] Although the agreements are voluntary, firms that decide to use the instrument can contribute to reduction of contaminants, lower emissions, and better waste management. Investments in sustainable and socially inclusive commercial forest plantation supported by *Prior Action 7* can have long term positive impacts on income generating opportunities through the creation of green jobs and reducing climate impacts by deforestation, particularly since deforestation has been growing rapidly in the past two decades. According to GEOBOSQUES, between 2001 and 2020 a total of 2.6 million hectares of forest have been deforested. [61]

72. **The promotion of climate-smart agriculture through the agricultural extension system per *Prior Action 8* is expected to have positive economic and social effects** among the 2.2 million beneficiary farmers by means of higher productivity and climate resilience.[62] Access to technology and adoption of sustainable practices are also expected to reduce rural poverty, improve livelihoods, and manage natural resources in a more sustainable way. Estimates suggest that income per produced hectare increases between 50 and 30 percent from adoption of technologies such as technical irrigation and certified seeds.[63] The updated land classification supported in PA 8 is expected to have mixed impacts. In the short term, reduced agricultural land availability may affect the income generation of rural households, but in the long term, economic opportunities may improve due to land becoming more sustainable.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

73. **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, four prior actions (prior actions 3, 6, 7, and 8) are expected to have positive environmental effects. Even though the implementation of two prior actions (prior actions 3 and 7) has the potential to lead to negative environmental effects, the national legal framework incorporates the necessary mitigation measures for their adequate management, as reflected below.

74. **The prior actions under the first pillar are expected to lead to more sustainable and efficient expenditures and more efficient and greener public and private investment.** Specifically, Prior Action 3 aims to integrate climate considerations in the design and execution of PPP leading to a reduction in GHG emissions and promotion of ecosystem conservation. Peru's system and robust environmental regulatory framework would be able to mitigate any adverse impacts that could result from the PPP projects' acceleration and enhancement. Besides, the corresponding decree (*Decreto Legislativo 1543*) under this Prior Action mandates that the principle of sustainability (including environmental sustainability and climate resilience) is considered in all phases of the project lifecycle (Article 4).

[60] Aragon et al (2017).
[61] GEOBOSQUES is the monitoring platform for changes in forest cover from the Ministry of Environment (MINAM).
[62] INA (2022).
[63] Apoyo (2021).

75. The third pillar of the operation supports greener production. It includes three measures with positive environmental effects, and one with potential negative indirect impacts, in which case the national legal framework incorporates the necessary mitigation measures for their adequate management. Prior Action 6 is expected to contribute to climate change adaptation and mitigation through the manufacturing firms' improvements to production processes and environmental management practices. Prior Action 7 aims to address deforestation and forest degradation through incentivizing private investments in commercial forest plantations in degraded public land areas in an environmentally sustainable manner. Although the proliferation of forest plantations may have associated adverse environmental impacts, if not properly managed, the measure clearly establishes that plantations cannot be implemented in primary or secondary natural forests. Also, plantations that due to their nature and location could generate negative environmental impacts, are subject to an environmental certification, as regulated by the country's environmental impact evaluation system (SEIA).

76. Prior Action 8 aims to promote climate-smart agriculture, through strengthening of the agricultural extension system, by Law Nº 31368. Strengthening the agricultural extension system is expected to enhance access, affordability and quality which could lead to greater technology and farming practices adoption contributing to productivity growth and resilience to climate change. Like other countries, Peru faces constraints in implementing agricultural extension such as lack of coordination among players, low quality control in the delivery, and planning and monitoring of results. A key step taken by the Government of Peru was the work done under the National Agriculture Innovation Program (PNIA). The PNIA was created by MIDAGRI to strength the Agriculture Innovation System (SNIA), which include public agencies, research institutes, universities, producer organizations, and private firms. The project supported several sub-projects funded through competitive grants to promote uptake of agriculture innovation by farmers. In addition, Prior Action 8, aims to regulate land use classifications to ensure optimal social and economic use while avoiding ecosystem degradation by Supreme Decree N° 005-2022-MIDAGRI, which aims to strength the capacity of the government to control the expansion of the agriculture frontier into forest areas unsuitable for agriculture development, therefore, reducing deforestation (CO_2 emissions from land-use change).

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

77. Peru's public financial management (PFM) system, the use of budget resources, and its foreign exchange (FOREX) internal control environment as managed by the Central Bank do not pose material risks to the development objectives of the operation.

78. Peru's PFM framework is closely aligned with best international practices. Peru's budgeting practices meet most of the principles of the IMF Fiscal Transparency Code at a good or advanced level, and it ranks 61 out of 100 in the Open Budget Survey.[64] Although moderate shortcomings exist, they do not pose material risks to the operation's development objectives. The areas for improvement include challenges in the medium-term budget planning, which are reflected in constant incremental changes in the initially approved budget compared to the executed budget.[65] Furthermore, the budget control and oversight functions present some limitations given the excessive concentration of control functions in the country's Supreme Audit Institution, which still has gaps with respect to international good practices.

79. Government commitment to support PFM reforms. During the last decade the GoP has demonstrated good progress in implementing PFM reforms at the central government level, including among others the existence of solid

[64] https://internationalbudget.org/open-budget-survey/country-results/2021/peru.
[65] The actual expenditure deviated from budgeted expenditure by 14 percent in 2019 and 3 percent in 2020 and 9 percent in 2021.

information technology systems, including the integrated financial management system (SIAF) and the single treasury account, the gradual implementation of International Public Sector Accounting Standards (IPSAS) at the central government level, and improvements in the tax collection system.[66] In addition, the country carried out a significant overhaul of its PFM legal framework in September 2018, issuing a new comprehensive set of decrees covering all the dimensions of the PFM cycle.

80. Budget credibility and comprehensiveness. Policies and priorities are broadly reflected in the budget. The budget is formulated using a Multiannual Macroeconomic Framework which sets the macro targets for the following three years on a rolling annual basis. The Ministry of Finance (MEF by its acronym in Spanish) is responsible for undertaking the budget preparation process, taking into consideration multiple factors, including the priorities identified during the budget planning process, the potential sources of income, the fiscal rules in place, and the macroeconomic and fiscal projections. The legal framework sets clear procedures for the preparation, approval, and execution of the budget.[67]

81. Budget transparency and control in budget execution. The general Government budget is made publicly available on MEF's external website.[68] Peru produces a wide array of in-year fiscal reports with a high degree of frequency and timeliness. The transparency section of the MEF's website allows access to information on budget execution updated on a daily basis and covers the national, regional, and local levels. Budget reports can be obtained based on programmatic, functional, and administrative classifications. In addition to this, the MEF prepares analytical reports with different frequencies, including follow-up on the compliance with fiscal rules (quarterly), debt report (daily, monthly, and quarterly), and execution of investment projects (updated daily). There is no evidence of material concerns regarding data accuracy of these reports.

82. Budget Control and Monitoring Systems. Budget execution, control and monitoring is done through the integrated financial management system (*Sistema Integrado de Administración Financiera,* SIAF). SIAF has embedded adequate controls for budget execution, which allows monitoring throughout the different stages of the budget process including commitment, certification, and final payment to beneficiaries. The single treasury account system is also integrated into SIAF, allowing for the consolidated control of the government bank accounts.

83. Public Procurement System. Public procurement is governed by the *Ley de Contrataciones del Estado* ("Public Procurement Law"), its amendments and rulings, which establish the criteria to carry out procurement with transparency, efficiency, competitivity, equality and integrity. The Public Procurement Law complies with good international practices related to the control of public procurement regarding independent control institutions, the existence of defined mechanisms in relation to control under the direction of the General Comptroller. According to the last assessment carried out in 2016 with Methodology of Assessing Procurement Systems (MAPS), there have been improvements in the 4 Pillars, compared to the previous study (2008), in particular with the ones related to two Pillars: (I) Legislative and Regulatory

[66] A Tax Administration Diagnostic Assessment Tool (TADAT) evaluation conducted by the IMF in 2017 concluded that the tax administration authority (SUNAT) was making good progress in implementing modern tax administration practices making use of new technology.
[67] Nevertheless, it is important to mention that the Fiscal Transparency Evaluation of 2015 (latest available) pointed out difficulties in connecting macro-fiscal objectives with annual and medium-term budget planning, which are reflected in the constant incremental changes in the initially approved budget.
[68] The general government budget is available at the MEF website: https://www.mef.gob.pe/es/?option=com_content&language=es-ES&Itemid=101160&lang=es-ES&view=article&id=951.

Framework[69], and (II) Institutional Framework and Management Capacities.[70] For public procurement, the electronic procurement system (*Sistema Electrónico de Adquisiciones y Contrataciones del Estado*, SEACE) is mandatory, easily accessible, and free for all user levels, providing information on contracting procedures. Therefore, no major procurement risks related to the implementation of the Prior Actions are expected. In addition to that, a new version of the current Regulation is expected to be approved in October 2022, and the project of a new procurement law is foreseen to be submitted to the Congress in October 2022.

84. External scrutiny of public expenditures. The CGR provides independent oversight of public finances. The CGR is an independent body established under the Constitution to audit all public entities. It undertakes compliance and financial audits of fiscal statements in accordance with the International Standards of Supreme Audit Institutions. Overall, the CGR is a solid institution with adequate independence, legal and normative framework. The CGR is also in the process of implementing further reforms aimed at modernizing its control practices.

85. Foreign exchange management. In the absence of a current IMF Safeguard Assessment Report (the latest report was issued in 2007), alternative procedures were undertaken. The published audited financial statements of the Central Reserve Bank of Peru (BCRP) for calendar year 2021 were reviewed. These financial statements present reliable financial information largely aligned with International Financial Reporting Standards. The audit was carried out in accordance with International Standards on Auditing by an audit firm acceptable to the World Bank. Unmodified opinions from the external auditors did not reveal any significant issues related to the internal control environment. This review concluded that the FOREX internal control environment does not pose risks to the development objectives of this operation.

86. Disbursement and auditing arrangements. Upon approval of the operation and effectiveness of the Legal Agreement, the proceeds of the loan will be disbursed into an account at the BCRP, which is part of the country's Foreign Exchange Reserves. The funds will then be transferred into the Single Treasury Account managed by MEF at *Banco de la Nación*. Transactions and balances will be fully incorporated into the Borrower's accounting records and financial statements through SIAF. The Borrower, within 45 days after the withdrawal of the funds from the financing account, shall report to the Bank: (i) the exact sum received into the account referred to in Section 2.03 (a) of the General Conditions; (ii) the details of the account to which the local currency equivalent of the Loan proceeds was credited; and (iii) the record that an equivalent amount has been accounted for in the Borrower's budget management systems. Given that the control environment into which the DPF proceeds would flow is adequate, the World Bank will not require a dedicated account at the BCRP for loan proceeds. On this basis, no specific audit of the deposit of the credit proceeds will be required and no additional fiduciary arrangements are considered necessary.

87. The closing date of the proposed operation is December 29, 2025.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

88. As the implementing entity, the MEF is responsible for collecting and monitoring information related to program implementation and progress towards the achievement of results for this DPF operation. MEF is further

[69] The main improvements include the following: (i) establishes a clear definition of the acceptable procedures to carry out the acquisitions, (ii) the calls are published in the SEACE promoting transparency and granting sufficient time to present an offer, (iii) establishes the participation of any supplier, not having preferential treatment, (iv) guarantees the right of review by those who participate in the selection processes, etc.

[70] Regarding this Pillar, the most important improvements include, among others the following: (a) Procurement actions are not initiated without the corresponding budget allocations, (b) OSCE is the normative entity with clearly assigned functions, which are specified in its legal and regulatory framework in a precise manner, without gaps or overlaps.

responsible for coordinating necessary actions among the agencies involved in the reform program supported by this DPF operation, which include MINAM, PRODUCE, SERFOR, SUNAT, *ProInversión*, 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 of the program development objectives. The monitoring and evaluation of the operation will be also carried out through ongoing policy dialogue, the preparation of any subsequent operations, and the accompanying technical assistance projects.

89. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as Prior Actions or tranche release conditions under a World Bank Development Policy Financing may submit complaints to the responsible country authorities, appropriate local/national grievance mechanisms, or the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Project affected communities and individuals may submit their complaint to the Bank's independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred, or could occur, as a result of Bank non-compliance with its policies and procedures, and the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the Bank's Accountability Mechanism, please visit https://accountability.worldbank.org.

6. SUMMARY OF RISKS AND MITIGATION

90. **The overall risk rating for the proposed operation is assessed as Substantial.** The key risk ratings are included in the table below. The substantial risks identified include: (i) political and governance and (ii) institutional capacity for implementation and sustainability.

91. **Political and Governance Risk are considered Substantial**. 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; (ii) complementary WBG engagement in the policy areas supported by the operation (such as PPPs, financial sector, and forestry), which will help maintain adequate high-level and technical dialogue despite possible political changes; and (iii) 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).

92. **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.

Table 5: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	Substantial
2. Macroeconomic	Moderate
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Moderate
7. Environment and Social	Moderate
8. Stakeholders	Moderate
9. Other	Moderate
Overall	Substantial

ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions and Triggers	Results		
Prior Action	**Indicator Name**	**Baseline**	**Target**
Pillar A: Strengthen fiscal resilience and efficiency			
Prior Action 1. To support fiscal consolidation, the Borrower has approved caps for the non-financial public sector on total gross debt of 38% of GDP starting in fiscal year 2023 and 30% within 10 years, and on the annual deficit of 2.4% in 2023 to 1.0% in 2026, respectively, as evidenced by Law No. 31541 published in the Official Gazette on August 4th, 2022.	**Results Indicator 1:** Fiscal deficit (% GDP)	RI#1: 2.6% (2021)	RI#1: 2% (2024)
Prior Action 2. To improve the targeting and efficiency of public investment in infrastructure, the Borrower has: (a) mandated an increase in the minimum percentage of FONCOR funds that Regional Governments are required to allocate to Regional Impact Investments from 35% in 2023 to 100% by 2027, as evidenced by Supreme Decree No 038-2022-EF, published in the Official Gazette on March 18, 2022; and (b) expanded the sources of funding and types of investments that are eligible for private financing and execution under the Works for Taxes modality, as evidenced by Legislative Decree No. 1534 published in the Official Gazette on March 19, 2022.	**Results Indicator 2A**: Percentage of FONCOR committed to finance Regional Impact Investments **Results Indicator 2B:** Increase in financing provided by private companies for public investments at the subnational level through the modality of Works for Taxes (percent)	RI#2A: 0% (2022) RI#2B: 0 % (2019)	RI#2A: 45% (2024) RI#2B: 80% (2024)
Prior Action 3. To foster low-carbon and climate resilient Public-Private Partnership (PPP) Projects, the Borrower has added environmental sustainability, including climate resilience, to the criteria that are required to be applied to all phases of the development of projects published within the National Infrastructure Plan for Competitiveness, as evidenced by Legislative Decree 1543 published in the Official Gazette on March 26, 2022 and the	**Results Indicator 3:** PPP projects that are included in the National Infrastructure Plan for Competitiveness (NIPC) are prioritized and awarded following the climate informed	RI#3: No (2022)	RI#3: Yes (2024)

Prior actions and Triggers	Results		
Supplementary Modifying Provisions of the Supreme Decree No. 211-2022-EF published in the Official Gazette on September 14, 2022.	environmental sustainability criteria		
Pillar B: Foster a more inclusive and competitive financial sector			
Prior Action 4. To improve financial inclusion and promote competition in the financial system the Borrower has: (a) facilitated the market entry of 100 percent digital financial service providers by eliminating requirements to have a physical headquarters or principal office, and permitting them to perform digitally all operations that they are licensed to perform, (b) facilitated the market entry of non-deposit-taking credit providers by introducing a new license for such providers with a simplified regulatory and supervisory framework; and (c) facilitated competition in the cash transportation sector by reducing minimum capital requirements for licensed providers, as evidenced by Legislative Decree No. 1531 published in the Official Gazette on March 19, 2022.	**Results Indicator 4a:** Percentage of adults with an account at a financial institution or mobile money provider **Results Indicator 4b:** Gender gap in percentage of adults with an account at a financial institution or mobile money provider (percentage points)	RI#4a: 57% (2021) RI#4b: 9 (2021)	RI#4a: 65% (2024) RI#4b: 4 (2024)
Prior Action 5. To improve the enabling environment for factoring, the Borrower, through SUNAT, has established a regulatory framework and a registry for the confirmation of electronic invoices, as evidenced by Superintendency Resolution No. 00165-2021/SUNAT published in the Official Gazette on November 18, 2021.	**Results Indicator 5:** Registry for the confirmation of electronic invoices is operational	RI#5: No (2021)	RI#5: Yes (2024)
Pillar C: Promote greener production			
Prior Action 6. To incentivize clean industrial production, the Borrower has approved a directive that regulates the expression of interest, evaluation, formulation, subscription, execution, follow-up and final evaluation of clean production agreements between industrial manufacturing or domestic trade firms and the Ministry of Production, as evidenced by Ministerial Resolution Nº 00146-2022-PRODUCE published in the Official Gazette on April 20, 2022.	**Results Indicator 6:** Number of clean production agreements signed	RI#6: 0 (2021)	RI#6: 7 (2024)
Prior Action 7. To develop a sustainable forest industry, the Borrower, through the National Forest and Wildlife Service, has approved the "Strategy for Promoting Commercial Forest Plantations 2021-2050", kick-starting a short-, medium-, and long-term series of concrete proposed actions (such as	**Results Indicator 7:** Area of degraded public land mapped and validated by SERFOR for the development	RI#7: 0 (2022)	RI#7: 800,000(2024)

Prior actions and Triggers	Results		
the mapping and classification of areas for potential plantations) by all key public and private stakeholders for developing the investment enabling conditions, production, transformation, and commercialization of new and existing commercial forest plantations in strategic geographic corridors, as evidenced by Resolution of the Executive Director No. D000190-2021-MIDAGRI-SERFOR-DE published in the Official Gazette on October 12, 2021.	of commercial forest plantations (hectares)		
Prior Action 8. To promote climate-smart agriculture, the Borrower has: (a) passed the Law Regulating the Agriculture Extension Service, which provides for the establishment of a national registry, accreditation system, and supervision of agriculture extension service providers, as evidenced by Law Nº 31368 published in the Official Gazette on December 7, 2021; and (b) approved an updated regulation on the land use classification, which includes forest cover as an integral part, as evidenced by Supreme Decree N° 005-2022-MIDAGRI published in the Official Gazette on April 24, 2022.	**Results Indicator 8:** Increase in farmers that receive technical assistance about climate smart and productivity enhancing agriculture practices (percent)	RI#8: 0% (2019)	RI#8: 34% (2024)

ANNEX 2: FUND RELATIONS ANNEX

PRESS RELEASE

PR22/138

IMF Executive Board Concludes 2022 Article IV Consultation with Peru

FOR IMMEDIATE RELEASE

Washington, DC – May 2, 2022: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Peru on April 29, 2022.

Economic activity in Peru rebounded strongly in 2021 from its deepest downturn in decades. The strong policy response in 2020 help mitigate the impact of the pandemic and created the conditions for a rapid recovery. Progress in the vaccination campaign allowed a gradual lifting of Covid-19 mobility restrictions. Real GDP rose 13.3 percent in 2021, supported by robust external demand, favorable terms of trade, and pent-up domestic demand. Real GDP surpassed its pre-pandemic level but remains below its pre-pandemic trend. Labor force participation and total employment haven't fully recovered. Poverty increased significantly in 2020 and is still above pre-pandemic levels despite some improvement in 2021. Volatility in financial markets has increased amid heightened political uncertainty.

Uncertainty around the outlook is high and the balance of risks is tilted to the downside. Growth is expected to slow to 3 percent in 2022 as external conditions tighten and the policy stimulus is withdrawn. External risks from ongoing geopolitical tensions, a sharp tightening of global financial conditions, extended global supply chain disruptions, and an abrupt growth slowdown in China, Peru's main trade partner could weigh on growth. Domestically, new Covid outbreaks could prompt the reintroduction of containment measures, while political uncertainty and social unrest could weigh on private investment. Inflationary pressures could be more persistent, requiring faster tightening of monetary policy. More rapid progress on containing the pandemic, both globally and domestically, and reduced political uncertainty could result in positive surprises.

Peru's very strong policy frameworks and macroeconomic buffers, further complemented by an FCL arrangement expiring on May 27, will help shield the economy from downside risks. Strong external and fiscal accounts, adequate reserve coverage, access to international capital markets, low public debt, and a resilient financial sector provide Peru with ample buffers to face adverse shocks.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They commended the Peruvian authorities for a decisive macroeconomic policy response, sustained by very strong policy frameworks and buffers, that helped mitigate the impact of the Covid-19 pandemic and

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

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Washington, DC 20431
USA

support a strong economic recovery. Directors noted, however, that the macroeconomic outlook remains uncertain, and external and domestic risks are still elevated. Against this background, they concurred that the policy mix should strike a balance between responding to rising inflation and managing downside risks to growth, as the impact of the pandemic on employment and poverty continues to be reversed. Directors also underscored the importance of maintaining and further strengthening policy institutional frameworks.

Directors agreed that fiscal policy should remain broadly neutral in the short term but a gradual consolidation, encompassing revenue mobilization and expenditure rationalization, including pension reforms, will be necessary to address emerging spending needs while preserving fiscal sustainability. They welcomed the authorities' steps to clarify policy intentions by aligning the fiscal rules and the medium-term budgeting framework, as well as their commitment to strengthen the Fiscal Council with technical assistance from the Fund.

Directors agreed that further tightening of monetary policy is warranted to bring inflation and inflation expectations back to the target range and help adjust to tighter global financial conditions. While foreign exchange intervention is warranted to contain excess volatility, Directors underscored that reducing its frequency would facilitate market development and de-dollarization.

Directors supported the gradual unwinding of pandemic-era prudential policies in a context of limited financial system vulnerabilities. They concurred that closing remaining regulatory and supervisory gaps and further enhancing systemic risk assessment will be important to strengthen financial resilience. Directors noted that exploring the introduction of a central-bank digital currency will require a thorough assessment of risks and costs.

Directors agreed that a renewed structural reform agenda in the context of the OECD accession process will be critical to mitigate scarring from the pandemic and support a green and inclusive recovery. They stressed the importance of addressing informality in the labor market, especially among women. More effective public services and greater transparency, including through civil service reform and anti-corruption measures, as well as a stable and predictable legal and regulatory environment, will be key to these efforts. Steps will also be needed to reduce risks from climate change, ease the transition to a low-emission economy, and contribute to global mitigation efforts.

Peru: Selected Economic Indicators

				Projections		
	2019	2020	2021	2022	2023	2024
Social Indicators						
Poverty rate (total) 1/	20.2	30.1	22.1	...	...	...
Unemployment rate (in percent; average)	6.6	13.9	10.9	...	...	...
	(Annual percentage change; unless otherwise indicated)					
Production and prices						
Real GDP	2.2	-11.0	13.3	3.0	3.0	3.0
Output gap (percent of potential GDP)	-1.6	-7.3	-0.4	-0.3	0.0	0.0
Consumer prices (end of period)	1.9	2.0	6.4	4.0	3.0	2.3
External sector						
Exports	-2.2	-10.6	47.1	16.1	3.4	2.8
Imports	-1.8	-15.6	39.3	17.9	4.7	4.8
External current account balance (% of GDP)	-1.0	0.8	-2.8	-1.5	-1.4	-1.5
Gross reserves						
In billions of U.S. dollars	68.4	74.9	78.5	78.2	77.9	78.9
Percent of short-term external debt 5/	428	487	586	561	537	565
Money and credit 2/ 3/						
Broad money	8.8	29.0	2.6	8.4	6.6	6.6
Net credit to the private sector	6.4	14.0	6.3	8.7	7.8	5.6
	(In percent of GDP; unless otherwise indicated)					

Public sector						
NFPS revenue	24.8	22.0	25.6	24.4	24.3	24.3
NFPS primary expenditure	25.0	29.2	26.6	25.5	25.1	24.5
NFPS primary balance	-0.2	-7.3	-1.0	-1.0	-0.8	-0.2
NFPS overall balance	-1.6	-8.9	-2.6	-2.6	-2.1	-1.5
Debt						
Total external debt 4/	34.7	43.3	46.1	43.5	40.0	37.8
NFPS gross debt 5/	27.1	35.1	35.9	34.4	34.7	34.4
External	8.5	14.9	19.6	20.2	19.4	18.5
Domestic	18.6	20.2	16.3	14.2	15.3	15.9
Savings and investment						
Gross domestic investment	21.0	19.3	21.3	25.1	24.7	24.5
National savings	20.0	20.0	18.6	23.6	23.3	23.0
Memorandum items						
Nominal GDP (S/. billions)	771	717	872	958	1,018	1,070
GDP per capita (in US$)	6,963	6,127	6,643	7,034	7,475	7,748

Sources: National authorities; UNDP Human Development Indicators; and IMF staff estimates/projections.

1/ Defined as the percentage of households with total spending below the cost of a basic consumption basket.

2/ Corresponds to depository corporations.

3/ Foreign currency stocks are valued at end-of-period exchange rates.

4/ Includes local currency debt held by non-residents.

5/ Includes repayment certificates and government guaranteed debt.

ANNEX 3: LETTER OF DEVELOPMENT POLICY

PERÚ | Ministerio de Economía y Finanzas | Despacho Ministerial

MEF

Firmado Digitalmente por SOTELO BAZAN Betty Armida FAU 20131370645 soft Fecha: 10/11/2022 11:09:12 COT Motivo: Doy V° B°

"DECENIO DE LA IGUALDAD DE OPORTUNIDADES PARA MUJERES Y HOMBRES"
"AÑO DEL FORTALECIMIENTO DE LA SOBERANIA NACIONAL"
"AÑO DEL BICENTENARIO DEL CONGRESO DE LA REPÚBLICA DEL PERÚ"

MEF

Firmado Digitalmente por COBEÑAS AQUINO Pedro Valentin FAU 20131370645 soft Fecha: 09/11/2022 21:53:33 COT Motivo: Doy V° B°

KURT BURNEO FARFÁN
MINISTRO

Lima, 11 NOV. 2022

OFICIO N° 1793 -2022-EF/10.01

CARTA DE POLÍTICAS

MEF

Firmado Digitalmente por CALDERON VALENZUELA Jose Armando FAU 20131370645 soft Fecha: 11/11/2022 17:03:48 CST Motivo: Doy V° B°

Señor
DAVID MALPASS
PRESIDENTE
GRUPO DEL BANCO MUNDIAL
WASHINGTON D.C.

Referencia: Programa de Crecimiento y Finanzas Sostenibles por US$ 750,0 millones.

Estimado Sr. Malpass,

Tengo el agrado de dirigirme a usted a fin de manifestarle el compromiso del Gobierno del Perú de impulsar medidas de políticas para fortalecer la sostenibilidad y eficiencia fiscal, fomentar un sector financiero más inclusivo y competitivo, así como promover una producción más verde.

En este marco, se ha venido desarrollando con el Banco Internacional de Reconstrucción y Fomento (BIRF) el "Crecimiento y Finanzas Sostenibles", el cual incorpora acciones de reforma y compromisos y comprende una operación de endeudamiento.

A continuación, se describe el contexto actual y perspectivas económicas del país y posteriormente los objetivos del Programa, así como los pilares y áreas de políticas que lo enmarcan.

PERÚ | Ministerio de Economía y Finanzas | Despacho Ministerial

"DECENIO DE LA IGUALDAD DE OPORTUNIDADES PARA MUJERES Y HOMBRES"
"AÑO DEL FORTALECIMIENTO DE LA SOBERANÍA NACIONAL"
"AÑO DEL BICENTENARIO DEL CONGRESO DE LA REPÚBLICA DEL PERÚ"

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A. Contexto actual y perspectivas económicas

A.1 Contexto internacional

En 2022, la economía global se encuentra en proceso de ralentización afectada por una lenta recuperación de las disrupciones en la cadena de suministros y un endurecimiento de las condiciones financieras como consecuencia de la política monetaria más restrictiva para controlar la inflación. Según, el último informe de Perspectivas de la Economía Mundial[1] del Fondo Monetario Internacional (FMI), el PBI mundo pasó de una proyección de 3,6% en abril a 3,2% en julio para 2022. En esa misma línea, según el Marco Macroeconómico Multianual 2023-2026, se revisó de 3,6% a 2,9% el PBI para 2022. El ajuste a la baja de las proyecciones se debe a la débil mejora en la cadena de suministros, la cual fue afectada por el conflicto entre Rusia y Ucrania, y la estricta aplicación de la política "Cero COVID" en China; además, del endurecimiento de las condiciones financieras globales por la subida de tasas de interés de los bancos centrales a nivel global para controlar la inflación, que se ha convertido en un problema complejo no visto en los últimos 40 años. En este contexto, los indicadores adelantados de actividad económica se vienen deteriorando. Por ejemplo, el indicador que engloba las actividades asociadas a los sectores de manufactura a nivel mundial (PMI) se ha deteriorado al pasar de 52,3 puntos en julio a 50,3 puntos en agosto y está próximo a ubicarse en zona de contracción. Cabe mencionar que persisten los riesgos latentes que podrían afectar la recuperación económica global. Entre los más importantes se encuentran: i) las condiciones financieras adversas por la implementación de las políticas monetarias más estrictas, principalmente, de la Reserva Federal de los EE. UU. (FED, por sus siglas en inglés) y del Banco Central Europeo (BCE), ii) la continuidad de la guerra entre Rusia y Ucrania, y agravamiento de las tensiones geopolíticas con los países de occidente, iii) la posibilidad de nuevos rebrotes de la COVID-19 que obligue a establecer nuevos confinamientos como lo ocurrido en China a inicios de año, iv) posible escenario de estanflación, y v) escenarios de crisis fiscales y financieras, especialmente, en economías con débiles fundamentos macroeconómicos.

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A.2 Situación actual de la economía

En 2021, el PBI de Perú lideró el crecimiento económico a nivel de los países de la región. La actividad económica creció 13,6% en 2021, convirtiendo a Perú en una de las economías con el mayor crecimiento a nivel mundial, favorecido por la flexibilización de las restricciones, el impulso de las medidas de reactivación económica, la rápida recuperación de las inversiones y el efecto estadístico positivo. Cabe mencionar que un factor clave para la recuperación económica ha sido el mayor avance del proceso de vacunación, ya que el control de la pandemia ha permitido aumentar la operatividad de las actividades económicas.

[1] World Economic Outlook.

PERÚ | Ministerio de Economía y Finanzas | Despacho Ministerial

"DECENIO DE LA IGUALDAD DE OPORTUNIDADES PARA MUJERES Y HOMBRES"
"AÑO DEL FORTALECIMIENTO DE LA SOBERANIA NACIONAL"
"AÑO DEL BICENTENARIO DEL CONGRESO DE LA REPÚBLICA DEL PERÚ"

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En ese sentido, el gobierno cumplió con superar ampliamente el porcentaje de la población cubierta con dos dosis (más del 85% de la población total).

Entre enero y julio de 2022, la actividad económica ha continuado con su proceso de recuperación, pese al impacto del contexto externo menos favorable. Así, entre enero y julio 2022, el PBI creció 3,2%, entorno a su crecimiento potencial, la cual estuvo sostenido por la dinámica favorable de los sectores no primarios que crecieron 4,2% destacando los sectores comercio, servicios y manufactura no primaria; a pesar de los choques de oferta que afectaron a los sectores primarios y condiciones externas menos favorables. En esa misma línea, los indicadores adelantados anticipan que la actividad económica continuará dinámica en los próximos meses. Por ejemplo, la producción de electricidad, indicador altamente correlacionado con el PBI, creció 4,8% en lo que va de septiembre y 3,0% en agosto. Asimismo, las ventas a través de comprobantes electrónicos crecieron 26,0% en agosto en términos reales y registran 23 meses por encima de sus niveles prepandemia.

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La economía continuará con su proceso de recuperación en la segunda mitad de 2022, lo que le permitirá cerrar el año con un crecimiento de 3,3%. Esto se explica por una mayor producción minera ante el inicio de operaciones de Quellaveco y la disipación de conflictos sociales, el incremento de la operatividad de sectores asociados a turismo, la resiliencia del consumo privado y la mayor ejecución de la inversión; además de la implementación del Plan ImpulsoPerú.

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La COVID-19 generó impactos negativos en las finanzas públicas a nivel mundial, lo que se evidenció con incrementos significativos de los déficits fiscales y deudas públicas, seguida de una moderada y desigual recuperación en 2021, por lo cual las cuentas fiscales del mundo se encuentran vulnerables, especialmente en el actual contexto que presenta múltiples riesgos para la economía global. Así, se observó que el déficit fiscal promedio del mundo pasó de 3,6% del PBI a 9,9% del PBI en 2020 y a 6,4% del PBI en 2021. Ello generó que la deuda pública promedio del mundo se incremente de 83,6% del PBI en 2019 a 97,0% del PBI en 2021. Para 2022, el FMI estima que la deuda pública global sería de 94,4% del PBI, manteniéndose en niveles históricamente altos en economías avanzadas, emergentes, Zona euro y América Latina. Esto sería reflejo de un elevado déficit fiscal en el mundo que, si bien caería y llegaría a 4,9% del PBI, registrando una caída por segundo año consecutivo, su reducción sería más acotada (de 1,5 p.p. del PBI entre 2021 y 2022, versus 3,5 p.p. del PBI entre 2020 y 2021) y continuaría estando por encima de lo registrado en 2019 (3,6% del PBI). Según grupos de países, las economías avanzadas y pertenecientes a la Zona euro reducirán su déficit fiscal promedio a un ritmo menor que el año anterior; mientras que, en América Latina y economías emergentes, se prevé un aumento del déficit fiscal.

En contraste, las finanzas públicas de Perú se mantienen como un pilar de competitividad, derivada de un historial de más de dos décadas de manejo fiscal prudente y responsable. De hecho, el manejo fiscal en estos términos durante la pandemia

PERÚ | Ministerio de Economía y Finanzas | Despacho Ministerial

"DECENIO DE LA IGUALDAD DE OPORTUNIDADES PARA MUJERES Y HOMBRES"
"AÑO DEL FORTALECIMIENTO DE LA SOBERANIA NACIONAL"
"AÑO DEL BICENTENARIO DEL CONGRESO DE LA REPÚBLICA DEL PERÚ"

ha permitido que en 2021 se registre una notoria recuperación de las fortalezas fiscales, que son clave para atender choques negativos, y hacen que el reto actual de las finanzas públicas es de menor dimensión al de otros países. Al respecto, Perú redujo su déficit fiscal de 8,9% del PBI en 2020 a 2,5% del PBI en 2021, la deuda pública en 2021 de Perú (35,9% del PBI) continuó siendo una de las menores entre América Latina (72,0% del PBI), países emergentes (65,1% del PBI) y de la Alianza Pacífico (52,8% del PBI), y mantiene una percepción favorable de los mercados financieros que se traduce en menores niveles de riesgo país, acceso a una mayor cartera de inversionistas y bajas tasas de interés. Además, las cuentas fiscales se han fortalecido considerablemente con la recomposición de activos financieros líquidos (2,1% del PBI en el Fondo de Estabilización Fiscal - FEF y la Reserva Secundaria de Liquidez - RSL) en una cuantía similar a sus niveles prepandemia. Cabe señalar que los activos fiscales brindan margen de acción para amortiguar choques adversos y volatilidad del mercado financiero, como en el actual contexto, y evitan que se recurra intensivamente en nuevo endeudamiento que, en contextos de elevada volatilidad, tiene un costo elevado.

Hacia adelante, a través de la recientemente aprobada Ley N° 31541, se dispone un proceso de consolidación fiscal gradual con el que se retornará hacia las reglas fiscales de mediano plazo del marco macrofiscal. En 2022, se prevé que el déficit fiscal se ubique en 2,5% del PBI y que la deuda pública disminuya a 34,9% del PBI, ubicándose ambas variables dentro de las reglas fiscales vigentes para este año (déficit fiscal no mayor a 3,7% del PBI y deuda pública no mayor a 38% del PBI) establecidas a través del Decreto de Urgencia N° 079-2021. Hacia adelante, el proceso de consolidación fiscal aprobada en la Ley N° 31541 no comprometerá la recuperación y el dinamismo de la economía. Así, se establece una reducción gradual del déficit fiscal que, en concordancia con la Ley, se ubicará en 2,4% del PBI en 2023, 2,0% del PBI en 2024, 1,5% del PBI en 2025 y 1,0% del PBI en 2026 y en adelante. Además, dicha norma dispone que la deuda pública se ubique en un nivel menor o igual a 30% del PBI en un periodo no mayor a 10 años (2032). Por ello, considerando dicha senda, la deuda pública se reduciría gradualmente y pasaría de 34,0% del PBI en 2023, 33,1% del PBI en 2025, 30,5% del PBI en 2030, 28,3% del PBI en 2035 y 26,5% del PBI en 2040.

La adopción de dicha senda de consolidación fiscal posiciona a Perú como uno de los primeros en establecer reglas fiscales de mediano plazo tras la COVID-19, y permitirá mantener el pilar de competitividad fiscal que caracteriza a las finanzas públicas del país. Aunque diversos países de la región emprenderán un proceso de este tipo, sus déficits fiscales continuarán siendo en general más altos que los de Perú y se ubicarán por encima de lo que registraban antes de la pandemia. Así también, sus niveles de deuda pública se mantendrán elevados, por lo que sus perspectivas en el escenario adverso actual no son favorables. En contraste, los déficits fiscales a la baja que ha planteado Perú conllevarán a una reducción de la deuda pública del país, con lo cual esta seguirá siendo una de las más bajas de la región y entre economías emergentes. Así, la deuda pública bruta de Perú tendrá una tendencia decreciente en los siguientes años y se ubicaría en 32,5% del PBI en 2026,

PERÚ | Ministerio de Economía y Finanzas | Despacho Ministerial

"DECENIO DE LA IGUALDAD DE OPORTUNIDADES PARA MUJERES Y HOMBRES"
"AÑO DEL FORTALECIMIENTO DE LA SOBERANIA NACIONAL"
"AÑO DEL BICENTENARIO DEL CONGRESO DE LA REPÚBLICA DEL PERÚ"

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significativamente menor al promedio de economías emergentes (73,8% del PBI) y de América Latina (70,6% del PBI). Mantener estas fortalezas fiscales es clave en el contexto actual, donde posicionarse con finanzas públicas competitivas aliviará potenciales aumentos de las tasas de interés y atraerá mayor diversidad de carteras de inversión.

B. Reformas asociadas al programa de apoyo presupuestal, con opción de activación diferida

La operación propuesta comprende reformas prioritarias para el Gobierno del Perú con la finalidad de promover el crecimiento sostenible. Los objetivos se han estructurado en tres pilares: Pilar A: Fortalecer la resiliencia y eficiencia fiscal; Pilar B: Fomentar un sector financiero más inclusivo y competitivo; y Pilar C: Promover una producción más verde.

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La matriz de políticas está compuesta por nueve acciones que se encuentran agrupadas en los tres pilares, de acuerdo al detalle siguiente:

Pilar A: Fortalecer la resiliencia y eficiencia fiscal.

El primer pilar modifica el marco fiscal de mediano plazo para hacerlo viable, fortalece la provisión de infraestructura a nivel subnacional y promueve un contexto propicio para las inversiones verdes. Todo ello contribuiría a mejorar la eficiencia en la inversión pública y privada. En primer lugar, con el propósito de apoyar la consolidación fiscal y renovando el compromiso con la responsabilidad fiscal, se han determinado reglas fiscales para los próximos años a través de la Ley N° 31541, aprobada el 04 de agosto de 2022. Dicha ley establece topes de 38% del PBI para la deuda bruta a partir de 2023 y de 2.4% para el déficit del sector público no financiero en 2023. Además, se prevé una reducción gradual del déficit fiscal y de la deuda pública hacia el cumplimiento de sus reglas fiscales de mediano plazo (1% del PBI y 30% del PBI, respectivamente). De esta manera, se prevé que el déficit fiscal se ubique en 1% del PBI en el año 2026 y que la deuda pública se ubique en 30% del PBI en un periodo no mayor a 10 años. En segundo lugar, para mejorar la focalización y la eficiencia de la inversión pública en infraestructura, se ha previsto dirigir las inversiones financiadas por el Fondo de Compensación Regional (FONCOR) hacia proyectos de mayor impacto, a través de un aumento gradual en el porcentaje mínimo de dichos fondos que deben asignarse por los gobiernos regionales a los Inversiones de Impacto Regional de 35% en 2023 hasta 100% en 2027, evidenciado por el decreto supremo número 038-2022-EF, publicado en el diario oficial el 18 de marzo del 2022. Asimismo, se han expandido las fuentes de financiamiento y los tipos de inversiones que son elegibles para el financiamiento privado y la ejecución de inversiones, bajo la modalidad Obras por Impuestos, por medio del decreto legislativo número 1534, publicado en el diario oficial el 19 de marzo del 2022. Finalmente, para fomentar proyectos de Asociaciones Público-Privadas (PPP) bajos en carbono y climáticamente resilientes, se ha agregado la sostenibilidad ambiental, incluida la resiliencia climática, a los criterios que deben aplicarse a todas las fases del desarrollo de los proyectos publicados dentro del Plan Nacional de Infraestructura para la Sostenibilidad y Competitividad, a través del Decreto Legislativo 1543, publicado en el Diario Oficial el 26 de

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PERÚ | Ministerio de Economía y Finanzas | Despacho Ministerial

"DECENIO DE LA IGUALDAD DE OPORTUNIDADES PARA MUJERES Y HOMBRES"
"AÑO DEL FORTALECIMIENTO DE LA SOBERANIA NACIONAL"
"AÑO DEL BICENTENARIO DEL CONGRESO DE LA REPÚBLICA DEL PERÚ"

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marzo de 2022 y las Disposiciones Complementarias Modificatorias del Decreto Supremo N° 211-2022-EF, publicadas en el Diario Oficial el 14 de septiembre de 2022.

Pilar B: Fomentar un sector financiero más inclusivo y competitivo.
El segundo pilar tiene como objetivo apoyar a aquellas reformas que permitan facilitar el acceso a los servicios financieros, tanto a los ciudadanos como a las empresas micro, pequeñas y medianas, al bajar los costos y suscitar la entrada de nuevos proveedores. En primer lugar, con la finalidad de mejorar el acceso al financiamiento y promover la competencia en el sistema financiero, se ha facilitado la entrada al mercado de proveedores de servicios financieros 100% digitales; se ha facilitado la entrada en el mercado de proveedores exclusivos de crédito, mediante la introducción de un nuevo marco regulatorio y de supervisión simplificado para dichos proveedores; y, se ha mejorado la competencia en el sector de transporte de efectivo, reduciendo los requerimientos mínimos de capital de estas compañías. Todas estas reformas están plasmadas el decreto legislativo número 1531, publicado en el diario oficial el 19 de marzo del 2022. En segundo lugar, buscando mejorar el entorno para factoring, SUNAT ha establecido un marco regulatorio y un registro para dar conformidad a los comprobantes de pago electrónicos como ha sido evidenciado en la resolución número 000165/SUNAT de la Superintendencia de Aduanas y de Administración Tributaria, publicada en el diario oficial el 18 de noviembre del 2021.

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Pilar C: Promover una producción más verde.
El tercer pilar busca mitigar el cambio climático al fomentar que los sectores industriales, forestales y agropecuarios produzcan de forma más verde. En primer lugar, con el propósito de incentivar una producción industrial más limpia y reducir emisiones industriales, se ha aprobado una directriz que regula los acuerdos de producción limpia entre empresas manufactureras o de comercio interior y el Ministerio de Producción, a través de la resolución ministerial número 00146-2022-PRODUCE aprobada el 18 de abril del 2022 y publicada en el diario oficial el 20 de abril del 2022. En segundo lugar, el Servicio Nacional Forestal y de Fauna Silvestre ha aprobado la "Estrategia para la Promoción de Plantaciones Forestales Comerciales 2021-2050", evidenciado por la resolución del director ejecutivo número D000190-2021-MIDAGRI-SERFOR-DE publicada en el diario oficial el 12 de octubre del 2021, la cual busca desarrollar una industria forestal sostenible y abordar el reto de la deforestación. Finalmente, para promover la producción agrícola compatible con la sostenibilidad climática, se ha promulgó la "Ley de Regulación del Servicio de Extensión Agrícola", que prevé el establecimiento de un registro nacional, un sistema de acreditación y la supervisión de los proveedores de servicios de extensión agrícola, evidenciado por la ley número 31368 publicada en el diario oficial el 7 de diciembre del 2021, y se ha actualizado el "Reglamento de Clasificación de Tierras por su Capacidad de Uso Mayor", la cual incluye la cubierta forestal como parte integrante, para asegurar el uso óptimo de las tierras, al mismo tiempo que se evita la degradación ambiental, evidenciado por el decreto supremo número 005-2022-MIDAGRI publicado en el diario oficial el 24 de abril del 2022.

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"DECENIO DE LA IGUALDAD DE OPORTUNIDADES PARA MUJERES Y HOMBRES"
"AÑO DEL FORTALECIMIENTO DE LA SOBERANÍA NACIONAL"
"AÑO DEL BICENTENARIO DEL CONGRESO DE LA REPÚBLICA DEL PERÚ"

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KURT BURNEO FARFÁN
MINISTRO

C. Conclusión

Como se desprende de lo descrito, el Gobierno Peruano está comprometido en sentar las bases para un Programa de Crecimiento y Finanzas Sostenibles, para fortalecer la sostenibilidad y eficiencia fiscal, fomentar un sector financiero más inclusivo y competitivo así como promover una producción más verde.

El Gobierno se compromete a continuar avanzando en estos ámbitos, para lo cual requiere contar con el apoyo del Banco Internacional de Reconstrucción y Fomento en las áreas señaladas.

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En virtud de lo manifestado, por medio de la presente el Gobierno Peruano solicita la aprobación del "Programa de Crecimiento y Finanzas Sostenibles" por un monto de US$ 750,0 millones por parte del Banco Internacional de Reconstrucción y Fomento.

Sin otro particular, hago propicia la ocasión para reiterarle a usted mi especial consideración.

Atentamente,

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KURT BURNEO FARFAN

MINISTER

Lima,

OFFICIAL LETTER No. -2022-EF/10.01

POLICY LETTER

Mr.
DAVID MALPASS
PRESIDENT
WORLD BANK GROUP
WASHINGTON, D.C.

Reference: Sustainable Growth and Finance Development Policy Financing for US$750 million.

Dear Mr. Malpass,

I am pleased to write to you to express the commitment of the Government of Peru to promote policy measures to strengthen fiscal resilience and efficiency, foster a more inclusive and competitive financial sector, and promote greener production

In this context, the "Sustainable Growth and Finance Program" has been developed with the International Bank for Reconstruction and Development (IBRD), which incorporates reform actions, commitments and includes a debt operation.

The following is a description of the country's current context and economic outlook, followed by a description of the Program's objectives, as well as the pillars and policy areas that frame it.

A. Current context and economic outlook

A.1 International context

In 2022, the global economy is in a slowdown process, as it is affected by a slow recovery from supply chain disruptions and a tightening of financial conditions as a result of the more restrictive monetary policy to control inflation. According to the International Monetary Fund's (IMF) latest World Economic Outlook report[71] world GDP went from a projection of 3.6 percent in April to 3.2 percent in July for 2022. Along the same lines, according to the 2023-2026 Multiannual Macroeconomic Framework, GDP for 2022 was revised and readjusted from 3.6 percent to 2.9 percent. The downward projection adjustments are due to a weak improvement in the supply chains, which was affected by the war in Ukraine, the strict application of the "Zero COVID" policy in China, and, also, by the tightening of global financial conditions due to the rise of interest rates in central banks worldwide to control inflation, which has become a complex problem not seen in the last 40 years. In this context, the leading economic activity indicators have been deteriorating. For example, the indicator that encompasses activities associated with the manufacturing sectors worldwide (PMI) has deteriorated, going from 52.3 points in July to 50.3 points in August and is close to being in a contraction zone. It is worth mentioning that latent risks persist that could affect the global economic recovery; the most important of which include: i) the adverse financial conditions due to the implementation of stricter monetary policies, mainly from the US Federal Reserve (FED) and the European Central Bank (ECB), ii) the ongoing war between Russia and Ukraine with the aggravation of geopolitical tensions with Western countries, iii) the possibility of new COVID-19 outbreaks that will force the establishment of new lockdowns, as the one in China at the beginning of this year, iv) possible stagflation scenario, and v) fiscal and financial crisis scenarios, especially in economies with weak macroeconomic foundations.

A.2 Current economic situation

In 2021, Peru's GDP led economic growth in the region. Economic activity grew 13.6 percent in 2021, making Peru one of the fastest-growing economies in the world, favored by restriction relaxations, economic reactivation measure promotions, rapid investment recoveries, and a positive statistical effect. It is worth mentioning that further progress in the vaccination process has been a key factor for economic recovery since control of the pandemic has made it possible to increase the operability of economic activities. In this sense, the government complied with widely exceeding the percentage of the population covered with two doses (more than 85 percent of the total population).

Between January and July 2022, economic activity has continued its recovery process, despite the impact caused by the less favorable external context. Thus, between January and July 2022, GDP grew 3.2 percent, around its potential growth, which was sustained by the favorable dynamics of the non-primary sectors that grew 4.2 percent, with commerce, services, and non-primary manufacturing sectors ranking at the top, despite the supply shocks that affected the primary sectors and the less favorable external conditions. Along the same lines, the leading indicators anticipate that economic activity will continue to be dynamic in the coming months. For example, electric power production, which is an indicator that is highly correlated with GDP, grew 4.8 percent so far in September, and 3.0 percent in

[71] World Economic Outlook.

August. Likewise, sales through electronic receipts grew 26.0 percent in August and register 23 months ahead of their pre-pandemic levels.

The economy will continue its recovery process in the second half of 2022, which will allow it to close the year with a growth of 3.3 percent. This is explained by a higher mining production before the start of operations in Quellaveco and the alleviation of social conflicts, the increased operability of tourism-associated sectors, the private consumption's resilience, and the greater investment executions; in addition to the implementation of the *Plan Impulso Perú.*

COVID-19 generated negative impacts on public finances worldwide, which was evidenced by significant increases in fiscal deficits and public debt, followed by a moderate and uneven recovery in 2021, for which the world's fiscal accounts are vulnerable, especially in the current context that presents multiple risks for the global economy. Thus, it was observed that the world's average fiscal deficit went from 3.6 percent of GDP to 9.9 percent of GDP in 2020 and 6.4 percent of GDP in 2021. This caused the world's average public debt to increase from 83.6 percent of GDP in 2019 to 97.0 percent of GDP in 2021. For 2022, IMF estimates that the global public debt would be 94.4 percent of GDP, remaining at historically high levels in advanced, emerging, Eurozone, and Latin America. This would be the reflection of a high fiscal deficit in the world that, although it would fall and reach 4.9 percent of GDP, registering a fall for the second year in a row, its reduction would be more limited (of 1.5 p.p. of GDP between 2021 and 2022, versus 3.5 p.p. of GDP between 2020 and 2021) and would continue to be above the level registered in 2019 (3.6 percent of GDP). According to country groups, advanced economies and those belonging to the Eurozone will reduce their average fiscal deficit to a lower rate than the previous year; while, in Latin America and emerging economies, an increase in the fiscal deficit is expected.

In contrast, Peru's public finances remain a pillar of competitiveness, stemming from a track record of more than two decades of prudent and responsible fiscal management. In fact, fiscal management in these terms during the pandemic has allowed for significant fiscal strength recovery in 2021, which is key to dealing with negative shocks, and making the current public finances challenges smaller than for other countries. In this regard, Peru reduced its fiscal deficit from 8.9 percent of GDP in 2020 to 2.5 percent of GDP in 2021; Peru's public debt in 2021 (35.9 percent of GDP) continued to be one of the lowest among Latin American countries (72.0 percent of GDP), emerging countries (65.1 percent of GDP) and the Pacific Alliance countries (52.8 percent of GDP), and maintains a favorable perception of the financial markets that translates into lower country risk levels, access to larger investor portfolios, and low interest rates. In addition, the fiscal accounts have been considerably strengthened with the restructuring of liquid financial assets (2.1 percent of GDP in the Fiscal Stabilization Fund – FEF and the Secondary Liquidity Reserve – RSL) reaching similar levels to those in pre-pandemic times. It should be noted that fiscal assets provide room for action to mitigate adverse shocks and financial market volatility, as in the current context, and prevent intensive recourse to new debt, which, in high volatility contexts, has a high cost.

Looking forward, through the recently approved Law No. 31541, a gradual fiscal consolidation process is established with which the medium-term fiscal rules of the macro fiscal framework will be resumed. In 2022, it is expected that the fiscal deficit will be 2.5 percent of GDP and that the public debt will decrease to 34.9 percent of GDP, placing both variables within the current fiscal rules for this year (fiscal deficit not greater than 3.7 percent of GDP and public debt not greater than 38 percent of GDP) as established through Emergency Decree No. 079-2021. Looking forward, the fiscal consolidation process approved by Law No. 31541 will not compromise the economy's recovery and dynamism. Thus, a gradual reduction of the fiscal deficit is established, which, in accordance with the Law, will be 2.4 percent of GDP in 2023, 2.0 percent of GDP in 2024, 1.5 percent of GDP in 2025, 1. 0 percent of GDP in 2026 and so on. In addition, this rule provides the public debt to be established at a level less than or equal to 30 percent of GDP in a period not exceeding 10 years (2032). Therefore, considering this path, the public debt would be reduced gradually and would go from 34.0 percent of GDP in 2023, through 33.1 percent of GDP in 2025, 30.5 percent of GDP in 2030, 28.3 percent of GDP in 2035 and to 26.5 percent of GDP in 2040.

The adoption of this path towards fiscal consolidation positions Peru as one of the first countries to establish medium-term fiscal rules after COVID-19 that will allow maintaining the pillar of fiscal competitiveness that characterizes the country's public finances. Although various countries in the region will undertake a similar process, their fiscal deficits will continue to be generally higher than those of Peru and will show higher levels than those registered before the pandemic. Also, their public debt levels will remain high, so their prospects in the current adverse scenario are not favorable. In contrast, the downward fiscal deficits that Peru has shown will lead to a reduction in the country's public debt, which will to continue to be one of the lowest in the region and among emerging economies. Thus, Peru's gross public debt will have a downward trend in the following years and will stand at 32.5 percent of GDP in 2026, significantly lower than the average for emerging economies (73.8 percent of GDP) and Latin America (70.6 percent of GDP). Maintaining these fiscal strengths is key in the current context, as positioning with competitive public finances will alleviate potential increases in interest rates and attract a greater diversity of investment portfolios.

B. Reforms associated with the budget support program, with an option for deferred activation

The proposed operation comprises priority reforms for the Government of Peru in order to promote sustainable growth. The objectives have been structured into three pillars: Pillar 1: Strengthen fiscal resilience and efficiency; Pillar 2: Foster a more inclusive and competitive financial sector; Pillar 3: Promote greener production.

The policy matrix is made up of nine actions that are grouped into all three pillars, as follows:

Pillar A: Strengthen fiscal resilience and efficiency.

The first pillar modifies the medium-term fiscal framework to make it viable, strengthens the provision of infrastructure at the subnational level, and promotes an enabling environment for green investments. All of this would contribute to improving the efficiency of public and private investment. First, with the purpose of supporting fiscal consolidation and renewing the commitment to fiscal responsibility, fiscal rules have been established for the coming years through Law No. 31541, approved on August 4, 2022. This law establishes caps of 38 percent of GDP for total gross debt from 2023 and 2.4 percent for the deficit of the non-financial public sector. In this way, it is expected that the fiscal deficit will be 1 percent of GDP in 2026 and that the public debt will be 30 percent of GDP in a period not exceeding 10 years. Second, to improve the efficiency of public investment in infrastructure, provisions have been made to direct investments financed by the Regional Compensation Fund (FONCOR) towards projects with greater impact, through a gradual increase in the minimum percentage of such funds to be allocated by regional governments to Regional Impact Investments from 35 percent in 2023 to 100 percent in 2027, as evidenced by Supreme Decree No. 038-2022-EF, published in the official gazette on March 18, 2022. Likewise, the financing sources and types of investments that are eligible for private financing and investment execution have been expanded, under the Works for Taxes modality, through Legislative Decree No. 1534, published in the official gazette on March 19, 2022. Finally, with the aim to increase climate resilience in private investment in public infrastructure projects, it has been established that those projects published under the National Infrastructure Plan for Competitiveness are designed in such a way as to guarantee climate resilience, adhering to the environmental sustainability criteria in all phases of the project, through Legislative Decree No. 1543, published in the official gazette on March 26, 2022 as well as the Supplementary Modifying Provisions of the Supreme Decree No. 211-2022-EF published in the Official Gazette on September 14, 2022.

Pillar B: Foster a more inclusive and competitive financial sector.

The second pillar aims to support those reforms that facilitate access to financial services, both for citizens and for micro, small and medium-sized companies, by lowering costs and encouraging the participation of new providers. First, to improve financial inclusion and promote competition in the financial sector, 100 percent digital financial service providers have been facilitated to enter the market; the entry of exclusive credit providers into the market has been facilitated through the introduction of a new simplified regulatory and supervisory framework for such providers; and competition in the cash transportation sector has been improved, reducing the minimum capital requirements of these companies, through Legislative Decree No. 1531, published in the official gazette on March 19, 2022. Second, to improve the enabling environment for factoring, SUNAT has established a regulatory framework and a registry for the confirmation of electronic invoices, as evidenced in resolution number 000165/SUNAT of the Superintendence of Customs and Tax Administration, published in the Official Gazette on November 18, 2021.

Pillar C: Promote greener production.

The third pillar seeks to mitigate climate change by encouraging the industrial, forestry and agricultural sectors to produce in a greener way. In the first place, with the purpose of encouraging cleaner industrial production and reducing industrial emissions, a guideline has been approved that regulates clean production agreements between manufacturing or domestic trade companies and the Ministry of Production, through Ministerial Resolution No. 00146-2022 -PRODUCE approved on April 18, 2022, and published in the Official Gazette on April 20, 2022. Second, the National Forest Service has approved the "Strategy for the Promotion of Commercial Forest Plantations 2021-2050", as evidenced by Executive Director’s Resolution No. D000190-2021-MIDAGRI-SERFOR -DE published in the Official Gazette on October 12, 2021, which seeks to develop a sustainable forestry industry and address the deforestation challenge. Finally, to promote climate-smart agriculture, the "Law on Regulation of the Agricultural Extension Service" has been enacted, which provides for the establishment of a national registry, accreditation system and supervision of agricultural extension service providers, evidenced by law number 31368 published in the Official Gazette on December 7, 2021, and the "Regulation of Land Classification for its Greater Use Capacity" has been updated, which includes forest cover as an integral part, as evidenced by Supreme Decree number 005-2022-MIDAGRI published in the official gazette on April 24, 2022.

C. Conclusion

Based on the above description, the Peruvian Government is committed to laying the foundations for a Sustainable Growth and Finance Program to strengthen sustainability and fiscal efficiency, foster a more inclusive and competitive financial sector, and promote a greener production.

The Government commits to continue advancing these areas, for which it requires the support of the International Bank for Reconstruction and Development in the indicated areas.

By virtue of the above, the Peruvian Government hereby requests the approval of the "Sustainable Growth and Finance Program" for an amount of US$750 million by the International Bank for Reconstruction and Development.

I would like to take this opportunity and express my special appreciation.

Sincerely,

KURT BURNEO FARFÁN

MINISTER

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Pillar A: Strengthen fiscal resilience and efficiency		
Prior action 1. Support fiscal consolidation	No	Yes: Likely positive
Prior action 2. Improve the targeting and efficiency of public investment in infrastructure	No	Yes: Positive
Prior action 3. Foster low-carbon and climate resilient PPPs	Yes: Positive	Yes: Likely positive
Pillar B: Foster a more inclusive and competitive financial sector		
Prior Action 4. Improve financial inclusion and promote competition in the financial system	No	Yes: Positive
Prior action 5. Improve small and medium firms' access to finance	No	Yes: Positive
Pillar C: Promote greener production		
Prior Action 6. Incentivize clean industrial production	Yes: Positive	Yes: Positive
Prior Action 7. Develop a sustainable forest industry	Yes: Positive	Yes: Positive
Prior Action 8. Promote climate-smart agriculture	Yes: Positive	Yes: Positive

ANNEX 5: DETAILED POVERTY AND SOCIAL IMPACT ANALYSIS

PRIOR ACTION 1

1. **Fiscal consolidation contributes to macroeconomic stability and is crucial to reduce risks to the income generation capacity of households.** Over the past two decades, 80 percent of all poverty reduction in Peru was driven by economic growth.[72] However, macroeconomic stability by itself does not ensure economic growth.[73] Additional structural measures are required such as trade liberalization, stable and predictable environment for private firms, civil service reforms, regulatory reforms, among others.[74] Fiscal consolidation also promotes macroeconomic stability in the long run, which is associated with less volatility of incomes that is crucial among the poor.[75] Evidence also points to higher food insecurity, lower child development, and general welfare losses as a result of income variability.[76] Fiscal sustainability also reduces country risks for borrowing and promote higher investment. As private sector borrowing depends on government borrowing rates, lower public rates also make private borrowing cheaper, increasing investments.[77]

2. **The economic and social effects of fiscal consolidation will also depend on the categories of spending that may be reduced.** The implementation of fiscal consolidation should be implemented carefully focusing on non-critical productive investments including social infrastructure and provision of basic services. Hence, the effect on poverty and household incomes of fiscal consolidation will ultimately depend on the categories of public expenditures that may be reduced in the short run versus the potential gains in revenues of higher investment due to lower macro-fiscal risks.

PRIOR ACTION 2

3. **Prior Action 2 is expected to have an indirect positive effect on poverty reduction, through the closure of regional public investment gaps.** FONCOR's updated definition of a Regional Impact Investments (RII) will target investment towards bigger regional projects of US$3 million or more, aimed at reducing regional investment gaps with a territorial approach. Infrastructure projects can have direct and indirect positive impacts on poverty reduction through multiple channels. Peru lags behind regional peers in access to basic goods and services. Despite significant improvements in access to water, access to safe drinking water stood at only 38 percent of the population. Furthermore, only 72 percent of individuals have access to sanitation. Regarding schooling, although primary school enrollment is not an issue in Peru, only 57 percent of children are enrolled in pre-primary, and 84 percent of youth enrolled in secondary schooling (Figure A5.1).

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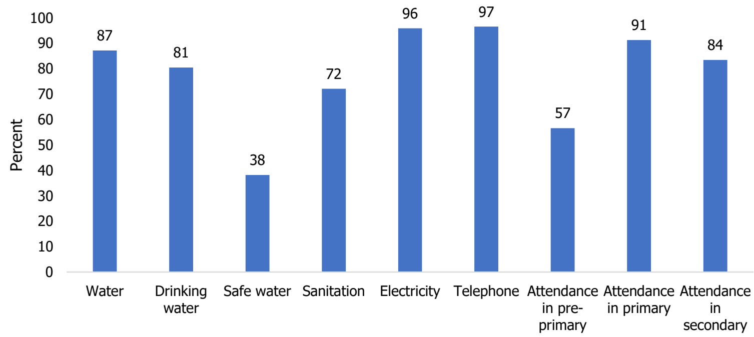
[72] Between 2004 and 2021, poverty measured by international poverty lines of US$ 5.5 per day went from X to Y. The 80 percent reduction is equivalent to 36.4 percentage points of poverty reduction.
[73] IMF (2001).
[74] World Bank (2002).
[75] Hill et al (2017).
[76] Please see Leete and Bania (2010); Sandstorm and Bania (2013); Hardy et al (2014).
[77] Rother et al (2010).

Figure A5.1. Access to basic services (%), 2021



Source: ENAHO, 2021

4. **The investment gap in access to basic infrastructure is close to 363 billion Peruvian Soles (around US$92 billions).**[78] In the short term, approximately 117 billion Peruvian Soles are required to reach the basic levels of infrastructure an economy the size of Peru should have given its socioeconomic characteristics (Figure A5.2). From this gap, 30 percent belongs to infrastructure in transport. In the long term the infrastructure gap of 363 billion Peruvian Soles would allow the country to reach the access to basic infrastructure of developed countries, such as those from OECD.

Figure A5.2. Estimated short term infrastructure gap (millions of Peruvian Soles)

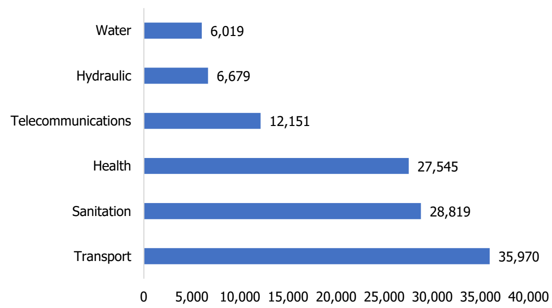
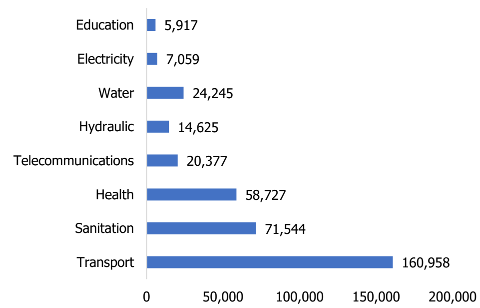


Figure A5.3. Estimated long term infrastructure gap (millions of Peruvian Soles)



Source: Bonifaz et al., 2019.

5. **Infrastructure projects increase average income and reduce poverty through direct and indirect jobs, but the effects vary depending on the categories of infrastructure investments.**[79] In Indonesia an increase in road investment of 1 percent is associated with a 0.3 percent drop in poverty.[80] Similarly, in the Philippines, estimates suggest that the elasticity of roads on average income of the poor is 0.05.[81] There are also indirect effects of infrastructure investment on poverty, as the assets created improve welfare of citizens. The links between infrastructure investment and poverty vary depending on the type of infrastructure. For example, transport and telecommunication infrastructure increases access to better job opportunities that would otherwise be out of reach. Evidence form 20 developing countries finds that telecommunication infrastructure and paved roads are associated with lower urban poverty, by allowing poor individuals

[78] Bonifaz et al (2019).
[79] Ali and Pernia (2003).
[80] Kwon (2000).
[81] Balisacan (2002).

to seize opportunities and participate in economic activities.[82] In Peru, investment in rural infrastructure such as roads and electrification are associated with income diversification in rural households, leading to higher nonfarm income.[83]

PRIOR ACTION 3

6. **Efficient and targeted public investment should indirectly impact poverty through better quality of public investments.** This prior action is expected to improve procurement process, project management and accountability of Peru's PPP projects, which might have positive economic and social spillovers if the increased efficiency of investments yields more and better-quality infrastructure projects. Two channels relevant to poverty might arise from this improvement. First, the increased efficiency can potentially yield better quality of infrastructure projects. Second, increased efficiency, and use of PMOs can get Peru's PPP projects closer to international standards, which in turn could increase international financing towards more public infrastructure projects.

7. **Improving efficiencies in design, management and execution of infrastructure investments may also support the reorientation of public funds to the provision of basic public services.** According to the Private Council of Competitiveness in Peru, over-costs of infrastructure projects are close to 18 percent of the initial proposed budget. In this context, it will be key to maintain lean processes that avoid wasting public resources. If what is saved as a result of PMOs is destined to social infrastructure projects and/or poverty-alleviation initiatives, this PA would potentially have positive indirect effects on poverty reduction.

PRIOR ACTION 4

8. **Higher competition in the financial system will likely have a positive direct effect on poverty and inequality reduction by reducing prices and expand access to financial services.** The three components of this prior action will likely increase the provision and affordability of financial services to traditionally underserved population and excluded firms. Access to financing services is still low in Peru, as compared to the rest of the region and to advanced OECD economies. According to the Findex 2021 data, 57.5 percent of adults had a bank account and 35.7 percent had a debit card, while these numbers are on average above 70 percent and 50 percent in the rest of the region.[84] Access to borrowing is also limited, as 12.9 percent of adults have a credit card to smooth consumption and 22.1 percent borrowed from a financial institution (Figure A5.4). Moreover, financial inclusion is not equally distributed across income levels. Adults in the richest 60 percent of the economy are more likely to have a bank account than those in the poorest 40 percent. Access to a bank account is also 10 percentage points higher in urban than in rural areas, and almost 20 percentage points higher among adults with secondary education or more than among adults with primary education or less (Figure A5.5).

[82] Seetanah et al (2009).
[83] Escobal (2001).
[84] The Findex Dataset is a World Bank Dataset on financial inclusion. Data is collected in 140 countries, surveying over 150,000 people on topics of access and use of financial services. This is the only world-wide survey on financial inclusion. At the country level, the survey distinguishes between rural and urban, gender, levels of education and range of ages.

Figure A5.4. Access to financial services, 2021

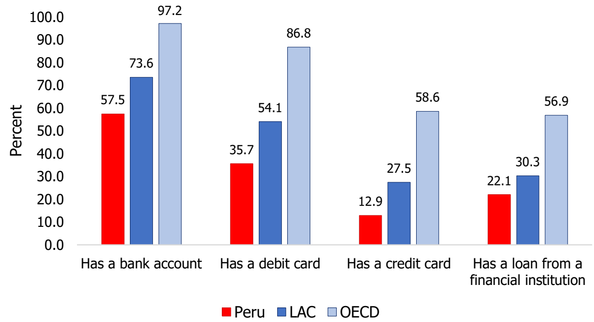
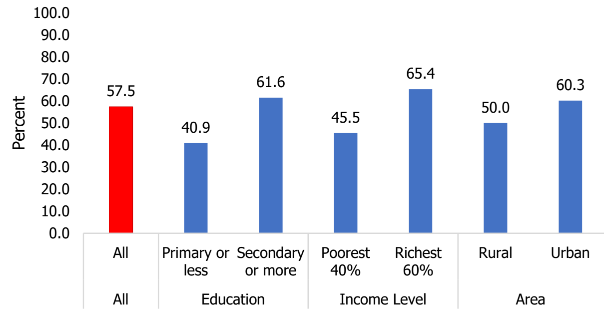


Figure A5.5. Access to a bank account by education level, income, and area, 2021



Source: Findex Dataset, 2021

9. **Although there have been efforts to increase financial access during the pandemic, the potential for financial inclusion in Peru is still underexploited.** As a response to the COVID-19-led crisis, the government rolled out multiple cash transfer programs. Their delivery, through financial institutions, nudged Peruvians to open bank accounts. Compared to the 2017 Findex results, in 2021 the average access to basic financial services (bank account, debit card, credit card, loan) had increased 10 percentage points. Nevertheless, potential to expand the use of financial services exists, as cash is still the most important means of payment for Peruvians. It is estimated that 91 percent of Peruvians use cash to pay for the food they consume inside the house, 88 percent of them use cash to pay for food consumed outside the house, and 85 percent use cash to pay their utility bills, such as electricity, water, phone, internet (Table A5.1).

Table A5.1. Access to financial services and forms of payment

	Form of payment used by type of transaction (%), 2021		
	Food inside the house	Food outside the house	Services
Cash	91.1	88.0	85.3
Debit Card	3.5	3.1	1.8
Credit Card	1.4	1.1	0.4
Electronic Payment	0.4	0.5	3.0
Other	10.6	0.4	0.0

Source: ENAHO, 2021.

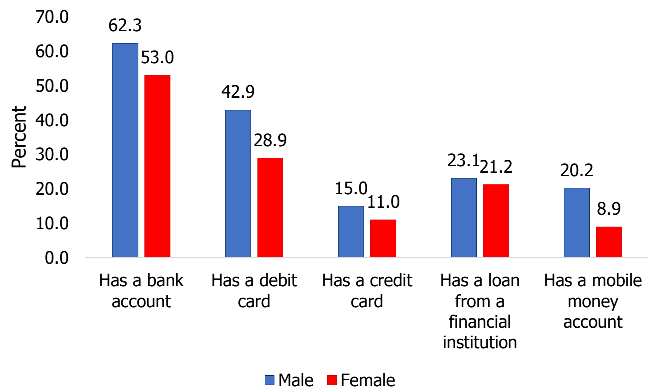
10. **The entry of 100 percent digital financial service providers will likely reduce the price of financial services and expand access to the banking sector for all segments of the population.** New market entrants that are 100 percent digital and do not own physical assets can offer less costly financial services for unserved and underserved population. Evidence shows that when unbanked population gain access to the financial system, they are more likely to invest in health and education or absorb unexpected financial shocks. Moreover, access to financial services is key to promote productive assets that can boost income-generating capacity of individuals and increase resilience to idiosyncratic shocks.[85] Evidence from Peru shows the benefits of having unbanked populations be financially included. A program in Puno and Cusco that targeted women to facilitate their access to financial services and cultivate a culture of savings showed that 63 percent of beneficiaries continued using accounts and 35 percent continued saving after the programs implementation.[86] Similarly,

[85] Burguess and Pande (2005); Karlan and Zinman (2010); Dupas and Robinson (2013); Kast and Pomenraz (2014); and Brune et. al (2016).
[86] Trivelli et al (2008).

in a pilot experiment derived from the conditional cash transfer program in Peru (*Juntos*), women were taught the culture of savings and provided a bank account, resulting in a 70 percentage point increase in women that saved.[87]

11. **This prior action is also expected to reduce the gender gap in access to financial services**. In Peru, the gender gap in access to financial services is significant: women have less access to bank accounts, credit, loans, and mobile money. The average gap in these services is 8 percentage points, and the biggest difference is in having a debit card. Only 28.9 percent of women reported having a debit card, while 42.9 percent of men reported having one (Figure A5.6). The evidence on closing the gender gap in mobile financial inclusion points to positive effects beyond smoothing consumption and increasing savings. Improving access to financial services contributes to emergence of female-owned businesses, increases women's empowerment and female labor force participation, as well as reduces vulnerability of households and businesses.

Figure A5.6. Gender gap in access to financial services (%), 2021

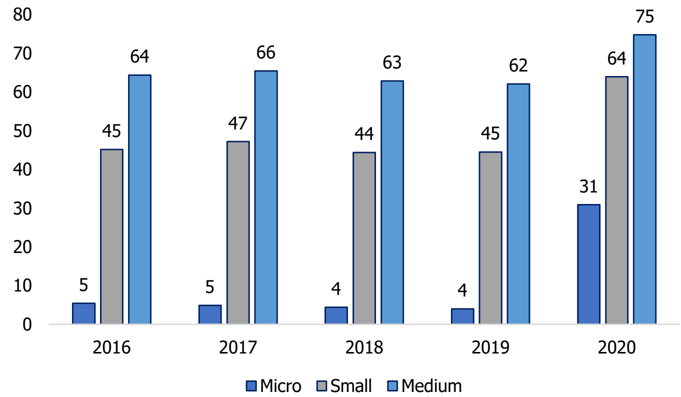


Source: Findex Dataset, 2021

12. **This prior action is also expected to increase the provision of financial services to a broader range of customers, including SMEs.** Small and medium size firms in Peru are those whose annual sales go from 150 Taxable Units (UIT) (690,000 Peruvian Soles or US$180,000) to 2300 UIT (10,5 million Peruvian Soles or US$2.7 million). Together with the micro-enterprises, micro, small and medium firms take up 99.5 percent of the market, are responsible for 61 percent of formal employment and comprise 35.9 percent of the total credit.[88] Moreover, the majority of SMEs in Peru are informal and lack access to services from formal financial institutions. PRODUCE estimates that in 2016, 53 percent of firms were informal. Moreover, among those that are formal, 31 percent of micro firms had access to credit, versus 64 percent for small firms and 75 percent of medium firms that had access to credit (Figure A5.7). Although the percentage of financial inclusion among SMEs has been increasing in the past 5 years, gaps between micro, small and medium firms have not been reduced. Catering to a broader range of customers can help reduce these gaps.

[87] Trivelli et al (2011).
[88] PRODUCE (2020).

Figure A5.7. Financial Inclusion among SMEs, 2015 – 2020



Source: Produce (2020), based on SBS and SUNAT.

13. **This PA will enable typically excluded SMEs to access credit, fostering growth and job generation, and closing the gender SME financing gap.** The entrance of credit-only providers is expected to reduce heavy collateral requirements for start-ups and SMEs. This will increase their potential to access credit, allowing firm growth, and take advantage of positive returns to capital. As of December 2021, the financial system had an appropriate capitalization (a capital adequacy ratio (CAR) of 14.9 percent), and profitability (a return on average equity (ROAE) of 13 percent). Higher investments and growth can generate more jobs, help SMEs become more competitive and induce positive impacts on productivity and poverty. The gender financing gap in Peru is estimated at US$500 million, with 11 percent of women-owned smaller enterprises facing financing constraints. According to the GEMs Women's Entrepreneurship Report, 12 percent of women entrepreneurs close down their businesses because of lack of access to finance, and women are 10 percent more likely to discontinue a business than men. As women are typically more constraint when it comes to accessing financial resources, they would benefit from having more options through credit-only providers.

PRIOR ACTION 5

14. **MSMEs continue to face barriers to access financing across the territory in Peru.** Only 39 percent of MSMEs have access to the regulated financial system, and just 8 percent of MSMEs had access to a loan product. The amount of credit outstanding to MSMEs represented about 16 percent of GDP, even though these smaller companies generated 85 percent of the country's jobs and 32 percent of its GDP. Access to credit for companies is unevenly distributed across Peru's different regions. While the amount of credit outstanding in the province of Lima represented 60.2 percent of its GDP as of December 2021, it was less than 30 percent in all the other 23 provinces.

15. **The regulatory framework supported by this prior action is expected to increase the access to finance through factoring to SMEs.** The Peruvian financial system is highly concentrated. The four largest commercial banks dominate with a market share of about 75 percent in terms of loans as of December 2021, and most to these loans are directed toward corporations and other larger companies (36 percent), trailed by loans to consumers and MSMEs (32 percent each). In this context, factoring may allow SMEs to address their financing needs by leveraging on the payor's creditworthiness, and grant SMEs that could not access formal financial services an alternative to meet their short-term liquidity needs.

16. **By granting an alternative source of financing, this prior action can also have positive effects on poverty through labor demand, productivity, and growth.** Given the concentrated state of the financial sector and the unmet demand for financing, increasing access to financial services among SMEs can potentially increase their investments. This in turn can

generate more jobs, help them become more competitive and have positive impacts in productivity and poverty. This PA will also promote the use of e-invoices for factoring, indirectly increasing companies' reporting and reducing the costs for firms of tax compliance.[89]

PRIOR ACTION 6

17. **Pollution and climate change risks compromise Peru's development path.** Air pollution is among the top five health risk in the country, causing more than 11,000 deaths per year, negatively affecting labor supply.[90] Emission in the country have been rising and are especially concerning in the energy sector. Emissions in energy have increased 84 percent between 2000 and 2016.[91] Extreme weather events, such as high temperatures, frosts, and heavy rains, are more common in districts with higher poverty rates. In districts exposed to extreme heat, less than half of households have access to piped water and adequate sanitation, making them more vulnerable to heat-related diseases. In frost-prone districts, only 10 percent of houses are built with quality materials (Peru Poverty Assessment).[92]

18. **Cleaner production agreements between manufacturing firms and the Ministry of Production (PRODUCE) may improve desired social outcomes through lower pollution.** The agreements supported by this DPF will incentivize firms to lower carbon emissions and promote climate resilient growth as established by PRODUCE. Cleaner production could have positive effects on welfare, especially on health, by reducing pollution and mitigating climate change. The impact of pollution on individual's health is well documented. According to the Global Burden of Diseases (GBD) from 2015, pollution related diseases were responsible for 9 million premature deaths, 264 million years of life lost and 14 million years lived with a disability (DALYs).[93] The Lancet Commission on pollution and health (2017) estimates that annual losses on welfare due to pollution equal 6.2 percent of total global economic output. International experience also showcases that climate smart production agreements can reduce emissions and climate change mitigation. In Chile, through the signing of 150 Clean Production Agreements, estimates suggest that between 2012 and 2018, CO2 emissions decreased by over 500,000 tones, inducing energy savings of 813.055 MWh/year equivalent to US$37 million. Water consumption savings also materialized, estimated at 27.6 million cubic meters valued at US$12.2 million.[94]

19. **Reduction of contaminants in the environment, through lower emissions, cleaner production supplies and better waste management, can also increase workers' productivity.** The literature on the negative effects of pollution on productivity is also robust. In Africa, cities with some level of pollution that reflect sufficient economic activity showcase that increases in pollution are negatively associated with labor productivity and employment growth.[95] Similarly in China, air pollution limits workers productivity by reducing the number of calls per worker per day in call centers.[96] Lastly, pollution also disproportionately affects the poor. An estimated 97 percent of deaths due to pollution occur in low- and middle-income countries.[97] Even within countries, the poor are more exposed and affected.

[89] ILO (2014).
[90] Aragon et al (2017).
[91] CCDR (forthcoming).
[92] Peru Poverty Assessment (forthcoming).
[93] This estimate includes risks from air pollution, water pollution, occupational risks and soil, heavy mental and chemicals pollution.
[94] Rona (2019).
[95] Soppelsa et al (2020).
[96] Chang et al (2016).
[97] The Lancet (2017).

PRIOR ACTION 7

20. **Environmentally sustainable and socially inclusive investments in commercial forest plantation should mitigate a process of deforestation across the country and reduce negative climate impacts**. According to MINAM, 47 percent of emissions in Peru are due to deforestation and changes in the use of land, driven by smallholder agriculture.[98]Deforestation has been growing rapidly in the past two decades. According to GEOBOSQUES, between 2001 and 2020 a total of 2.6 million hectares of forest have been deforested.[99] At this rate, experts worry that Peru will soon pass the tipping point of the Amazon, which would bring devastating effects locally and globally.[100,101] Deforestation also degrades the soil and makes water sources unsustainable. As forests take years to recover and poor households, who depend on forests, loose access to goods and services derived from forests, food insecurity and poverty is likely to increase from deforestation.[102]

21. **Higher investments in sustainable forest industry are expected to support income generating opportunities for households through creation of green jobs**.[103] For a country with its levels of GDP per capita, Peru lags regional peers in terms of green jobs, with only 18 percent of workers employed in this sector .[104] Commercial forest plantation could potentially offer agricultural workers green jobs, thus reducing their vulnerability to future layoffs and pushing them out of poverty.[105] Estimates show that green jobs in LAC are associated with hourly wages about 20 percent higher compared to non-green jobs.[106] Thus, by expanding the supply of green jobs, this policy could facilitate the green jobs transition and reduce poverty.

PRIOR ACTION 8

22. **Strengthening the agricultural extension system is expected to have positive effects on poverty reduction among farmers by helping them achieve higher productivity and climate resilience.** By improving the governance of the agricultural extension, providing an accreditation process to improve the quality of the extensionists, and increasing access to technical advisory, the Law supported in this PA aims at benefiting over 2.26 million agricultural producers nationwide.[107] Past experiences with the extension system in Peru point to successful technology transfers from big agricultural exporters to small-scale producers. Exporting companies such as DANCER S.A.C. successfully transfer technology and provide information to small-scale producers though extension services.

23. **Access to technology and adoption of sustainable practices are linked to lower rural poverty and improved management of natural resources**. Estimates suggest that income per hectare produced increases between 50 and 30

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[98] Peru CCDR Report (forthcoming).
[99] GEOBOSQUES is the monitoring platform for changes in forest cover from the Ministry of Environment (MINAM).
[100] The tipping point of the Amazon is a threshold of deforestation beyond which the ecosystem would flip from a biodiverse moist tropical rainforest to a less diverse and dry forest.
[101] Peru (CCDR) based on Dourojeanni et al (2020) and Bastos et al (2021).
[102] CGD (2017); Chomitz (2007).
[103] Green jobs are defined by occupations and sectors depending on weather they contribute to preserving the environment. Green occupations are measured following the "Green Economy" program developed by the Occupational Information Network or O*NET. Accordingly, Greenhouse Gas emissions (GHGe) per worker are used to categorize sectors of economic activity in green and non-green. In particular, GHGe from the main emitting sectors are allocated to all sectors of economic activity using input-out matrices. Sectors above (below) the median within each country are considered (non-green) green. (Montoya, Olivieri, Sanchez, Vazquez and Winkler, forthcoming).
[104] Employment in green jobs is defined as either working in a green sector or in a green occupation in a non-green sector.
[105] UNECE (2018).
[106] Montoya et al, (forthcoming).
[107] INA (2022).

percent from adoption of technologies such as technical irrigation and certified seeds.[108] Moreover, farmers that have access to extension services and use certified seeds earn on average almost double of what produces who do not. In the Andean and Amazon region, there are considerable opportunities to leverage geospatial technologies and territorial planning to integrate small farmers into the export value chain. Strengthening extension systems can accelerate the access of smallholders to technology, know-how, market intelligence, and climate-smart practices.[109]

24. **An updated land use classification supported by this prior action is expected to have mixed economic effects.** On one hand, in the short term, reduced agricultural land availability may affect the income generation of rural households, but on the other hand, in the long term, economic opportunities may improve due to land becoming more sustainable. Specifically, the new classification is expected to promote land sustainability, especially in the Amazon, which in turn should have positive effects on land returns. Moreover, land protection can have positive welfare impacts on the indigenous population, whose livelihood depends on natural capital related to the conservation of that land.

[108] Apoyo (2021).
[109] Country Private Sector Diagnostic Report (forthcoming).