

World Bank Comments to the Bank Information Center (BIC) report: World Bank Development Policy Finance and Climate Change in Peru

Thank you for giving us the opportunity to comment on the BIC's analysis of the climate impact of the two recent Development Policy Financing operations in Peru: the Boosting Human Capital and Productivity DPF with a Deferred Drawdown Option (P156858); and the Public Expenditure and Fiscal Risk Management DPF with a Deferred Drawdown Option (P154981). The Government of Peru (GoP) requested that these DPF-DDOs support policy and institutional reforms to improve competitiveness, productivity and public financial management, rather than the set of climate change-related actions Peru has been implementing over the past several years. In this regard, we would like to focus these comments on: (1) providing an overall context of the efforts that the GoP is making to improve the country's environmental policies and institutions and to deal with climate change; and (2) point out several factual errors in the draft report we have reviewed.

Overall Context

Over the past decade, the GoP has been making significant efforts to improve its policies and institutions for environment and climate change management. The Ministry of Environment was created in 2008 to centralize core responsibility for environmental management that was previously shared by more than a dozen agencies – including core state functions, such as the prevention of environmental and natural resource degradation and the promotion of public participation in the decision making process for sustainable development. The responsibilities of the Office of Evaluation and Environmental Enforcement (OEFA) were also clarified and adopted through regulations, including performance indicators to monitor their results. Since then, the GoP has adopted specific policy measures to curb environmental degradation and has achieved remarkable results. For example, since 2001 the government has promoted conversion of vehicles to natural gas in Lima and supplied clean diesel (with a sulfur content less than 50 ppm) in areas affected by high levels of air pollution, such as Lima-Callao, Arequipa, Puno, Cuzco, and Madre de Dios. Another example is the country's successful phase-out of lead in gasoline, which has substantially contributed to a reduced risk of lead poisoning in the country. A third example is related to water supply and sanitation: between 2000 and 2012, the population's access to improved drinking water sources has gone up from 81 percent to 88 percent, with an increase from approximately 64 percent to 77 percent in rural areas alone. During the same period, the GoP expanded the coverage of improved sanitation from around 58 percent to 67 percent of the total population, primarily in rural areas.

A recent Environmental Performance Review of Peru has been prepared by the OECD-ECLAC, which recognize GoP's efforts in this area:

“...During the period under review—from the early 2000s to the present—significant progress has been made towards this end: the legal framework and environmental institutions have been strengthened, information systems have been improved, management tools that integrate economic and environmental components have been applied and progress has been made in defining a green growth strategy. Efforts made in environmental education, promoting citizen participation and access to justice on environmental matters are contributing to a more aware and active society in support of sustainable development.”

“... Peru has good environmental indicators, including moderate waste generation, a small vehicle fleet and a limited contribution to climate change. This situation may make it easier to promote the changes needed to achieve sustainable development.”¹

The Bank has supported Peru’s effort to mitigate and manage the impacts of climate change and natural disasters through a range of instruments, including DPFs. Examples of the Bank’s support include:

- Three Programmatic DPLs completed between 2011 and 2015 helped Peru to introduce the institutional and regulatory framework for improved environmental management and outcomes, and also contributed towards the creation of the Ministry of Environment and Natural Resource Management.
- On reduction of GHGs, the Lima Metro project will contribute to improving air quality, and the Dedicated Grant Mechanism implemented by indigenous people groups in the Amazon region is related to sustainable management of forest resources and reduction of GHGs. GEF funded projects supporting PROFONANPE, have helped prevent what could have been significant levels of deforestation within natural protected areas.
- The national level roads program (PATS) that is currently under implementation is working on introducing systems to facilitate sustainable road access to rural communities in the face of increasing climate variability, through increasing the resilience of the rural road network in Peru to climatic events and increasing climate variability.
- The Bank has also supported the regional GEF funded project on glaciers retreat that supported some adaptation in Andean communities.
- The WB is currently supporting the GoP’s preparation of an implementation plan of the Peru Environmental Performance Assessment prepared by OECD and ECLAC.
- The Bank is also currently preparing an investment operation to support the improvements of Peru’s environmental monitoring systems (P147342) and analytical capacity, and to increase public access to environmental quality information and promote informed public participation in environmental quality management.

As for the two DPFs assessed in the BIC report, their development objectives were respectively to: (1) support Peru’s efforts to boost human capital and productivity by enhancing the education policy framework to enable better quality of skills, facilitating the entry, operation, and exit of firms; and reducing transaction costs in trade; and (2) to improve the management and reporting of public expenditures in subnational governments (SNGs), and the Government’s legal and institutional framework for public-private partnerships (PPPs).

Given Peru’s significant challenge to continue making strides in poverty reduction and boosting shared prosperity, these objectives were deemed by the Peruvian authorities to be key for the current context, but the Peruvian authorities requested the Bank to continue to support the climate change agenda through other instruments as elaborated in the previous paragraphs.

These two DPFs include an assessment of the impact of the supported policy actions on environment, forests and natural resources that is consistent with the requirements of World Bank’s operational policy framework (OP08.60). That assessment concludes that policy actions included in the DPFs have a positive or neutral impact, and that the risk of un-anticipated effects is very low.

Factual Errors.

¹ Quotes taken from page 5 from the OECD-ECLAC report, which can be downloaded from:
<http://www.oecd.org/environment/country-reviews/16-00312-environmental%20performance%20review-peru-web.pdf>

We would also like to point out a number of factual errors in the BIC draft report:

1. *The environment and the GoP's efforts to curb uncoordinated regulations and administrative procedures.* Contrary to what is reported, the regulations supported by the operation do not override Environmental or other types of legislation already valid and enforceable in Peru. These simplification efforts were supported by the Prior Action No. 6 in the Boosting Human Capital and Productivity DPF and are expected to ease the functioning of small and medium-enterprises and, thus, help to generate needed employment and induce further poverty reduction.
2. *Environmental provisions in public investment projects and the GoP's effort to modernize the legal, regulatory and governance framework for Public-Private Partnerships.* The reforms aimed at mitigating fiscal risks and ensure that the good investment management practices that are applicable to public investments in Peru are also applicable to investments financed through PPP transactions. These efforts were supported by Prior Actions 6 to 8 in the Public Expenditure and Fiscal Risks Management DPF and are expected to reduce the fiscal burden from PPPs, improve their transparency and enhance the roles and responsibilities of the different agencies involved in the formulation of a given PPP project. More importantly, these reforms are expected to contribute to close the significant service gap across regions in sectors, such as transport, education, health and others. The BIC report argues that the new framework could have a potential negative impact on the environment by citing a number of public-private partnership (PPP) projects in Peru that were completed before the reforms supported by these two DPFs were enacted (e.g., the South Gas Stream Pipeline). Unfortunately, the reforms cannot be applied retroactively to contracts that were already signed and therefore have no connection to them. On the projects quoted in the BIC report, it should, however, be mentioned that detailed environmental impact assessments were prepared and are available from the authorities for a detailed review. One of these projects in the existing PPP portfolio, i.e., the Lima Metro Line 2, is being supported by an investment operation of the World Bank and is expected to contribute to reducing the carbon footprint. In this case, the World Bank, together with the other financiers, requested a complementary Environmental Impact Assessment (EIA) to address gaps in the original EIA.
3. *The new PPP framework and fuel or gas subsidies.* PPPs in Peru are classified as “self-financed” if the tariffs (or tolls) fully cover the cost of the new infrastructure and “co-financed” if the project requires “availability payments” from the budget. The Hydropower plants and the southern gas pipeline quoted in the report were structured before the reforms supported by the Bank were put in place, but we would like to still point out that these were classified by the Peruvian Ministry of Economy and Finance as self-financed and, thus, are not expected to receive subsidies from the state. Furthermore, the new PPP framework introduced a best practice risk-allocation framework for the public and private sector that should, overall, contribute to reduce government's direct budgetary contributions to PPP projects – irrespective of the sector as it is important to specify that the PPP framework is not designed to any particular sector and can cover, for instance, PPP projects for schools, hospitals, etc.
4. *The new PPP framework adopted by the GoP strengthens governance of PPPs* by ensuring that the good investment management practices that are applicable to all public investments in Peru, will also apply to investments financed through PPP transactions. This stronger regulatory and governance framework for PPPs is likely to help reduce potential negative impact on environment, forests and natural resources by enabling better scrutiny of investment projects financed by the PPPs. Also, this new PPP framework aims at promoting better policies and systems to address issues of fiscal risks and public investment management practices related to

PPP transactions, irrespective of the scale of the project or the sector to which a project is affiliated (e.g., energy, agriculture, education, health).

5. *The new PPP framework enacted by GoP and gas and oil projects in the Amazon.* Like in any other country, the laws and regulations on PPPs are different to the laws and regulations that apply to the oil and gas sector exploration and development projects.
6. *The PPP framework in Peru, like in any other country, does not deal with incentives to any type of public or private investments, including those related to the promotion of climate smart renewable energy investments.* In Peru, the incentives for climate smart renewable energy investments are included in the Renewable Energy Act. In support to this agenda, a World Bank Project on rural electrification is promoting the introduction of renewable solutions for poorer rural households and we have also provided advice on the Renewable Energy Act (as a stand alone activity).
7. *Following international best practices, the recently modernized PPP framework provides 10 days for the Ministry of Economy and Finance to provide an opinion to the initial and final business case that a line ministry or a subnational government prepares to justify a PPP.* However, like in most other countries it takes between 12 and 24 months to structure a PPP project precisely because the environmental and social safeguards (together with other technical aspects of a project) have to be fully completed before a PPP contract can even start to be structured.
8. *The tax stability agreements that apply to foreign investments in Peru are not part of the PPP legal framework and, thus, were not covered by the recent reforms of the PPP framework that the Peruvian authorities implemented.* On taxation issues, the GoP, however, simplified the withholding systems used to collect the value added tax (VAT), an issue that is completely different to the one quoted in the BIC report and that does not weaken SUNAT's ability to collect taxes. This reform was supported by the Boosting Human Capital and Productivity DPF with a Deferred Drawdown Option.
9. The supported laws, policies and investment frameworks enacted by the Government of Peru and supported by these two DPFs can all be downloaded from the Government's legal database or the publication platform (El Peruano).