### BASIC INFORMATION

#### A. Basic Project Data

<table>
<thead>
<tr>
<th>Country</th>
<th>Project ID</th>
<th>Project Name</th>
<th>Parent Project ID (if any)</th>
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<tbody>
<tr>
<td>Ecuador</td>
<td>P178636</td>
<td>Ecuador Second Green and Resilient Recovery DPF (EGARR DPF-2)</td>
<td>P176983</td>
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</tbody>
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<table>
<thead>
<tr>
<th>Region</th>
<th>Estimated Board Date</th>
<th>Practice Area (Lead)</th>
<th>Financing Instrument</th>
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<tbody>
<tr>
<td>LATIN AMERICA AND CARIBBEAN</td>
<td>06-Dec-2022</td>
<td>Energy &amp; Extractives</td>
<td>Development Policy Financing</td>
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<tr>
<th>Borrower(s)</th>
<th>Implementing Agency</th>
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<tr>
<td>Republic of Ecuador</td>
<td>Ministry of Economy and Finance</td>
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#### Proposed Development Objective(s)

The Program’s Development Objective (PDO) is to assist the government of Ecuador in its agenda to tackle selected structural challenges to foster inclusive, resilient, and low-carbon development.

#### Financing (in US$, Millions)

**SUMMARY**

| Total Financing         | 530.00 |

**DETAILS**

<table>
<thead>
<tr>
<th>Total World Bank Group Financing</th>
<th>500.00</th>
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<tr>
<td>World Bank Lending</td>
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<table>
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<tr>
<th>Total Non-World Bank Group Financing</th>
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<td>Trust Funds</td>
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**Decision**

The review did authorize the team to appraise and negotiate
B. Introduction and Context
Country Context

The proposed Second Green and Resilient Recovery Development Policy Financing (DPF), for US$500 million and US$30 million from the Global Concessional Financing Facility (GCFF), is the second operation in a programmatic series of three. The series seeks to assist the Government of Ecuador (GoE) in tackling selected structural challenges to foster inclusive, resilient, and low-carbon development. The first operation, for US$700 million, was approved by the World Bank’s (WB) Board of Executive Directors in February 2022. This programmatic series is fully aligned with the National Development Plan 2021-2025 (Plan de Creación de Oportunidades 2021-2025, NDP) and the Country Partnership Framework (CPF) FY2019-2023, as well as the World Bank Group (WBG) Roadmap for Climate Action in Latin America and the Caribbean as it focuses on transitioning to a green, inclusive, low-carbon and resilient development pathway.

Despite substantial progress in fostering recovery from the pandemic and rebalancing the economy, Ecuador still needs to address structural challenges to consolidate fiscal sustainability, achieve inclusive growth, and protect vulnerable people by increasing inclusion and social resilience. After dropping 7.8 percent in 2020, Gross Domestic Product (GDP) grew by 4.2 percent in 2021, mainly due to a successful vaccination campaign and improving external context. The fiscal deficit was reduced from a peak of 9.7 percent of GDP in 2016 to 1.5 percent in 2021 on the back of improving oil prices, and sustained efforts to rationalize public expenditure and friendly debt renegotiations with international bondholders and China, decelerating the accumulation of public debt. Similarly, international reserves increased from a low of 2.4 percent of GDP in 2017 to 7.4 percent in 2021, restoring confidence in dollarization and macroeconomic stability.

Yet, Ecuador still needs to undertake significant reforms to cement confidence, regain access to international capital markets, and achieve strong, inclusive, green, and resilient growth. Although the oil demand recovery after the pandemic, the Organization of the Petroleum Exporting Countries production cuts, and the war in Ukraine have increased oil exports and fiscal revenues, the compounding global crisis, which entails substantial risks, has also augmented social pressures. With a fully dollarized economy, the GoE aims to implement an inclusive and resilient fiscal framework that sustains fiscal consolidation and helps restore building buffers to face the potential effects of compounded global crises, increasing inclusion and social resilience of vulnerable people, and advancing climate commitments. After decades of negligible productivity gains, Ecuador needs to enhance its productivity to improve competitiveness and generate new growth engines and employment as a decarbonizing world induces the country to move away from the oil sector. High informality and limited diversification result from an underdeveloped private sector linked to structural issues, such as the prevalence of protectionism, rigid labor markets, and distortive market regulation.

A lack of consensus around critical reforms, reflected in repeated episodes of social unrest, poses challenges for advancing reforms that require National Assembly approval. Critical reforms, including those related to improving the public-private partnership (PPP) legal framework or reducing rigidities in new hirings, could not be advanced. The global context of rising fuel prices, compounded by social tension led by higher food and fuel prices, has triggered the suspension of the gasoline and diesel prices band system introduced in 2020 to reduce the fuel subsidy, the above-inflation minimum wage increase applied in an attempt to kick off a dialogue on labor reforms, and the reduction of gasoline and diesel prices to end prolonged demonstrations led by indigenous groups in June 2022. These demonstrations resulted in changes in the GoE agenda that will likely result in additional public expenditures and delay new investments in hydrocarbon and mining.

The GoE remains committed to laying the foundations for a sustained and inclusive fiscal consolidation and greener, more resilient, and inclusive medium-term growth. After amendments in 2021, the International Monetary Fund (IMF) Extended Fund Facility (EFF) is on track. The GoE is committed to continuing the ongoing reforms to support a growth-friendly and inclusive fiscal consolidation, strengthen governance, and foster private investment. The GoE has increased
the tax burden on better-off people and firms with higher profits, set incentives for investment to close the digital divide, applied regulation to make public procurement more efficient and sustainable, and enhanced the integration of climate change-related challenges and disaster risk analysis into budget planning and assessment of fiscal contingency risks. The country is also taking steps to enhance competitiveness by reducing trade barriers, negotiating trade agreements, improving labor market outcomes by strengthening vocational training, and enhancing financial inclusion through management of environmental, social, and governance initiatives. To foster inclusion and social resilience to protect the most vulnerable, the GoE has been building on previous efforts to improve and expand the social safety net to reach the most vulnerable, including those exposed to climate and other natural disasters, reduce malnutrition that affects one-quarter of children under five years old and could worsen due to climate change's impact on agriculture, and ease the integration of migrants in the society and the economy.

Ecuador’s high exposure to climate-related disasters calls for enhanced efforts to foster green and resilient growth. Ecuador is among the 10 countries with the highest natural disaster risk, particularly exposed to earthquakes, recurrent floods, and intensifying droughts. Vulnerability to phenomena like the El Niño Southern Oscillation (ENSO) and related disasters such as floods and landslides is exacerbated by the fact that 96 percent of the urban population lives in the coastal and mountainous regions. Every year, Ecuadorian firms lose US$1 billion due to infrastructure disruptions, mainly involving transport and power. Ecuador has much to gain from global efforts to combat climate change and is committed to decoupling economic growth from greenhouse gas (GHG) emissions.

Despite its low per capita GHG emissions, Ecuador is committed to reaching carbon neutrality by 2050. In its updated Nationally Determined Contribution (NDC), Ecuador committed to an unconditional reduction of 9 percent of its GHG emissions and an unconditional target of 20.9 percent in the energy, industrial, waste, and agricultural sectors by 2030. Promoting voluntary carbon offset programs and increasing its institutional capacity to mainstream climate issues economywide. Ecuador is committed to reducing emissions in forestry and agriculture, accounting for 41 percent of total emissions, and the energy sector, accounting for 46 percent. It aims to improve sustainable forest management and reduce gas flaring in the oil fields, which have important mitigation impacts and can improve lives of rural communities. The country also aims to bring private investment into non-conventional renewable energy (NCRE)

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1 The GCFF was established in 2016 to provide concessional financing to support middle-income countries (MICs) that provide a global public good by hosting large numbers of refugees. The Facility is a partnership that brings together refugee hosting countries, donor countries, multilateral development banks, and the United Nations to enable eligible MICs to borrow at concessional rates for MDB projects that benefit both refugees and host communities. It does so by using donor contributions to reduce interest rates on MDB loans for these projects to concessional (or IDA-like) levels. Ecuador has been a beneficiary of the GCFF since 2019 and received concessional financing for US$21.2 million for two operations—the Second and Third Inclusive and Sustainable Growth Development Policy Loan approved in 2020. This is the third DPF operation nominated for GCFF concessional financing.

2 The formulation of the PDO was slightly revised to better reflect the reforms sought.

3 The Ecuador Green and Resilient Recovery (EGARR, P176983) DPF was approved by the WB’s Executive Board on February 1st, 2022 and became effective on February 24th, 2022.


5 IADB. 2021. Políticas climáticas en América Latina y el Caribe: Casos exitosos y desafíos en la lucha contra el cambio climático.

6 Countries can prioritize sustainable development when well-designed climate change mitigation, and adaptation and resilience measures generate enormous economic, social, and environmental benefits. According to a recent ILO/IDB study, a decarbonization-focused recovery could generate 15 million jobs in Latin America. Studies have identified that infrastructure investment paths can be compatible with full decarbonization and they do not need to cost more than more polluting alternatives (Rozenberg, Fay. 2019. Beyond the Gap: How Countries Can Afford the Infrastructure They Need while Protecting the Planet). With the right policies, investments of 4.5 percent of GDP would enable low- and middle- income countries to achieve the infrastructure-related sustainable development goals and stay on track to limit climate change to 2°C. In Chile the Ministry of Finance, with support from the WB, led a study (Green Growth Opportunities for the decarbonization goal for Chile, published 2020), concluding that implementing a mitigation policy package, jointly proposed by the Ministries of Energy, Environment, and Agriculture, can have a positive impact on the economy, that could mean an additional growth of 4.4 percent of its GDP by 2050 and could translate into an additional US$31 billion towards the country's economic development.
generation. To further mobilize private capital for investments in ecological transition, Ecuador is creating a voluntary carbon trading platform and establishing the governance and institutional setup for increasing the integration of economy-wide climate action and further access to climate financing.

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

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

C. Proposed Development Objective(s)
The Program’s Development Objective (PDO) is to assist the government of Ecuador in its agenda to tackle selected structural challenges to foster inclusive, resilient, and low-carbon development.

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Key Results
The expected results of this operation include Ecuador’s macro-fiscal policies and practices aligning with its climate goals and adopting a budgeting approach that prioritizes climate-responsive investments and moves from greening projects to greening the economy. These structural changes are expected to foster growth and protect the vulnerable population, while the structural reforms can bolster the participation of the private sector in the provision of non-conventional renewable energy (NCRE), and reduce GHG emissions generated from gas flaring, from supporting voluntary carbon markets, and by improving sustainable forest management.

D. Project Description
Pillar 1 of the second DPF operation supports critical structural reforms to foster green growth, inclusion, and climate resilience. It strengthens the fiscal framework by increasing tax collection in an inclusive, transparent, and green manner
and enhancing the institutional setup to address climate-related challenges, including climate budget planning and disaster risk fiscal impacts. These measures are relevant to support the implementation and monitoring of economy-wide climate programs and to provide a systematic way of assessing fiscal contingency risks to PPP projects. They also support reforms to foster social inclusion and resilience by cross-referencing the social registry to better target those vulnerable to natural disaster risks and implementing result-based budgeting to improve the supply prioritized nutrition package for pregnant women and children, and measures to integrate Venezuelan migrants, including children and adolescents separated from their families and those traveling alone, and protect victims of human trafficking and natural disasters, including those associated with climate change. This last set of reforms is critical for the most vulnerable women as potential beneficiaries of social assistance programs and partially addresses the disproportionate burden women have suffered during the COVID-19 pandemic and other weather-induced disasters.7

Actions under Pillar 2 support the GoE’s efforts to strengthen low-carbon development. The measures are aligned with the WBG Roadmap for Climate Action in Latin America and the Caribbean8 as they seek to prioritize actions on the largest mitigation opportunities to help integrate climate and development in Ecuador. They aim to promote private capital mobilization and green growth. The key sectors contributing to GHG emissions in Ecuador are energy, with 42 percent of emissions, and forestry and agriculture, accounting for 41 percent of total emissions. Reforms under this pillar focus on mitigation measures with the potential for a green and resilient economic recovery by promoting private investment in NCRE energy, encouraging gas-flaring reduction, promoting sustainable forest management, and supporting the development of carbon-trading markets through the strengthening of MRV to help mitigate GHG emissions. These policy lines are expected to be complemented by measures to foster energy efficiency and transport decarbonization in the third operation.

The proposed operation is broadly aligned with the Green, Resilient, and Inclusive Development (GRID) framework, the Global Crises Response Framework (GCRF), and the WBG Roadmap for Climate Action in Latin America and the Caribbean and provides significant climate co-benefits as Ecuador become more resilient and reach its climate commitments. The reform program is aligned with GCRF pillars: (ii) Protecting People and Preserving Jobs; (ii) Strengthening Resilience; and (iii) Strengthening Policies, Institutions, and Investments for Rebuilding Better. On the adaptation side, the proposed operation acknowledges GoE’s efforts to reduce fiscal risks by cutting dependency on oil revenues, reducing public debt, and building fiscal buffers. These are critical to improving resilience and attracting private investment to reduce climate change impacts. Adaptation is also reflected in the GoE effort to enhance the institutional setup to handle climate disaster risks and integrate climate considerations into budgetary planning. A broadened safety net, ramped-up action on reducing malnutrition with resilience to climate disasters among the most vulnerable populations. On the mitigation side, the proposed operation includes actions to enhance the energy sector’s decarbonization by promoting NCRE, reducing gas flaring to help cut emissions from oil extraction, fostering the development of voluntary carbon markets, and promoting sustainable forest management to reduce deforestation and increase conservation and restoration. The operation is therefore addressing critical mitigation levers identified by the Intergovernmental Panel on Climate Change (IPCC).

E. Implementation

7 Around one-fifth of individuals have lost their job since the onset of the pandemic in Ecuador, of which 60 percent are women. Women are more likely to be in more precarious employment pre- and post-COVID-19 as informality rates were two percentage points higher for women than for men in 2019 (i.e., 47.9 and 45.9 percent respectively), and the gap widened to four percentage points in 2020 (i.e., 53.4 vs. 49.5 percent respectively). Women were more likely than men to withdraw from the labor market due to the need to take care of children and the elderly at home. Women work 20 hours more per week than men in unpaid work such as food preparation, cleaning, dwelling, laundry, and childcare.

Institutional and Implementation Arrangements

The MEF will be the main coordinating agency for monitoring and evaluation among other participating ministries. The Prior Actions detailed in this operation are the prime responsibility of the following ministries and agencies: MEF, Ministry of Production, Investment, Commerce and Fisheries, National Planning Agency, Ministry of Labor, MIES, Ministry of Foreign Affairs and Human Mobility, MEM, MAATE, Internal Revenue Service, Economic and Financial Analysis, and the Office of the Presidency. MEF will coordinate with other ministries to monitor the results indicators based on publicly available information. The WB will monitor the implementation of the DPF through regular supervision missions and the preparation of the DPF.

Program outcomes will be monitored by measuring progress toward achieving results indicators included in the policy and results matrix. They will be evaluated following the disbursement of the first DPF. MEF will be responsible for presenting the information related to the reform implementation and progress made toward results on time upon request and in a format satisfactory to the WB.

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

Poverty and Social Impacts

The Prior Actions supported by the proposed operation are expected to have positive or neutral impacts on poor households and vulnerable groups in the short term. In the medium and long terms, the expected effects are overall positive. This Poverty and Social Impact Assessment (PSIA) follows Bank guidelines and analyzes the potential distributional impacts of the GoE's program. It covers poverty and shared prosperity implications and other welfare-related outcomes, such as household income and expenditures, employment, and prices. The policies supported by this operation, such as the tax reform and improvements in managing climate change-related expenditures are expected to have impacts on the less well-off. In addition, Prior Actions on expanding social programs in the event of natural disasters and increasing the efficiency of resources for combatting malnutrition are expected to protect poor and vulnerable populations, mainly women. Finally, measures for strengthening low-carbon development are expected to boost green growth and job creation. The expected effects are based on quantitative analysis, a review of academic literature, and additional information gathered during the preparation of the operation.

Policies under Pillar 1 are expected to have mostly neutral or positive impacts on households’ welfare in the short run. The tax reform will be progressive, and it will mainly affect the upper deciles of the income distribution. It will not impact the poor or the bottom 40. The measures to improve monitoring and managing climate change-related expenditures, strengthen public finances by promoting the prevention, mitigation, and management of fiscal risks, and streamline procurement processes will not impact households in the short run. They might have positive impacts in the long run, depending on how resources will be allocated. The creation of the Fiscal Risk Committee and stabilizing criteria to identify the government’s contingent liabilities caused by climate and other disasters in PPP projects are not expected to significantly impact equity and poverty in the short term. In the long run, indirect positive welfare impacts could be expected by implementing PPPs to finance and reduce fiscal costs of infrastructure projects, leading to improvements in the country's infrastructure. Strengthening procurement processes by establishing low-carbon and green requirements is expected to have neutral effects on the welfare of the poor. The effects on poverty and inequality of eliminating non-tariff measures (NTMs), especially on food and agricultural products, are unclear, but aggregate welfare impacts could be positive if the removal of NTMs reduces consumer prices. The immediate expansion of social programs in the event of natural disasters and policies for increasing the efficiency of resources allocated to malnutrition are expected to have positive effects on vulnerable populations’ welfare. The migration regularization policies will help Venezuelan refugees...
and migrants by integrating them into society, improving their employability (while lowering pressure on more vulnerable low-skilled workers in host communities), and enabling access to public services and social protection. However, complementary actions are needed to realize the opportunities that come with migration.

The policies under pillar 2 are aimed at strengthening low-carbon development and would not have negative impacts on poverty and the bottom 40. Incentives to promote the participation of private sector investments in renewable and clean energy projects are not expected to impact welfare directly in the short run. In the medium and long runs, increased private investment may contribute to reducing generation costs, increasing environmental benefits, and creating jobs. Neutral impacts on poverty and shared prosperity are expected from requiring public and private firms operating oil fields to reduce associated gas flaring. However, these measures might positively impact living conditions in other dimensions. Enhancing transparency and the country’s access to national and international financial resources would not impact poverty or inequality reduction. Impacts depend on the proper implementation of this program and compensation mechanisms. Strengthening the capacity of rural populations to create better economic opportunities aligned with sustainable forest management will increase the value of agricultural and forest products. These policies would positively impact the welfare of rural populations in the long term.

Environmental, Forests, and Other Natural Resource Aspects

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

- **Pillar 1**: Tackle selected structural challenges to foster green growth, inclusion, and climate resilience deals largely with implementing a more progressive tax system; reducing taxes for hybrid and electronic vehicles; better managing climate change related expenditures; and strengthening climate and disaster risk management considerations. A positive environmental impact from emission reduction is expected from PA#1 related to incentivizing electric and hybrid vehicles. Indirect environmental positive impacts are also expected from PA#2 and PA#3 since they will better inform and improve Ecuador’s resilience to climate change. Potential indirect negative impacts may result from the inadequate disposal of old gasoline vehicles and the potential E-waste generated from electric vehicles. Nonetheless, Ecuador has established robust legislation to ensure proper disposal and mitigate any adverse impacts that could result from both actions. Hazardous waste is regulated under Chapter VII of the Ministerial Acord. N.061 (Registro Oficial No 316 of 2015). For e-waste, Ecuador approved its national law on managing hazardous waste and recently created a program to manage e-waste (RAEE) in 2008.

- **Pillar 2**: Strengthen low-carbon development aims to produce positive impacts on Ecuador’s environment, forests, and natural resources. PA#5 seeks to promote private investment in NCRE energy. This is expected to ultimately lead to a decrease in emissions as the nation transitions to a low-carbon energy matrix thanks to the greater usage of NCRE energy. The introduction of energy efficiency legislation in oil sectors, called for in PA#6, is expected to support mitigation efforts and reduce pressure on the natural environment and nearby ecosystem. High environmental benefits are expected from transitional provisions to end legacy flaring no later than 2030. PA#7 endorses the enactment of regulations to support the tracking of GHG emission reductions to contribute to Ecuador’s NDC and develop a robust MRV system as a precursor to voluntary carbon markets. This is expected to increase transparency of emission reduction actions, potentially leading to GHG emissions reduction and positive spillover impacts on the natural environment locally and the global public good. PA#8 and PA#9 will support reducing emissions in the forest sector and disincentivizing deforestation by establishing good forestry practices certification and promoting private sector investment in sustainable forestry projects.
G. Risks and Mitigation

The overall risk of this operation is substantial. Key risks include political and governance risks, macroeconomic risks, institutional capacity, fiduciary risks, and stakeholder risks, some of which cannot be fully extenuated. However, a strategic approach allows the DPF series to be adjusted in case these risks materialize. Specific risks, along with mitigation measures, are discussed below.

Political and governance risks are substantial. The ruling party's limited representation in the National Assembly has curtailed the GoE's capacity to pass legislative reforms. Increasing gang and narco-traffic-related crime and violence have created social discontent. Social unrest led by indigenous organizations (CONAIE) has created pressure to increase social expenditures and reduce gasoline and fuel prices, with significant fiscal and financing implications. As part of the agreement with the CONAIE, the GoE derogated Decree 95, which established the Performance Stimulus Fund, eliminating a trigger for this operation. Also, Decree 95 supported policies aimed to attract private investment in oil exploration. As a mitigation measure, the GoE has decided to rely on executive powers to continue moving forward with substantive reforms in its program. In response, this DPF operation has acknowledged progress in these relevant areas, including sustainable procurement, forest management, and gas flaring to replace the original ones that required the National Assembly approval, mainly labor reforms.

Macroeconomic risks are substantial. Even if the global health crisis is overcome, Ecuador could be hit by the compounding international crises that are increasing international interest rates, dampening the economic recovery, and increasing food prices. Ecuador's prospects are also exposed to natural disasters, like floods and earthquakes, delays in the ongoing fiscal consolidation, and lower-than-expected recovery of private investment. Some actions supported by this DPF series aim to mitigate these risks by, for example, supporting measures to make fiscal accounts more resilient (including climate-related shocks), improving the fiscal balance to accumulate fiscal buffers and regain access to international capital markets, and supporting the most vulnerable population.

Institutional implementation capacity risks are substantial. The GoE is deeply committed to the proposed program, but implementation capacity is low in several areas. The authorities have mobilized technical assistance, including expertise from the WB, in many areas supported by this operation to mitigate these risks. WB's technical assistance includes support for designing the expansion of social assistance, analyzing the incidence of tax reforms, promoting tax transparency, enhancing institutional governance for the issuance of green bonds, promoting sustainable procurement, establishing result-based budgeting to tackle malnutrition, and assessing disaster risk for fiscal liabilities. Other multilateral donors have also provided significant technical support. The WB's dialogue is supported by and closely coordinated with the IMF and the IADB to avoid duplication and enhance synergies.

Stakeholder risks are substantial. Although the selection of prior actions has factored in local political economy considerations, political and social tensions can block the successful implementation of the overall GoE reform agenda. This operation seeks to mitigate stakeholder risks by assessing the scope of potential opposition extending beyond the specific operation. The GoE mitigates these risks through consultations to ensure that critical reforms are well communicated and understood.
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APPROVAL

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Approved By

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19-Sep-2022