Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 25-May-2019| Report No: PIDC27216

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Ecuador	P171190	Second Inclusive and Sustainable Growth (P171190)	P169822
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
LATIN AMERICA AND CARIBBEAN	May 19, 2020	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Republic of Ecuador	Ministry of Economy and Finance		

Proposed Development Objective(s)

This DPF series support reforms to: i) promote a more efficient mobilization and allocation of government resources; ii) reduce barriers for private sector development; iii) protect and include vulnerable segments of the population.

Financing (in US$, Millions)

SUMMARY

Total Financing	300.00

DETAILS

Total World Bank Group Financing	300.00
World Bank Lending	300.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

Ecuador achieved high growth and significant social gains during the last oil price boom, but it accumulated macroeconomic vulnerabilities. Between 2001 and 2014, GDP growth averaged 4.5 percent, well above the regional average. The poverty rate fell from 37 to 22 percent, lifting 1.4 million people out of poverty. During this time, the public sector more than doubled its size, and became the main driver of growth after 2007. This expansion was financed by higher oil revenues and by reducing fiscal buffers. Ecuador also dismantled its sovereign oil funds, incurred in a selective default, and increased its public debt from 17 percent of GDP in 2012 to 27 percent in 2014. These policies accentuated the symptoms of Dutch disease, which combined with a non-conducive business environment, dampened private investment. The country is now facing the difficult process of adapting its economy to volatile oil prices and tightened external financing. With a dollarized economy and limited fiscal buffers, Ecuador could neither depreciate its currency nor undertake countercyclical fiscal policies when oil prices dropped in 2014. As revenues plummeted, and despite spending cuts, fiscal deficits widened, arrears accumulated, and the public debt increased swiftly, reaching 46 percent of GDP in 2018. External imbalances led to a sharp decline in international reserves since 2015 and poverty reduction stalled.

Relationship to CPF

The proposed DPF series supports this economic transition and is a key instrument for re-engaging with the Ecuadorian government on a new County Partnership Framework (CPF) FY19-FY23, the first full-fledged CPF since 2007. It underpins two of the three results areas of the CPF: (i) Supporting Fundamentals for Inclusive Growth; and (ii) Building Human Capital and Protecting the Poor.

C. Proposed Development Objective(s)

This DPF series support reforms to: i) promote a more efficient mobilization and allocation of government resources; ii) reduce barriers for private sector development; iii) protect and include vulnerable segments of the population.

Key Results

D. Concept Description

The proposed operation is the second in a DPF series that supports the Government's program aimed at promoting fiscal sustainability and reigniting inclusive growth. Reforms under pillar 1 aim to promote a more efficient mobilization and allocation of government resources. They would include improvements in budget and procurement processes, sound human resources management, lower and better targeted energy subsidies, and an effective tax structure that raises more revenues through less distortive taxes.[1] Reforms under pillar 2 aim to reduce barriers to private sector development. They would include regulations to foster private investment and public-private partnerships, lower entry and import costs, and reduce financial sector distortions. Finally, reforms under pillar 3 aim to protect and include vulnerable segments of the population. These efforts would improve the effectiveness of social programs to mitigate the impacts of the fiscal reforms, promote formality by making labor regulations less rigid[2].

[1] The tax reform benefits from coordinated TA from the WB and IMF and contemplates measures such as the increase in the VAT rate and reduced exemptions, adjustment of personal income tax schedule and cap for deductions, and green taxes.

[2] The WB is providing technical assistance on the preparation of the labor reform, which aims at increasing flexibility, reduce non-wage labor costs, encourage formality, and help improve the competitiveness of Ecuador's dollarized economy.

E. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

A few prior actions could potentially have adverse social and environments impacts, but mitigation mechanisms can be built into the operation during preparation. Several prior actions are expected to have no significant social or environmental impacts, except for PAs #2, 3, 4, and 5. PA#2 supports HR reforms in the public sector. This reform could lead to the retrenchment of public employees, adversely impacting their standards of living. The Government is studying ways to facilitate the integration of these employees in the private sector to minimize such impacts. PA#3 supports reductions in energy subsidies, which could include increases in electricity tariffs as capital expenses are part of the tariff calculation. These measures might affect vulnerable groups. That said, the Government is assessing to maintain the dignity tariff as one of the compensation mechanisms for these groups as well as improving their targeting. PA#8 includes such compensation mechanisms. PA#4 consists of a structural tax reform, which could include increases on VAT rates and reductions on VAT exemptions. Even if carefully designed, these measures could end up affecting vulnerable segments of the population. The Government is exploring the possibility of mitigating this impact through targeted transfers or exemptions. PA#5 will encourage infrastructure investments, which, given weak government oversight capacity, could lead to adverse environmental effects. The Bank is working closely with the Government on identifying and quantifying potential adverse impacts of selected reforms and design mitigation measures. Finally, PA#3 and PA#4 are likely to have positive environmental impacts. PA#3 will lead to more efficient energy use, incentivizing more rational consumption and reducing associated emissions. PA#4 is likely to include the introduction of green taxes being considered as part of the reform package, which would have positive environmental impacts. These expected positive and negative impacts will be reflected in the PSIA and in the Environment Aspects Section of the program document of DPF II.

Environmental Impacts

See above

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APPROVAL

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