INSTITUTIONAL STRENGTHENING OF THE MINISTRY OF ECONOMIC AFFAIRS AND FINANCE

(EC-0198)

EXECUTIVE SUMMARY

Borrower and guarantor:	Republic of Ecuador	
Executing agency:	Ministry of Economic Affairs and Finance	
Amount and source:	IDB: (OC/IFF) Local: Total:	US$5.12 million US$1.28 million US$6.40 million
Terms and conditions:	Amortization period: Grace period: Disbursement period: Interest rate: Inspection and supervision: Credit fee: Currency:	25 years 42 months 42 months variable (IFF) 1% 0.75% United States dollars drawn from the Single Currency Facility

Objectives: The general objective of this operation is to support the consolidation of Ecuador's fiscal sector as the main instrument of economic policy, in a context of fiscal policy reforms and institutional strengthening of the Ministry of Economic Affairs and Finance (MEF). The operation's specific objectives are as follows: (a) to bolster systems for formulating, analyzing and monitoring the country's economic policy; (b) to tighten up the control, recording and monitoring of public borrowing; (c) to develop capacity to monitor sectional finance; (d) to support the definition of public investment policies, and the monitoring and evaluation of investment projects; and (e) to strengthen general internal management in the MEF, in areas such as human-resource policy, training and information technology.

Description: The general concept of the program involves developing certain substantive areas that are crucial for adequate functioning of the MEF, while at the same time strengthening horizontal elements to enhance the sustainability of the reforms, in particular human-

resource policy. The support being proposed will aim to form a solid base of permanent and well trained staff, operating with appropriate and sustainable technological support, in an organization structured to respond adequately to the responsibilities legally assigned to it.

The components of the program encompass the main substantive areas of the General Undersecretariat for Economic Affairs and the Undersecretariat for Management. As regards the General Undersecretariat for Finance, the program will only support the public credit area, since budget, treasury and accounting are already being supported by the Integrated Financial Management System Program (SIGEF) funded by the World Bank. The proposed program, together with SIGEF, provide comprehensive support for strengthening all the main MEF areas.

The program is structured in five components that will provide specialized technical assistance and training, together with coordinated informatics systems and equipment, through an executing unit within the MEF. This will report to the Ministry's General Coordination Unit; its operating costs will amount to approximately US$791,000 (12% of the program total). The components, together with approximate amounts, are as follows:

1. **Component 1: Economic policy support (US$842,000)**

The objective of this component is to support the definition and monitoring of the country's macroeconomic policy, through institutional strengthening of the Undersecretariat for Economic Policy, which is part of the General Undersecretariat for Economic Affairs. Support will target three key areas: (a) analysis of current circumstances: preparation of notes, bulletins and reports on current economic issues (including fiscal reforms), to provide a basis for macroeconomic policy fine-tuning; (b) macroeconomic programming: medium and long-term management using financial programming, projections and impact simulations; and (c) fiscal statistics: generation of complete, up-to-date and accurate fiscal data, and maintenance of an economic and social database to assist in designing and evaluating economic policy.

2. **Component 2: Strengthening of public debt management (US$328,000)**

The objective of this component is to support the management of public debt, both domestic and external, in the light of recent developments in capital markets, through institutional strengthening in the Undersecretariat for Public Credit, which forms part of the General Undersecretariat for Finance. Support will strengthen the

following areas: (a) public debt management: responsible for the recording of borrowing and its financial management; (b) evaluation and monitoring: focusing on debt contracting and monitoring processes; and (c) financial operations: responsible for the issuance, placement and registration of government bonds.

3. Component 3: Support for sectional finance (US$1,202,000)

The objectives of this third component are to strengthen the new Sectional Finance Support Coordination Unit to enable it to monitor subnational finances and act as interlocutor with municipal and provincial governments on fiscal issues, as well as establishing a flow of information on sectional finance.

The main activities of this component are as follows: (a) design, implementation and training for the Sectional Finance Information System (SIFIS); (b) monitoring of sectional finance in terms of compliance with applicable legislation; (c) advising the ministry on the establishment of rules and directives on sectional finance, as well as supervising their execution and promoting their diffusion; (d) systemizing and promoting the dissemination of regional financial information for citizen use; (e) coordinating training initiatives and technical assistance on fiscal matters for sectional governments; and (f) conducting studies and investigations on subnational finances.

4. Component 4: Strengthening of public investment (US$800,000)

This component is based on the recent creation of the Undersecretariat for Public Investment (SIP), in the General MEF Undersecretariat for Economic Affairs. The component aims to strengthen the SIP to enable it to carry out its regulatory and operational functions on the public investment system.

The main activities of this component are: (a) to review and redefine the public investment analysis and processing cycle; (b) to design the re-engineering of SIP processes; (c) to establish mechanisms for validating investment proposals; (d) to design mechanisms to monitor and evaluate investment projects; (e) to strengthen linkages between the development plan and the public budget; (f) to strengthen linkages between the macroeconomic plan and the annual investment plan; and (g) to design, develop and implement informatics systems for public investment management.

5. Component 5: Strengthening of MEF general management (US$1,667,000)

This component is expected to support a variety of general management areas in the MEF as part of its institutional strengthening process, in order to enhance its capacity to attract and retain qualified staff, and to update, integrate and broaden staff access to information through the information technology structure.

The key activities of this component are: (a) development and implementation of a comprehensive human-resource policy; (b) institutional strengthening of the Human-Resource Coordination Unit; (c) implementation of strategies for dealing with new MEF staffing needs; (d) design and implementation of an informatics system for human-resource management; (e) implementation of the Ministry Training Center, and review and execution of the strategic training plan; (f) development and implementation of the strategic information technology plan, procurement of hardware and implementation of specific software; (g) development and implementation of a corporate intranet and ministry website; and (h) design and implementation of an institutional communication plan for the MEF.

The Bank's country and sector strategy: The Bank's strategy in the country is limited to four main objectives: (a) stabilization of the economy and restoration of its growth capacity; (b) poverty alleviation, human-capital formation and social inclusion; (c) efficient management of infrastructure with private-sector participation; and (d) State modernization and decentralization, and promotion of sustainable regional development. The proposed operation is consistent with the following objectives: (a) economic stabilization, strengthening of fiscal management tools in a context of dollarization, in which monetary policy is practically nonexistent; and (b) State modernization and decentralization, in which the MEF is seen as a key part of the State apparatus, incorporating a program component to contribute to an orderly fiscal decentralization process.

Environmental and social review: Given the nature of the activities to be funded through the program, no direct social or environmental impacts are anticipated. The program is expected to have a positive indirect impact on the environment by strengthening ex ante evaluation of the environmental impact of public-sector investment projects; and in the social area also, as it is likely to support and deepen the fiscal decentralization process and thus result in better targeting of social expenditure.

Benefits: The main benefit of the operation is that it will represent a major contribution to the achievement of sustainable macroeconomic

stability. Given the characteristics of the Ecuadorian economy, in which fiscal policy is practically the only macroeconomic management tool available, appropriate planning and execution of public-sector finances are of primary importance. The program seeks to strengthen the MEF in key areas of fiscal management, and this, combined with support from other multilateral agencies, represents comprehensive support for the institution.

One of the program's major benefits is that it will help make the decentralization process more orderly and measured. The country is in the process of designing an administrative and fiscal decentralization strategy, and the MEF is expected to play a leading role in this. The program will create institutional capacity in the MEF to enable it to fulfill this role permanently, in coordination with other agencies involved in the process.

Risks:

The low level of pay and high staff turnover, in public administration generally, puts the sustainability of the proposed reforms at risk. The government has authorized wage increases for restructured public bodies, but these have not yet been approved for the MEF. At the present time, the MEF shores up critical areas of its work using skilled staff hired through technical cooperations with the Bank, or in conjunction with other public bodies such as the Central Bank or the Banco del Estado. This is not a comprehensive and permanent solution, however. The operation includes design and implementation of a human-resource policy for the MEF, aimed at ensuring it skilled and adequately paid staff on a sustainable basis.

As is true of many institutional reform processes in the region, the legal basis underpinning MEF reform is not very robust. Given that the Ministry of Finance and Public Credit was converted into the Ministry of Economic Affairs and Finance by presidential decree, the structure and functions of the new entity—particularly in recently incorporated areas—could well be altered through the same channel. There is a possibility that future governments may totally or partially reverse the reform process by restructuring the Ministry through another presidential decree.

The chief factor mitigating against this risk is institutionalization of the reform itself, such that the benefits and potential consequences of reversing the process are clear. The program will help form an institutional image for the MEF, in keeping with the established order in the economic sector and the new relations and responsibilities assigned to other bodies such as the Central Bank and the Planning Department (ODEPLAN).

Special contractual clauses:

Conditions precedent to the disbursement of Bank funding will be as follows:

1. Creation, by ministerial agreement, of the program coordinating unit (UCP) and the programming and evaluation committee (CPE), both with structures and functions acceptable to the Bank (see paragraph 3.4).

2. Provision of physical space and selection of staff for the UCP (see paragraph 3.4).

Poverty-targeting and social sector classification:

This operation does not qualify as a social-equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). It also does not qualify as a poverty-targeted investment (PTI).

Exceptions to Bank policy:

None.

Procurement:

The procurement limits applicable to Ecuador are US$250,000 for goods and services and US$200,000 for consulting services. Procurement of goods and services with reference prices in the range US$100,000-US$250,000 will be carried out through local competitive bidding; and those below US$100,000 will use the open call for proposals mechanism. The selection of consulting services with reference values below US$200,000 will entail prequalification of consulting firms and direct invitation to firms shortlisted by the executing agency (see paragraph 3.7).

I. Reference Framework

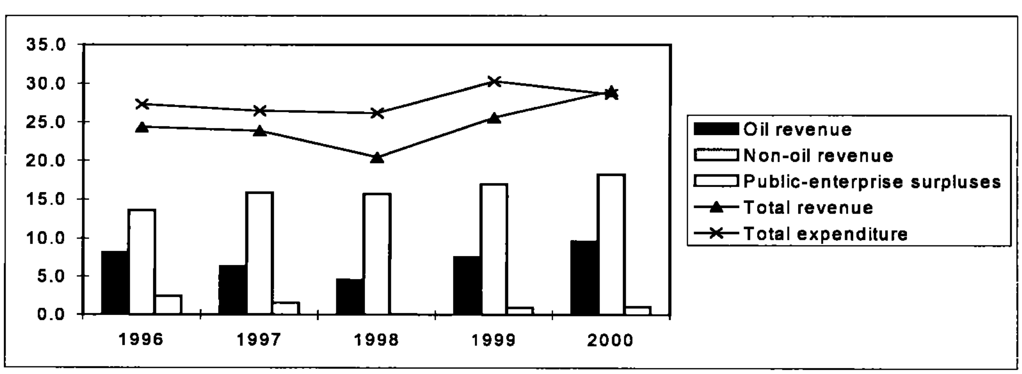
A. Macroeconomic and fiscal environemnt

1.1 During the five year period 1996-2000, Ecuador was submerged in a complex political, economic and social crisis. Political instability and social conflict resulted in five different people holding presidential office during that period. Total public-sector social spending fell by more than half of a percentage point of GDP, while expenditure on education fell by nearly one point. Unemployment peaked at 15.1% in 1999, up from 9.3% in 1997. In 1999, the worst year of the economic crisis, GDP shrank by 7.3%, inflation climbed to around 60.7% and the sucre was devalued by nearly 200%.

1.2 The year 2000 saw a turning point in the process of economic decline. The sucre was successfully replaced by the United States dollar, GDP grew by 1.9%, bank deposits increased and confidence in the financial system strengthened, the non-financial public sector posted a surplus of 1.5% of GDP, and an agreement was reached for restructuring the country's external debt. Inflation, on the other hand, remained high at 91%, mainly because of exchange-rate overshooting prior to dollarization.

1.3 Government fiscal management has improved thanks to an increase in tax and oil revenues supported by expenditure cuts. A primary budget surplus was achieved in 2000 equivalent to 9.1% of GDP. Significant improvements have been achieved in national tax administration, and tax revenues today amount to over 13% of GDP compared to about 10% two years ago. National tax revenues for the current fiscal year have exceeded initial expectations by about US$300 million. Local tax revenues in the country's main municipios have also risen in the wake of revaluations carried out on urban and rural real estate.

Figure 1
Fiscal results 1996-2000
(as a percentage of GDP)



B. Fiscal reform initiatives

1.4 The Government of Ecuador has set an ambitious agenda of short and medium-term reforms to fiscal policy and management. The year's first initiative was a reform proposal that included raising the rate of VAT from 12% to 15%, establishing a simplified regime, and absorbing the Ecuadorian Customs Corporation (CAE) into the Internal Revenue Service (SRI). Following a series of exchanges with Congress in which most of the measures proposed were rejected, the government succeeded in raising VAT to 14% on a temporary basis, until an injunction filed by a congressional faction in the Constitutional Court restored the 12% rate in August 2001.

1.5 Despite this setback, the government has decided to continue sending major fiscal reform initiatives to the legislature. The Fiscal Discipline and Prudence Bill (also known as the Fiscal Responsibility Law) has been extensively discussed by a variety of government bodies and is expected to be submitted to Congress in the near future. In addition to implementing fiscal prudence rules guaranteeing equilibrium in public finances, this legislation will also seek to eliminate the many existing predetermined budgetary allocations that make fiscal management unacceptably rigid.

1.6 The subnational tax structure is also a worrying issue for the government. This is being analyzed in the context of fiscal decentralization and is likely to result in a bill to reform the Municipal Regime Statute. This bill is expected to reformulate some basic taxes, including those levied on urban and rural properties and permits, and it will also modernize and simplify municipal taxation in general.

1.7 The government also intends to set up a fiscal stabilization fund using revenue generated by the new heavy crude oil pipeline. The Petroleum Fund System Act will establish this, and parameters currently under discussion envisage setting aside 80% of pipeline revenues for stabilizing oil revenues and buying back public-sector debt. The remaining 20% would be channeled into a savings fund for use when oil wells run dry.

1.8 Public-sector financial management needs to be organized so as to allow more efficient use of fiscal funds and generate a homogeneous, useful and complete base of information for decision-making. The government has drafted a State Financial Management Bill to replace the obsolete Financial Management and Control Statute (LOAFYC) and Budget Act, with a view to fostering more modern and transparent management of the budgetary process.

Table I-1
Main Fiscal Reform Initiatives

MEASURE	MAIN OBJECTIVES	CURRENT SITUATION
Fiscal Discipline and Prudence Statute (Fiscal Responsibility law)	Abolish predetermined allocations, and establish rules and sanctions to discipline management and make all public bodies, both national and sectional, more transparent. The aim of this is to achieve structural surplus and reduce borrowing.	The government has a bill prepared which will be sent for debate in Congress in the near future.
State Financial Management Statute	Modernize public finances by replacing the LOAFYC and the Public Sector Budget Act, consistently with the fiscal responsibility law.	The MEF has a draft for submission to Congress in the near future.
Petroleum Fund System Law (Stabilization fund)	Using the State's 80% share of revenues from the export of crude oil transported by heavy crude pipeline, a fund will be set up to stabilize oil revenues and buy back public-sector debt. The remaining 20% will be put into a savings fund for use once the oil fields are exhausted.	The MEF has a draft for submission to Congress in the near future.
Law reforming the Municipal Regime Statute (Municipal tax reform)	Modernize and simplify municipal tax laws, abolishing taxes and reformulating basic elements such as the urban property tax, the rural property tax, the single permit tax, and vehicle license tax.	The Ecuadorian Municipalities Association has drafted a bill which the MEF is considering for submission to Congress.

C. The Ministry of Economic Affairs and Finance (MEF)

1.9 The decision to adopt the United States dollar as Ecuador's sole official currency forced a reorganization of the institutions involved in economic policy. The preponderance of fiscal over monetary policy in a context of dollarization has obliged the Central Bank of Ecuador to give up several of its key monetary and exchange-rate policy functions. At the same time, the then Ministry of Finance and Public Credit had to take on new responsibilities to ensure public finances were managed holistically and in coordination with economic sectors.

1.10 Fiscal-policy management is critical under this new economic arrangement, especially in an economy like Ecuador's that is highly vulnerable to external shocks. For this purpose, it is essential that the entity responsible for fiscal management should be solid and technically well endowed, to enable it to fulfill its macroeconomic management tasks responsibly and predictably. In response to this requirement, the government issued Decree 366 on 10 May 2000, turning the Ministry of Finance and Public Credit into the Ministry of Economic Affairs and Finance. A General Undersecretariat for Economic Affairs was established to oversee the economic area, assuming highly important economic and fiscal

management functions in areas such as economic policy, public investment and fiscal statistics.[1]

1.11 The mandate of Decree 366 was implemented through Ministerial Agreement 94 issued on 16 April 2001. This instrument constitutes the MEF's regulatory statute and establishes the institution's structure and functions in some detail. In addition to statutory definition of the economic affairs area, the ministerial agreement also seeks to strengthen other areas such as the public debt management, within the General Undersecretariat for Finance. The new MEF structure, despite being established in the ministerial agreement, is far from being fully operational; the new areas have few staff and will require additional civil servant hirings. The authorities aim to create sufficient posts in the 2002 public budget to achieve a critical mass of staff in key areas.

1.12 The two general MEF Undersecretariats, for Economic Affairs and Finance, are themselves subdivided. The General Undersecretariat for Economic Affairs has two basic undersecretariats: Economic Affairs and Public Investment. The General Undersecretariat for Finance encompasses the traditional functions of financial management: budget, treasury, accounting and public credit. The Undersecretariat for Management, responsible for everything to do with administration of MEF human and material resources, reports directly to the ministry. In addition, the MEF General Coordination Unit is responsible for issues relating to institutional strengthening and planning (see Annex I-1).

1.13 The Undersecretariat for Finance, which has responsibility for many of the functions carried out by the former Ministry of Finance and Public Credit, has received support through the MOSTA (State modernization project), financed by the World Bank and executed through the National State Modernization Council (CONAM). This project included re-engineering and modernization of financial management processes within the respective MEF undersecretariats, and development of the Integrated Financial Management System (SIGEF). So far SIGEF has not yet been fully implemented, and the process of transition from the previous system is running into difficulties, in particular as regards the production of data for decision-making.

1.14 A second World Bank loan is currently in the design phase and will be aimed at final implementation and consolidation of SIGEF at all levels: central government, decentralized and deconcentrated bodies, and subnational governments. Support provided by this new project is expected to solve current problems of lack of information for fiscal monitoring.

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[1] Some of the responsibilities of the General Undersecretariat for Economic Affairs are not new to the ministry, as the previous Technical Undersecretariat had several economic-policy functions.

1. Economic policy

1.15 The typical economic affairs functions in the restructured MEF have not yet been fully developed, and in practice the same structure exists as in the previous technical undersecretariat prior to the new regulatory statute. The undersecretariat for Economic Policy in August 2001 had just three staff economists supported by five short-term consultants. Institutional weakness is evident because the typical functions of this undersecretariat are not being adequately performed, which affects economic policy formulation and analysis in the country.

1.16 Research is limited to the production of economic notes on topics of current interest, and there is an absence of research to justify economic-policy measures and evaluate their impact—an activity generally carried out by the Central Bank. Macroeconomic programming is also done by the Central Bank, and MEF merely makes projections of central government accounts, gathers macroeconomic information (projections, simulations) produced by other institutions, and monitors financial programming in the framework of agreements with the International Monetary Fund (IMF).

1.17 In addition the shared database system *(*data warehouse) has been virtually shelved. The generation of fiscal accounts is also not automatic, because of incompatibility or a lack of connection between sources, particularly budget and debt, and also because there are no reliable information flows from the rest of the public sector (beyond central government). The transition to the SIGEF adds further obstacles to the analysis of fiscal figures since there is no information on accrued public expenditure, and cash flow data are received two months in arrears.

1.18 The new regulatory statute organizes this undersecretariat into four coordinating units, and defines a series of responsibilities which include: (a) preparing, monitoring and evaluating the economic program; (b) preparing current business reports; (c) generating and disseminating economic and social statistics, and (d) participating in the fiscal decentralization process, among other things. These functions are becoming more important now, since steering the country's economy relies essentially on fiscal policy, and in the next few months a series of fiscal reform laws and initiatives are expected to be introduced.

1.19 Naturally, the satisfactory fulfillment of these functions requires adequate human capital. For this, there are plans to hire a larger number of economists in order to establish a staff of about ten professionals in this undersecretariat. Current wage ceilings in the ministry are an obstacle when hiring qualified staff, for which reason a human-resource policy will be needed that raises wages as far as possible and provides training incentives.

2. Public debt management

1.20 In the public debt area, MEF reform involves strengthening of the Undersecretariat for Public Credit in the General Undersecretariat for Finance. The former suffers from limitations that impede efficient public-debt management. The first thing that hinders the work of this undersecretariat is the dispersion of relevant legal rules, as most fiscal laws (Fiscal Management and Control Statute, Budget Act, and so forth) contain elements relating to public credit that are not always mutually consistent.

1.21 The new arrangement essentially maintains the structure of the previous undersecretariat, with three areas (coordination units) that have major weaknesses. The Debt Management Coordination Unit is responsible for the recording and financial management (projections of disbursements, amortization and interest payments) of public debt, both domestic and external. Its work is based on the Integrated Debt Management and Administration System (SIGADE),[2] which suffers from technical problems that have saturated the system and prevent it from operating continuously.

1.22 The Evaluation and Monitoring Coordination Unit is responsible for the debt contracting process (from negotiation to signature), and for the authorization and monitoring of disbursements. It has an 11-strong professional staff for this purpose. Lastly, the Financial Operations Coordination Unit is in charge of issuing and floating government bonds and securities, along with their registration, and is also responsible for cash flow programming in relation to public debt. This coordination unit works with three stockbrokers, who maintain all information relating to bond and security dealing.

1.23 As can be seen, there is a degree of overlap in processes within the undersecretariat, and functions assigned are not always carried out efficiently. Research and analysis is scarce, and the weaknesses of this undersecretariat have led to other mechanisms being set up in the MEF and elsewhere to undertake substantive analysis of public-sector borrowing. For example, a few years ago during the external debt crisis caused by the cessation of payments on Brady bonds, an ad hoc commission had to be set up to deal with the emergency, reporting directly to the President of the Republic.

1.24 Although this undersecretariat has a large staff, there are still major human-resource needs. The rapid development of new products, such as book-entry (paperless) bonds, or the need for studies to improve efficiency in public-sector debt management, require different professional specifications than currently exist. Moreover, the government expects to participate actively in capital markets in the

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[2] An informatics system developed by UNCTAD.

near future, mainly to buy back debt, so modernization needs in this area are becoming urgent.

3. Management of public investment

1.25 The public investment system, encompassing the set of rules and procedures that guide, evaluate, authorize and monitor publicly funded investment projects, has traditionally been an element in the planning system. The legal framework governing the planning system is based on a number of laws that assign regulatory functions to the Planning Office of the Presidency of the Republic (ODEPLAN) and to the MEF. The following table summarizes the legislation that underpins this, and the public investment system in particular.

Table I-2
Laws Underpinning the Planning System

LAW	DATE	ART.	PROVISION
Political Constitution of the State	10 August 1998	255	Brings the national planning system under the responsibility of a technical body reporting to the President of the Republic.
Decree 120	16 September 1998	1	Creates ODEPLAN as the body referred to in Article 255 of the Constitution.
Financial Management and Control Statute	16 May 1977	48	Makes the Ministry of Finance responsible for coordinating planning and budgetary processes on the basis of the country's established development priorities.
Decree 366	19 May 2000	2	Gives the MEF a role in economic planning and macroeconomic programming.
Ministerial Agreement 094	16 April 2001	5.1.2	Creates the MEF Undersecretariat for Public Investment, with a mission to coordinate public investment programming and evaluation.

1.26 Since its creation in 1998, ODEPLAN has faced major difficulties in fulfilling its function as regulator of the public investment system. The drastic staff downsizing it suffered in 1999, compounded by the unsuccessful implementation of the public investment programming and monitoring system (SPSIP), have resulted in a discontinuation of active monitoring of investment projects, and the quality of annual investment plans (PAI) has declined significantly. In recent years, PAIs have had to be extensively reviewed internally by the MEF before being incorporated into the public budget, to make them compatible with the fiscal program and with public borrowing guidelines.

1.27 The lack of clarity in the legal environment, compounded by the weakness of mechanisms for managing public investment and the need for robust fiscal programming in the context of dollarization, caused the government to reassign

certain key ODEPLAN functions to the MEF. Under the Financial Management and Control Statute and Decree 366, the MEF created an undersecretariat for Public Investment in April 2001, operating in the General Undersecretariat for Economic Affairs. This new agency, in turn, has subordinate coordinating units in the areas of economic and social validation of projects, project bank management, and evaluation of project execution.

1.28 The new undersecretariat is currently in the formation stage. Despite having a director and three staff members redeployed from other MEF areas, it does not have an operational structure, and its material and technological resources are few. The organization established in the statutory regulation has not been implemented at the coordination unit level, and it is clear that conditions do not yet exist for the functions established in the regulation to be fully assumed. The draft public budget for 2002 contains funding for a group of professional posts in this undersecretariat.

1.29 The legal basis of the planning system remains ambiguous, however, and its reform is not a short-term matter. To initiate the process of legally assigning public investment responsibilities between ODEPLAN and the MEF, joint workshops were held between the two institutions to specify their respective functions; the result was a memorandum of understanding signed by their top authorities, which includes: (a) the specific functions of each institution on public investment; (b) the legal reforms needed to formalize those functions; and (c) the work plan to implement the legal reforms.

1.30 Obviously these functions should have been clearly defined before the MEF Undersecretariat for Public Investment was set up. Nonetheless, the arrangements agreed with ODEPLAN largely coincide with the organization and functions established in the ministerial agreement that created it in April 2001. Its main responsibilities include economic, social and environmental validation of investment projects, management of the public investment informatics system, reconciliation of investment plans with macroeconomic and borrowing guidelines, relating investment plans to the budget, and monitoring of the execution of investment projects. ODEPLAN remains the central pillar of the planning system, with responsibility for preparing the development plan, formulating general investment policies and macro-monitoring of plans and programs.

1.31 The Financial Management Statute will be the legal instrument consolidating these functions, and will largely replace existing public finance regulations in Ecuador. This legislation is expected to set out clearly the regulatory and operational functions of ODEPLAN and the MEF in its chapter on public investment. The draft legislation is currently under discussion in the MEF and CONAM, and is expected soon to be sent to the legislature.

4. Sectional finance

1.32 The MEF is the body responsible for the country's fiscal and budgetary policy, along with domestic and external financing. It has responsibility for formulating and implementing State fiscal policy, and it defines mechanisms and procedures for managing public finances. As sectional bodies are part of the State, the MEF has to monitor their finances and ensure they maintain fiscal discipline and keep borrowing within sustainable limits. Despite its legal and statutory responsibilities, the MEF still does not have the technical and managerial capacity needed to carry out its tasks. The following table summarizes the laws that assign such responsibilities to the MEF, including, specifically, the power to regulate and monitor sectional finance.

Table I-3
Laws Relating to Legal and Statutory Responsibilities of the MEF

LAW	DATE	ARTICLE	PROVISION
Political Constitution of the State	10 August 1998	1, 118 and 260	Establishes Ecuador as a unitary state; entities forming the autonomous sectional regime are defined as State institutions; makes formulation and execution of fiscal policy the responsibility of the executive branch.
Financial Management and Control Statute	16 May 1977	24, 41, 42, 43 and 48	Makes the Ministry of Finance responsible for ensuring correct legal application of all laws concerning State financial or material resources; for issuing all kinds of provision and budgetary system policies for public-sector entities or organizations; for coordinating fiscal policy execution with other policies; and for formulating borrowing policy.
Economic Transformation of Ecuador Act	29 April 1999	99	Gives the Ministry of Finance and Public Credit exclusive responsibility for issuing technical regulations on government accounting procedures.
Ministerial Agreement 182	22 January 2001	2.4.1.3	Requires all public-sector bodies to file financial statements with the MEF on a monthly basis.
Ministerial Agreement 286	24 October 2001	1	Creates the Sectional Finance Support Coordination Unit with a mission to conduct studies, produce information and permanently monitor sectional public finances.

1.33 The MEF Undersecretariat for Government Accounting now performs the important function of consolidating the yearly financial statements for the non-financial public sector, including those relating to municipios and provincial councils. This task is undertaken manually assisted by an informatics system, which should be replaced by the SIGEF for data relating to central government and some

of its bodies. On the basis of Ministerial Agreement MEF 182, which currently regulates the financial management system, this unit receives cash flow figures, along with accounting and budgetary execution data from government bodies, including sectional entities.

1.34 The purpose of this yearly activity is to produce consolidated accounts for the non-financial public sector. It does not provide the information needed for close monitoring of sectional finance in terms of timeliness, or required frequency and format. In 2000, 72% of provincial councils and 61% of municipios sent their annual reports to the MEF in printed form, which means the information has to be validated and the financial statements retyped in the computer. This process takes time and does not make it possible to produce an up-to-date set of indicators for analyzing the behavior and evaluating the trend of sectional finance.

1.35 The Comptroller General, together with the Central Bank and the Banco del Estado also receive financial statements and budgetary reports from municipios and provincial councils—in each case for a specific purpose, but not intended for closely monitoring the behavior and trend of subnational finances.

1.36 Through Ministerial Agreement 286 the MEF created a Sectional Finance Support Coordination Unit (CAS) within the Undersecretariat for Economic Policy. This new agency has two subordinate units, dealing with the monitoring and studies area, and technical assistance; the unit is in the formation stage, as yet lacking director, staff, operating structure and material and technological resources, which are in short supply throughout the ministry.

5. Human resources and general management

a. Human-resource policy and management

1.37 In recent years the MEF has gone through many institutional changes that have undermined its capacity to attract and retain qualified staff. Hiving off SRI and CAE, along with other cost-cutting measures, drastically reduced the Ministry's staff just when the institution was seeing its jurisdiction and field of action in macroeconomic management widened. This climate of change did not elicit a strategic process for developing a new human-resource policy, thereby depriving the institution of the staff it needs to perform its functions.

1.38 A temporary solution is to attract qualified staff on secondment from other organizations such as the Central Bank and the Banco del Estado. This is happening at the present time with good results, but it is not a long-term solution because seconded staff may return to their original institutions at any moment. In addition, the arrangement leads to wage distortions within the MEF because permanent ministry staff are paid less. Given the staff shortage, the MEF is currently in a process of creating new posts, which will result in new staff hirings in early 2002.

1.39 It is important for the MEF to offer wages that are more competitive on the market, in order to attract and retain skilled staff. A wage increase has been programmed but not yet formalized; this will raise the MEF salary scale in line with certain benchmark criteria. The average proposed increase of 47% will come into force once approved by the National Wages Council (CONAREM). The MEF qualifies for the new salary scale having gone through a restructuring process, like other institutions including the Ministry of Tourism.

b. Information technology

1.40 The lack of an institutional policy on information technology has led to dispersed and inefficient use of the few computer resources available in the ministry. The MEF Informatics Coordination Unit does not manage all informatics systems, which are dispersed through three computer centers, with technical staff from this area working in various operating units.

1.41 The productivity of the MEF human resources is undermined by the shortcomings of available computer systems. The ministry has 230 personal computers, of which 70% are now obsolete. Of these, nearly half are coming to the end of their useful life. The data exchange network is disorganized, and only a few workstations have access to the internet. In addition, the MEF is experiencing serious problems with its wiring structure and electric power distribution systems.

D. The country's strategy

1.42 The government is aware that the MEF will be unable to fulfill its responsibilities given current technical, technological and human-resource limitations. The institution's new areas, focusing on economic affairs, are clearly weak and in some cases effectively nonexistent. Current or past ministerial strengthening initiatives have achieved acceptable results but have not addressed the institution as a whole in an integrated way.

1.43 The MOSTA project, financed by the World Bank, has concentrated on the finance area. Its main product, the Integrated Financial Management System (SIGEF), has been conceived as a traditional financial management tool that focuses on the budget, treasury and accounting areas. If final implementation is successful, SIGEF will make it possible to rationalize and integrate these areas, thereby generating suitable information for decision-making.

1.44 The Bank's contributions to institutional strengthening have involved non-reimbursable technical cooperations (ATN/SF-6850-EC and ATN/SF-7034-EC), to support certain critical areas where the shortage of permanent trained staff has forced the ministry to hire outside consultants to maintain a minimum level of analytical capacity, particularly in the economic affairs and public credit areas. This

has been of valuable assistance, but it has not contributed to permanent institutional development in the MEF.

1.45 There is clearly still a significant area that international cooperation has not reached and where the MEF requires considerable support. The country has decided it needs a program to strengthen functions in the economic affairs area, and to develop institutional capacity to support the fiscal decentralization process. This effort should not be compartmentalized, however, but given special support to generate a sense of greater institutional solidity throughout the ministry, by developing policies and processes to strengthen horizontal elements—human resources, information technology and training, among other things. This is the only way to achieve an MEF that is strengthened its key areas with capacity that is sustainable over time.

E. The Bank's strategy in the sector

1.46 The Bank's strategy in the country is limited to four key objectives: (a) stabilization of the economy and restoration of growth capacity; (b) poverty relief, human-capital formation and social inclusion; (c) efficient management of infrastructure with private-sector participation; and (d) State modernization and decentralization, and promotion of sustainable regional development. The proposed operation is consistent with the following objectives: (a) economic stabilization, together with a strengthening of fiscal management tools in a dollarized economy where monetary policy is practically nonexistent; and (b) State modernization and decentralization, in which the MEF is seen as a key player in the State apparatus, building a component into the proposed program that contributes to an orderly fiscal decentralization process.

F. Experiences of the Bank and other organizations

1.47 The Bank has considerable experience of comprehensive strengthening programs in agencies responsible for public finance in a number of countries. These include the fiscal management modernization program in El Salvador (941/OC-ES), a program to strengthen and modernize public-sector administration in Panama (1004/OC-PN), and a program to consolidate public-sector administrative and financial reform in Argentina (826/OC-AR). In addition, a variety of sectoral programs have been approved with strong fiscal reform components, along with several technical cooperation projects in specific areas of public finance, such as public debt, fiscal statistics, public investment and so forth.

1.48 In the case of Ecuador, and in the areas related to the proposed program, the most significant effort has been the program to strengthen the investment system (900/SF-EC), implemented through ODEPLAN. Execution of this program, which concluded in mid-2000, had among its key objectives the development and implementation of an informatics system in support of planning and public

investment (SP-SIP). According to analyses made at the end of the project, it was prevented from achieving its objectives partly because of structural changes in executing agency for reasons extraneous to the program. The proposed program will seek to make use of the unfinished work of SP-SIP for the new public investment system.

1.49 Within the General Undersecretariat for Finance, the Undersecretariats for Budget, Treasury and Accounting have received support through the MOSTA program, financed by the World Bank and executed through CONAM. This project supported the re-engineering and modernization of financial management processes within the respective MEF undersecretariats and developed the SIGEF. A second World Bank loan is currently in the design phase and will seek to consolidate the SIGEF at all levels: central government, decentralized and deconcentrated bodies, and subnational governments.

1.50 The proposed operation takes account of several lessons learned from these programs, including, firstly, the need for work in substantive areas to be supported by human-resource policies that make the reforms sustainable. Secondly, there is a need for legal clarification of the attributions of the beneficiary institution in the event of any duplication of functions with another public body. Thirdly, it is important to clearly define areas of action with other financing agencies; and fourthly, a self-contained executing unit needs to be set up to run the program from the technical and administrative points of view.

II. THE PROGRAM

A. Objectives

2.1 The general objective of this operation is to support the consolidation of Ecuador's fiscal sector as the main economic-policy tool, in a context of fiscal-policy reform and MEF institutional strengthening. The specific objectives of the operation are: (a) to strengthen systems for formulating, analyzing and monitoring the country's economic policy; (b) to strengthen the control, recording and monitoring of public-sector debt; (c) to develop capacity for monitoring sectional finance; (d) to support the definition of public-sector investment policies and the monitoring and evaluation of investment projects; and (e) to strengthen general internal management in the MEF, in areas such as human-resource policy, training and information technology.

B. Description

2.2 The general concept of the program involves working on certain substantive areas that are crucial for the proper functioning of the MEF, as well as strengthening horizontal elements that make the reforms more sustainable—particularly human-resource policy. The support proposed will be aimed at forming a solid base of permanent well-trained staff, backed by suitable and sustainable technological support, in an organization with a structure appropriate to the responsibilities assigned to it by law.

2.3 The program's components encompass the main substantive areas of the General Undersecretariat for Economic Affairs and the Undersecretariat for Management. As regards the General Undersecretariat for Finance, the program will only assist the public credit area, as budget, treasury and accounting are already being supported by the SIGEF program financed by the World Bank. This program and SIGEF between them are providing comprehensive strengthening for all the main MEF areas.

2.4 The program is structured in five components to be implemented through an executing unit within the MEF. The components and approximate amounts are as follows:

1. Component 1: Economic policy support (US$842,000)

2.5 The objective of this component is to support the MEF in preparing, analyzing and monitoring the country's macroeconomic policy. In particular, technical cooperation will be provided to support institutional strengthening in the Undersecretariat for Economic Policy, which is dependent on the General Undersecretariat for Economic Affairs. To that end, funding will be provided for

consulting services, procurement of equipment and software and the training of technical staff in three coordination units within the Undersecretariat for Economic Policy.

2.6 Support will be aimed at three key areas, each of which is represented by a coordination unit. These are: (a) analysis of current business, basically involving the preparation of notes, reports and bulletins on economic topics of current interest (including fiscal reforms), which are expected to serve as a basis for macroeconomic policy fine-tuning; (b) macroeconomic programming, responsible for medium and long-term management using financial programming, projections and impact simulations; and (c) fiscal statistics, where the aim is to generate complete, up-to-date and accurate fiscal data, in addition to maintaining a database of economic and social indicators useful for the design and evaluation of economic policy.

2.7 To achieve these objectives, the program will finance 24 months of international consulting services in the following areas: (a) current economic situation and policy; (b) macroeconomic programming; (c) macroeconomic models for projections and simulations; and (d) fiscal statistics and leading indicators of national accounts. These international consultants are expected to spend an average of two months in Ecuador, so about 12 different consulting services could be financed during the 24 months of the component. Consultants will not only prepare reports but also work directly with the permanent staff of the undersecretariat in order to disseminate experience and knowledge. The cost of international consulting services is estimated at US$280,000.

2.8 In addition, the undersecretariat will be supported by local consultants in its three main areas. These would be expected to supply a total of 36 consultant-months during the two years of component execution on the following topics: (a) development of leading and early warning indicators; (b) competitiveness; (c) fiscal policy under dollarization; (d) social policy; and (e) foreign trade. In addition, the component envisages contracting two informatics consulting services for 12 months each, specifically: (a) an expert to develop a system of fiscal statistics; and (b) an expert to design and implement a data warehouse system to provide a complete and up-to-date database for use in economic analysis and to support policy making. The estimated cost of these consulting services is US$170,000.

2.9 The component also envisages the procurement of computer equipment and software for undersecretariat staff, basically personal computers, for an amount equivalent to US$26,400. Use of the server for the data warehouse will be shared, so its cost is included in the management component. Funding will also be provided for the training of technical staff, involving courses on issues relating to macroeconomic policy, macroeconomic models and programming, and fiscal statistics and national accounts, at an estimated cost of US$245,000. More general

courses, also involving staff from this undersecretariat are included in the management component.

2. Component 2: Strengthening of public debt management (US$328,000)

2.10 The objective here is to support the MEF in improving the management of public debt, both domestic and external, in the light of capital market developments. In particular, this technical cooperation will support institutional strengthening in the Undersecretariat for Public Credit, which is dependent on the General Undersecretariat for Finance. Funding will be provided for consulting services, procurement of equipment and software, and training for technical staff in its three coordination units.

2.11 Support will focus on strengthening the following organizational areas: (a) public-sector debt management, responsible for the maintenance maintaining of borrowing records and its financial management; (b) evaluation and monitoring, encompassing the contracting and monitoring of debt; and (c) financial operations, responsible for the issuance, placement and recording of bonds issued by the government.

2.12 To achieve these objectives, the component will finance four consultancies to perform the following tasks: (a) a short-term international consultant, to support the undersecretariat in the designing a database on funding sources and on more modern techniques of intervention in international capital markets (dealing, derivatives, and so forth); (b) a short-term international consultant to provide technical support in private-sector funding for public projects; (c) a short-term local consultant to review all legislation on public credit, and make a proposal for unifying it under a possible public credit law; and (d) a medium-term local expert to design a system for controlling bond issues. The estimated cost of these consulting services is US$102,900.

2.13 In addition, there is provision for the procurement of computer equipment and software for undersecretariat staff, basically personal computers and a server to operate the SIGADE, at a cost of US$57,900. Support will also be provided for the training of technical staff, with courses on issues relating to efficient public-debt management, together with internships in countries of the region with advanced public credit offices, managing modern instruments, at an estimated cost of US$135,000. More general courses, also involving the staff of this undersecretariat, are included in the management component.

3. Component 3: Support for sectional finance (US$1,202,000)

2.14 This component is based on the future creation of a Sectional Finance Support Coordination Unit (CAS), in the Undersecretariat for Economic Policy. The CAS has its structure and functions defined in a ministerial agreement, but in practice it does not have the material and technical resources needed to fulfill its brief. The

objectives of this component are to strengthen the CAS through specialized technical consultancy, training and information technology, as well as establishing access to a flow of information on sectional finance, to enable it to perform its functions effectively. The country's contribution will include hiring the staff needed to fill the new posts of this coordination unit.

2.15 The main activities of this component include: (a) design and implementation of the Sectional Financial Information System (SIFIS) together with associated training; (b) monitoring of sectional finance for compliance with applicable legislation; (c) advising the minister on establishing rules and directives on sectional finance, as well as supervising their execution and promoting their dissemination; (d) systemizing and promoting the diffusion of regional financial information for citizens' use; (e) coordinating training and technical assistance initiatives on fiscal matters for sectional governments; and (f) carrying out studies and research on subnational finance.

2.16 To execute these activities, the program will make short-term hirings of a variety of consultants specialized in local taxation, sectional finance and local government management, and in budgetary management and government accounting applicable to local governments. Other consultants will be hired longer-term (12 to 30 months) for activities relating to fiscal statistics, sectional finance and subnational taxation. High-level international consultants will also be hired in the area of intergovernmental fiscal relations, to support the fiscal decentralization process and help design new rules on transfers and sectional government taxation powers. To support development and implementation of the SIFIS, including the initial phase of its operation, consultants will be contracted in the informatics area, together with advisory services for the Ecuadorian Municipalities Association (AME) and the Ecuadorian Consortium of Provincial Councils (CONCOPE), with a view to mobilizing and disseminating the system among sectional governments. The estimated cost of consulting services in this component is US$443,800.

2.17 This component's training activities are divided into two general areas: (a) courses, and seminars and internships for strengthening the technical capacity of CAS technical staff to perform their functions; and (b) activities to mobilize leaders of sectional governments and train their accountants and financial directors to implement and operate the SIFIS, in order to guarantee a timely flow of quality information transmitted electronically. The total cost of training activities in this component is US$336,000.

2.18 Informatics and office equipment will be required to support the component for two purposes: (a) computers, software and other equipment for CAS operations; and (b) a set of 80 computers and corresponding basic software to be made available to certain municipalities and provincial councils, under a loan-for-use arrangement, whereby those entities receive technical and material support but undertake to

submit their financial reports electronically. The total cost of the informatics and office equipment to be procured is US$208,160.

2.19 An additional cost of the component relates to salaries for staff contracted to carry out functions in the CAS. Of the eight professional staff envisaged, five will be hired in the first year and another in the second, and the team will be completed by the third year. The total estimated cost of these hirings is US$182,400, to be financed from the local counterpart funding.

4. Component 4: Strengthening of public investment (US$800,000)

2.20 This component is based on the recent creation of the Undersecretariat for Public Investment (SIP) in the General MEF Undersecretariat for Economic Affairs. The structure and functions of the SIP are defined in the April 2001 Ministerial Agreement, but in practice it does not have the human or material resources needed to fulfill its brief. The objective of the component is to strengthen the SIP through specialized technical assistance, training and information technology to enable it to perform its functions. The country's contribution consists, among other things, of hiring the staff needed to fill the new posts created in this undersecretariat.

2.21 The component's main activities are: (a) to review and redefine the public investment analysis and processing cycle; (b) to design the re-engineering of SIP processes; (c) to establish validation mechanisms for investment proposals; (d) to design mechanisms for monitoring and evaluating investment projects; (e) to strengthen links between the development plan and the public budget; (f) to enhance linkages between the macroeconomic plan and the annual investment plan; and (g) to design, develop and implement an informatics system to manage public investment.

2.22 In carrying out these activities, the program will hire specialized consultants in the following areas: organization and methods; economic, financial, social and environmental project evaluation; and fiscal programming. A high-level international expert will be contracted to advise on general and strategic aspects of public investment. In addition, a local consulting firm will be hired to design and develop the public investment informatics system. The total cost of consulting services in this component is estimated at US$480,400.

2.23 The component's training activities are divided into two general areas: (a) courses and seminars on public investment management and other related issues; and (b) courses relating to the use and maintenance of the public investment informatics system. The first of these categories will include events dealing with topics such as project formulation and evaluation, logical framework, applied fiscal policy, public investment policies, and so forth. The total cost of the training activities in this component is US$164,000.

2.24 The estimated cost of informatics and office equipment to be financed by the project is US$38,000, while expenditure on improvements to physical infrastructure and furniture are estimated at US$15,000. The estimated cost over three years of hiring three new senior and two junior professionals to join the permanent SIP staff, amounts to US$102,600. This will be financed through local counterpart funding to the component.

5. Component 5: Strengthening of general MEF management (US$1,667,000)

2.25 This component will provide institutional strengthening to various general management areas in the MEF, aimed at increasing its capacity to attract and retained skilled staff, and to update, integrate and expand access to information through its information technology structure.

2.26 The main activities in this component are: (a) development and implementation of a comprehensive human-resource policy for both the long and short term; (b) institutional strengthening of the Human-resource Coordination Unit to give permanency to activities of formulating policies, strategy, projects and their execution (in selection and entry, job classification, description of functions, remuneration, performance assessment, training, benefits, and so forth); (c) implementation of strategies for dealing with new MEF staffing needs (new individual hirings, outsourcing of activities, attraction of external staff on secondment; labor retraining and higher salaries); (d) design and implementation of an informatics system for human-resource management; (e) implementation of the Ministry Training Center, and review and execution of the strategic training plan involving about 160 courses; (f) development and implementation of a strategic information technology plan to open up access for its staff to information via personal computer, Internet and electronic mail, including the procurement of hardware and implementation of specific software; (g) development and implementation of a corporate intranet and ministry website; and (h) design and implementation of an institutional communication plan for the MEF.

2.27 To achieve these objectives, the program will provide funding for short-term international consultancy contracts, both international and local, specializing in human resources, information technology and institutional communication. Expenditure on individual consulting services is estimated at US$178,320 (under 11% of total expenditure in this component), with a more intensive hiring process in the first year of the program, declining significantly in the second year, and residual in the third. The general strategy is to strengthen the capacity of the ministry's internal staff, by hiring new employees and implementing a very broad training program. Ministry counterpart funding for this item is estimated at US$144,000.

2.28 As part of the training activities, the component will support implementation of the Ministry Training Center and execution of its training plan, which includes about 60 general courses and 100 specific ones over a three-year period. The ministry will provide counterpart funding for investment in infrastructure, installations and furniture for the training center (US$50,000); and the Bank will finance the purchase of equipment such as microcomputers, printers, projectors, screens, intelligent whiteboard, photocopier, and so forth. The program will also pay for instructors and a number of courses held outside the training center. The total cost of the training courses in this component is US$293,620.[3]

2.29 The component will finance the purchase of informatics equipment for the ministry (including the training center) encompassing servers, microcomputers, printers, projectors, switches, routers and other network equipment, among other things, for a total of US$425,600. Physical modifications will also be made to facilitate installation of this new equipment, in the institution's electrics and cabling structure, for a total of US$97,500 to be financed out of local counterpart funding.

2.30 At the software level, local firms will be hired to develop and set up a corporate intranet and institutional website, in addition to procuring and implementing a comprehensive human-resource management informatics system. Funding will also be provided for the purchase of specific programs, such as firewalls, development tools, network applications and general productivity software, for a total cost of US$333,473. Implementation of this software includes training the ministry's technical staff to update and permanently maintain it, and preparation of user manuals.

2.31 To implement an institutional communication plan, graphics services will be hired to produce printed newspapers, along with a corporate image manual and annual activities report; material for communications media and ministry staff; a glossary of economic terms; and basic guidelines on economic issues. A magazine library will also be set up. Other services include the production of educational videos about the ministry, for institutional circulation, together with informative media spots and brief announcements on economic issues of social interest, and the establishment of a video library. The total cost of implementing the institutional communication plan is US$145,000.

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[3] To avoid losing skilled staff to the private sector, the MEF requires staff members to sign strict pledges of commitment before participating in courses.

C. Cost and financing

1. Program costs

2.32 The total cost of the program amounts to US$6.4 million, of which the Bank will fund US$5.12 million drawn from Ordinary Capital funds, as set out in the following table.

Table II-1
Total Cost of MEF Strengthening Program
(US$ thousand equivalent)

	IDB (OC/IFF)	Government of Ecuador	Total	%
1. Program management	**758**	**108**	**866**	**13**
1.1 Executing unit	683	108	791	12
1.2 External audit	75	-	75	1
2. Direct costs	**4,038**	**803**	**4,841**	**76**
2.1 Studies and technical assistance	1,846	-	1,846	29
2.2 Training	1,115	59	1,174	17
2.3 Equipment and software	891	-	891	14
2.4 Additional counterpart staff	-	581	581	9
2.5 Other direct costs	186	163	349	5
3. Not specifically assigned	**273**	**292**	**565**	**9**
SUBTOTAL	**5,069**	**1,203**	**6,272**	**98**
4. Financial costs (*)	**51**	**78**	**128**	**2**
4.1 Credit fee	-	78	78	1
4.2 Inspection and supervision	51	-	50	1
Total	**5,120**	**1,280**	**6,400**	**100**
Percentage by source	**80%**	**20%**	**100%**	
* The borrower will pay interest on the loan directly to the Bank.				

2. Execution and disbursement periods

2.33 The program will be executed over a 36-month period, with disbursements over 42 months.

3. Bank financing

2.34 Financing by the Bank, totaling US$5.12 million, will be drawn from Ordinary Capital funds, with interest rate support from the Intermediate Financing Facility (IFF). Table II-2 sets out the terms and conditions of the loan.

Table II-2
Loan Terms and Conditions

Source of funding:	Ordinary Capital (Intermediate Financing Facility)
Amount:	US$5,120,000
Terms:	
Amortization:	25 years
Grace:	42 months
Disbursement:	42 months
Interest rate:	Variable
Inspection and supervision:	1%
Credit fee:	0.75% on undisbursed amounts
Currency:	United States dollars drawn from the Single Currency Facility

III. PROGRAM EXECUTION

A. Borrower, guarantor and executing agency

3.1 In the proposed loan, the borrower will be the Republic of Ecuador. The executing agency will be the Ministry of Economic Affairs and Finance, acting through a program coordinating unit.

B. Project execution and management

1. Program coordinating unit (PCU)

3.2 The PCU will be attached to the ministry's General Coordinating Unit, which is responsible for administering institutional strengthening programs. It will have sufficient administrative autonomy to manage the program's funds speedily and efficiently, and consist of a coordinator general, together with a lead technical adviser, an informatics coordinator, an administrative coordinator and support staff.

3.3 The PCU will have the following functions: (a) supervision and overall control of the program; (b) assisting technical groups in the different components in carrying out their activities; (c) promoting legal and regulatory reforms arising from the program; (d) supervising the work of consultants, procurement of informatics equipment and training activities; (e) preparing yearly training plans; (f) administering program funds, including disbursement processes, managing separate bank accounts for the Bank loan and the local contribution, appropriate systems for finance and accounting, filing and internal control, preparation and presentation of audited financial statements and other reports as required; (g) maintaining adequate systems for administering hirings and procurements, in accordance with the rules established for such purposes; (h) preparation of work plans, progress reports and other program reports; (i) support for Bank supervision activities; and (j) other functions to do with program coordination.

2. Programming and evaluation committee (CPE)

3.4 The MEF will set up a programming and evaluation committee (CPE), through the same ministerial agreement that establishes the PCU. The CPE will be responsible for planning and monitoring achievement of the program's objectives, and for ensuring program funds are used rationally. It will be headed by the Minister of Economic Affairs and Finance, and will consist of the General Undersecretary for Economic Affairs and Finance, the General Ministerial Coordinator, and the Undersecretaries for Public Investment, Economic Policy, Public Credit, and Management. The general coordinator of the program will act as the committee's technical secretary. The committee will meet at least every three months, and among other things will be responsible for approving progress reports and work

plans, and facilitating progress of the components from the institutional point of view. **Promulgation of the ministerial agreement creating the PCU and the CPE, together with the provision of physical space and selection of PCU staff, will be conditions precedent to disbursement of the Bank loan.**

3. Work plan and monitoring

3.5 The PCU will prepare quarterly reports to be presented and approved by the CPE. These will also be submitted to the Bank, and will contain the following: (a) program results during the quarter just ended; (b) detailed work plan for the following quarter, including changes in targets agreed with the CPE; (c) minutes of CPE meetings held during the reporting period; and (d) other matters pertaining to program monitoring and evaluation. Reports that coincide with the end of a year of program execution will also contain a detailed reformulation of the work plan until conclusion of the operation.

3.6 The Bank will carry out its monitoring functions through six-monthly meetings with the PCU and CPE. These will evaluate indicators of progress, and decide on corrective measures as necessary.

4. Use of the Bank loan

3.7 **Procurement of goods and services.** All selection and hiring of services and goods procurement in the program will be carried out in accordance with Bank procedures. Bidding processes and/or calls for proposals will be international in the case of goods procurement in excess of US$250,000 and consulting contracts for more than US$200,000. Local competitive bidding will be used in goods and services procurement with reference prices between US$100,000 and US$250,000; and an open call for proposals among local suppliers will be announced for amounts below US$100,000. The selection of consulting services with reference prices below US$200,000 will involve prequalification of consulting firms and direct invitation to those included on the executing agency's shortlist (see Annex III-1, Procurement plan).

3.8 **Consulting services and training.** The program's consulting services involve individual local and international consultants, and consulting firms. A total of eight local invitations to tender are expected to be made, with 44 individual consultants to be hired, under Bank rules and procedures. Training activities will be coordinated through the MEF Undersecretariat for Management which has a training coordination unit and a training center. Up to 200 Bank-funded training events are expected to be held, for a total cost of US$1,115,000.

3.9 **Information technology.** The program will finance the purchase of computer equipment, software and office equipment. For this purpose, 10 local invitations to

tender and one international tender are envisaged, for the provision of informatics equipment, software and technical support.

5. Counterpart funding

3.10 The local contribution will mostly cover the hiring of new staff to fill the posts created specifically in the program's areas of action, without which it would be impossible to achieve the critical mass of professional staff needed to make the proposed reforms sustainable. The MEF has reported that the 2002 public budget already includes items to cover the posts identified for undersecretariats or coordination units involved in the operation's five components, together with budgetary allocation for the proceeds of the Bank loan. In addition, the MEF will provide administrative and support staff to operate the PCU.

C. Execution and disbursement period

3.11 The program will be executed over an estimated three-year period, with disbursements spread over 3.5 years.

Table III-1
Disbursement Schedule
(US$ thousand)

Source	Year 1	Year 2	Year 3	Total	%
IDB	2,515	1,773	832	5,120	80
Local	495	427	358	1,280	20
Total	**3,010**	**2,200**	**1,190**	**6,400**	**100**
Annual %	**47%**	**34%**	**19%**	**100%**	

3.12 The PCU will open and maintain specific and separate Bank accounts for managing program funds. A revolving fund will be established for up to 5% of the Bank loan, to facilitate program disbursements. Six-monthly statements of the revolving fund will be presented no less than 60 days after the end of each semester.

D. Evaluations

3.13 The borrower, acting through the executing agency, and the Bank will hold evaluation and monitoring meetings to assess technical quality and progress made towards achieving the program's targets, based on the physical target indicators set out in the logical framework (Annex III-2), and information gathered for periodic evaluation and monitoring meetings during execution.

3.14 **Midterm evaluation**. A midterm evaluation of the program will be made after 18 months. This will coincide with the first six-monthly evaluation of the second year of execution. It will assess the progress and results of activities relating to technical assistance, training and information technology in the program's different components.

3.15 **Ex post evaluation.** The government has decided to conduct an ex post evaluation of the program, and this will be performed one year after it has concluded. The purpose of such an evaluation is to measure the program's contribution to the country's institutional and socioeconomic development; it will make use of studies and indicators on institutional, fiscal and macroeconomic impacts. The ex post evaluation will focus particularly on the following topics: (a) impact on the country's macroeconomic and fiscal management; (b) impact on fiscal linkages between the MEF and subnational governments; (c) impact on the quality and timeliness of the PAIs; (d) impact on the quality, quantity and permanency of MEF human resources; (e) the sustainability of training activities; and (f) design of execution mechanisms including the PCU and CPE. During program execution, information for the ex post evaluation will be gathered through the program's evaluation and monitoring system, and from the periodic and final program reports.

3.16 The borrower, acting through the executing agency, will present the following for the Bank's approval:

a. Within two months of the loan contract coming into force: (i) basic initial data; and (ii) a description of the procedure to be used to compile and process annual figures for comparison with basic initial data in evaluating the results of the project.

b. The comparative annual data mentioned in the previous paragraph, once the loan contract has been in effect for one year, and until the third year following the final disbursement.

c. A midterm evaluation report, based on methodology and in accordance with guidelines approved by the Bank in the initial report referred to in subparagraph (a), once the loan contract has been in effect for 18 months.

E. Audit and control

3.17 During program execution, the borrower will present annual audited financial statements for the program, no less than 120 days following the end of the respective accounting year. Financial statements will be audited by an independent firm of auditors acceptable to the Bank. The cost of the external audit will be paid out of the proceeds of the Bank loan and in accordance with terms of reference agreed with the Bank.

IV. VIABILITY AND RISKS

A. Viability

4.1 Institutional viability. Program design has taken into account the capacity of MEF to absorb institutional reforms, and it has been structured considering the specific requirements of each area. As the MEF does not have recent experience in carrying out a wide-ranging institutional strengthening program, this operation will be implemented through a project coordinating unit, consisting entirely of consultants, with both technical and managerial responsibilities for execution.

4.2 The main constraint on the institution's capacity to assimilate the program stems from low wages and a shortage of technical staff in key areas. MEF is currently working to obtaining approval for new salary scale and allocate resources in the 2002 budget for new posts.

4.3 **Legal viability**. Implementation of the components relating to economic policy, public-sector debt and general management do not involve any additional regulatory or legal requirement. The definitive and successful implementation of the public investment component will require a legal instrument to clearly distribute planning and public investment responsibilities between ODEPLAN and the MEF; this will probably be the Financial Management Law, currently in the review stage. If necessary, the program will assist in preparing this legal instrument during execution.

4.4 In the specific case of goods procurement and construction work financed by the program, the borrower will issue a decree to allow goods procurement and construction work to be funded by programs with multilateral or international agencies, as an exception to the prohibition contained in Decree 1221. The latter, issued on 7 February 2001, prohibited the procurement of furniture and equipment, including vehicles of any kind.

B. Environmental and social impacts

4.5 Given the nature of the activities to be funded through the program, no direct environmental or social impacts are anticipated. The program is expected to have an positive indirect impact on the environment by strengthening the ex ante environmental evaluation of public investment projects; and in the social area also, by boosting the fiscal decentralization process leading to more effective targeting of social expenditure.

C. Benefits

4.6 The main benefit of the operation is that it will make a significant contribution to achieving sustainable macroeconomic stability. Given the characteristics of the Ecuadorian economy, in which fiscal policy is practically the only macroeconomic management tool available, adequate planning and execution of public finance is of prime importance. The program seeks to strengthen the MEF in certain key areas of fiscal management. Combined with assistance being provided by other multilateral agencies, this represents comprehensive support for the institution.

4.7 A major benefit of the program is that it will foster a more orderly and considered decentralization process. The country is currently drawing up an administrative and fiscal decentralization strategy, and the MEF has a leading role to play in this. The program will create institutional capacity to enable the MEF to fulfill that role permanently, in coordination with other organizations involved in the process.

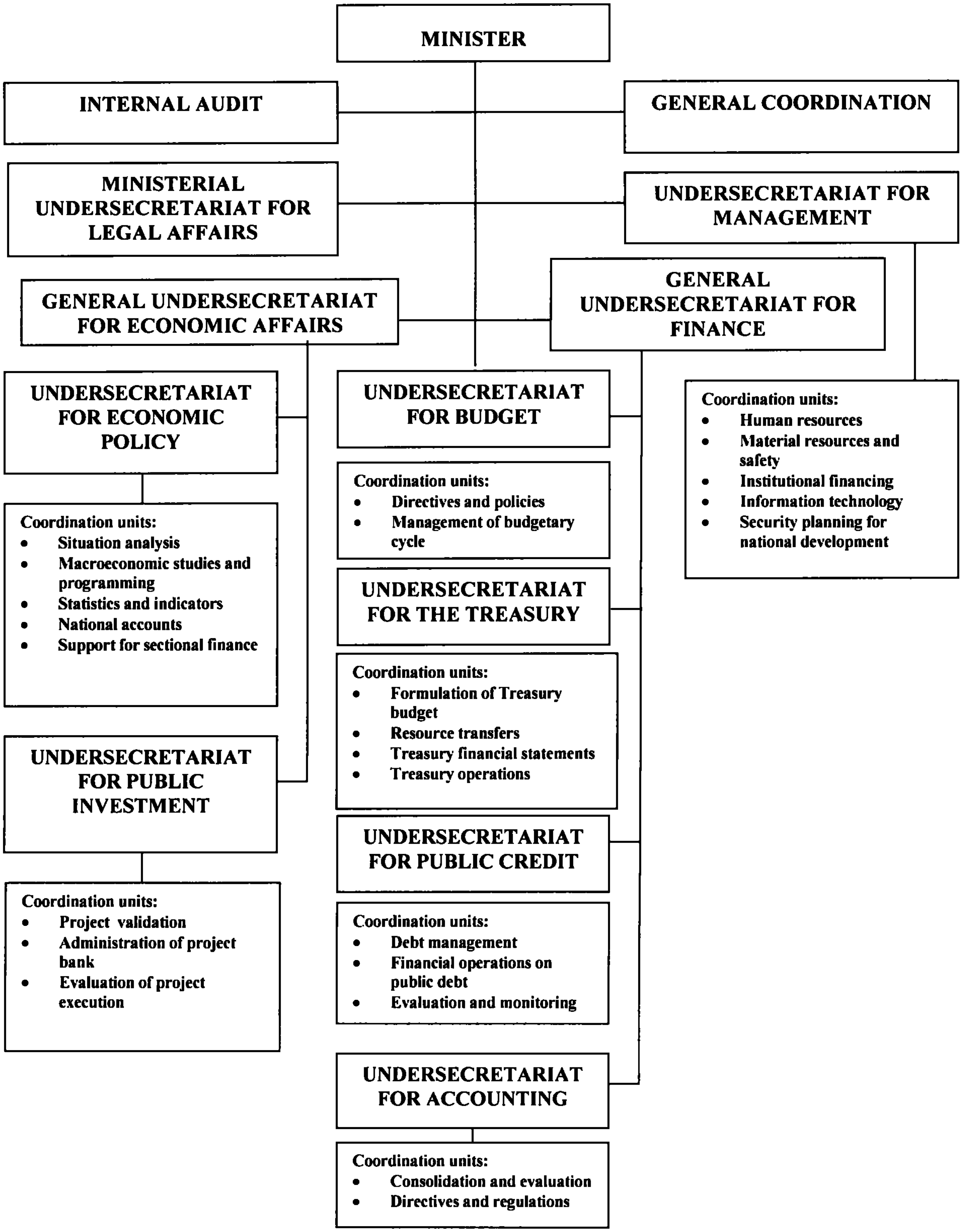
D. Risks

4.8 Low wages and high turnover among civil servants in general puts the sustainability of the proposed reforms at risk. The government has authorized salary increases in restructured public bodies, but these have not yet been approved for the MEF. The ministry is currently shoring up certain key areas of its work by using qualified staff hired through technical cooperations with the Bank, or on secondment from other public bodies such as the Central Bank or the Banco del Estado. This does not constitute a comprehensive and permanent solution, however. The operation will design and implement a human-resource policy for the MEF, aimed at ensuring continuous availability of trained and adequately paid staff.

4.9 As with many institutional reform processes in the region, the legal basis underlying the process in the MEF is not strong. Given that the Ministry of Finance and Public Credit was turned into the Ministry of Economic Affairs and Finance by presidential decree, the structure and functions of the new entity—in particular the recently incorporated areas—could be changed through the same channel. There is a risk that future governments might totally or partially reverse the reform process by restructuring the ministry again through another presidential decree.

4.10 The main factor mitigating against this risk is institutionalization of the reform itself, such that its benefits and the potential consequences of reversing the process are clearly understood. The program will help form an institutional image for the MEF, consistent with the order established in the economic sector and the new relations and responsibilities of other bodies such as the Central Bank and ODEPLAN.

Ministry of Economic Affairs and Finance of Ecuador
Organizational Structure by Areas and Hierarchical Levels



INSTITUTIONAL STRENGTHENING OF THE MINISTRY OF ECONOMIC AFFAIRS AND FINANCE (EC-0198)
LOGICAL FRAMEWORK

SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIO
date fiscal power as the main mic policy.	• Technical and well sustained macroeconomic programming, in coordination with other organizations involved (Central Bank, sub-national governments and others), following conclusion of the project. • Fiscal policy that is balanced and sustainable over time.	• MEF annual reports; reports from multilateral organizations; fiscal statistics.	• Promulgation of fi regulations in area tax reform, stabiliz elimination of pre allocations, fiscal responsibility.
strengthening of Ministry of ffairs and Finance	By the end of program execution the following results are expected: • MEF is country's leading macroeconomic and fiscal programming body. • Efficient management of public debt, based on modern systems and techniques of access to the capital market. • Adequate monitoring of sectional public finance in the framework of current regulations. • Information on sectional public finance complete, timely and available to the public. • Public investment plans (PAIs) prepared to required standards. • Human-resource and information-technology policies reviewed and implemented.	• On-site evaluation; annual reports. • On-site evaluation; fiscal reports. • Analytical reports on sectional finance. • Statistical reports published on MEF website. • Investment plans. • Internal regulations.	• New posts in orga structure filled by staff. • Professional level adjustment. • Hiring of new staf • Approval of chang regulatory statute • Effective interinsti coordination

SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIO
NTS			
ic policy support	• Minimum of five studies on current issues, dealing with topics such as tariff policy, taxation, trade, efficiency of public expenditure, labor market policy. Three studies by the end of 2002. • Computerized macroeconomic programming model implemented by late 2002, capable of projecting macro-variables. • Fiscal database implemented for the NFPS by end 2002 and updated on a quarterly basis. • Methodology for estimating and projecting national accounts implemented. • Minimum of three consultancy reports on fiscal reform. Two reports concluded by late 2002. • Three staff members trained in macro-programming (IMF) by late 2002. Three staff members trained during 2003. • Three staff members trained in statistics/national accounts by late 2002. Three staff members trained during 2003. • Computer platform implemented by late 2003.	• Studies completed and published on MEF website. • On-site validation; progress reports • On-site validation; progress reports • On-site validation; progress reports • Progress reports • Staff trained (diplomas or certificates checked). • Staff trained (diplomas or certificates checked). • On-site validation; progress reports	• Effective coordina other public bodies particularly the Ce
ebt management	• SIGADE operational and updated on new hardware by late 2003. • Minimum of three studies on efficient debt management. One completed by late 2002. • Bond trading on capital market in 2002 and 2003. • Proposals for public investment project financing in 2003. • Two staff members trained in debt management in 2002. Two staff members in 2003. • Two staff members trained in project financing in 2002. Two staff members trained in 2003. • Draft legislation for rationalizing the public credit system by late 2002.	• SIGADE capable of generating up-to-date information on public debt. • Studies completed. • Evidence of security trading. • Project finance documents for public investment project. • Staff training certificates. • Draft Bill published.	• Access policy to c market defined. • Political support f debt management MEF.

SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIO
t for sectional finance	• Design and implementation of at least 30 contracts with sectional bodies and start of operation of SIFIS, by the end of the first half of 2002. • Operation of SIFIS with information on income, expenditure and debt for at least 50 municipios, including 8 of the 20 with largest population and 10 provinces, by the end of 2002. • Information on at least 100 municipios, including 12 of the 20 with largest population and from 12 provinces by the end of the first half of 2003. • Information on at least 150 municipios, including 16 of the 20 of largest population and 15 provinces, by the end of 2003. • Preparation and publication of directives and regulations on sectional finance. • Undertaking of permanent activities to produce consolidated sectional fiscal information, in easily understandable formats for non-experts as from the first half of 2003. • Distribution of computers and start of training activities in second half of 2002. • Permanent sectional training programs in areas of government accounting and finance as from first half of 2003. • Preparation of studies and technical notes on sectional finance, including pattern of expenditure and structure of funding and debt as from second half of 2002.	• Publication of consolidated budgetary execution report and debt of sectional bodies. • Publication of data on tax revenue, rates and local contributions, inter-governmental transfers, budgetary execution and sectional public debt, in addition to indicators of compliance with applicable laws. • Issuance of rules. • Announcements and circulars disseminated. • Regular reports that are easy to understand. • Reports on training activities, indicating objective, didactic content, duration, cost, location, staff trained and entities involved. • Presentation of specific reports.	• High degree of co of national and se governments with of achieving fisca • Agreements with CONCOPE to im systems. • Approval of mini agreement creatin finance coordinat
t for public investment	• Public investment cycle approved by the Financial Management Act (first semester 2003). • Internal processes and structure reviewed and approved (first semester 2003). • Validation mechanisms approved (first semester 2003). • Monitoring mechanisms approved (first semester 2003).	• Financial Management Act passed. • Ministerial Agreement promulgated. • Procedural manual. • Procedural manual • Procedural manual • 2003 public budget. • 2003 annual investment program. • On-site validation; progress reports.	• Timely considera Financial Manage by legislature.

SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIO
	• Evaluation mechanisms approved (first semester 2003). • Development plan incorporated into 2003 budget (second semester 2002). • PAI prepared under macroeconomic, fiscal and borrowing policy parameters (first semester 2003). • Informatics system implemented (second semester 2003).		
l management strengthening	• Development and implementation of human-resource policy in second semester of 2002. • At least 50% of new human-resource needs covered in the first year; 80% in second year; and 100% in third. • Human-resource system implemented and operating with 100% of information on staff members updated in the records in second half of 2002. • At least 80% of courses in the strategic training plan carried out and evaluated by participants (in second semester 2004). • 80% of MEF professional staff with access to a personal computer, Internet, intranet and electronic mail (in second semester of 2003). • Structural cabling expanded and electrical installations upgraded (in first semester 2003). • MEF website reviewed and updated and Intranet implemented (in first semester 2003). • Informative publication distributed to MEF staff and made available to the public (in first semester 2003).	• Internal document prepared. • Progress report. • Progress report. • Progress report. • Progress reports; on-site verification. • Progress reports; on-site review. • Review via Internet and intranet. • Publication.	• Political will to in new human-resou management para • Training center o

SUMMARY	INDICATORS		MEANS OF VERIFICATION	ASSUMPTIC
ES				
rt for economic policy engthen the study of current nomic topics. velopment of macroeconomic gramming instruments. engthen generation and analysis iscal statistics and analysis of nomic statistics. pport design and implementation iscal reforms.	Consulting services: Equipment: Training: Counterpart: **Total:**	US$450,800 US$ 26,400 US$245,000 US$120,000 **US$842,200**	• Budget execution	• Budget execution
debt management pport for generation of domestic external public debt figures. pport for legal consolidation on lic credit. mote efficient intervention in ital markets. velop new instruments for ncing public investment oject finance).	Consulting services: Equipment: Training: Counterpart: **Total:**	US$102,900 US$ 57,900 US$135,000 US$ 31,920 **US$327,720**	• Budget execution	• Budget executior
rt for subnational finances ign, implementation and ration of a sectional finance ormation system (SIFIS), uding programming, allation and training. nitor finances of sectional ernments, in relation to current slation, and for consolidation of -financial-public sector nces. ticipate in preparing fiscal rules promote their dissemination.	Consulting services: Equipment: Training: Counterpart: **Total:**	US$ 443,880 US$ 208,160 US$ 336,000 US$ 182,400 **US$1.202,440**		

SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIO
temize and promote semination of regional financial rmation for citizen use. rdinate training and technical stance on fiscal issues for tional governments with a tomer-service outlook. ry out research and studies on tional public finance and ticipate in preparing studies on al decentralization with NAM.		• Budget execution	• Budget execution
rt for public investment view and redefine the public estment analysis and processing le. sign re-engineering of dersecretariat for Public estment. ablish validation mechanisms investment proposals. sign mechanisms for monitoring estment projects. sign mechanisms for evaluating estment projects. engthen plan-budget linkage. engthen linkage between croeconomic plan and estment plan. sign, development and lementation of informatics tem for public investment nagement.	Consulting services: US$480,400 Equipment: US$ 38,000 Training: US$164,000 Counterpart: US$102,600 **Total: US$800,000**	• Budget execution	• Budget execution

SUMMARY	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIO
general management velop and implement a nprehensive human-resource icy in the MEF. plement an informatics system human-resource management. plement strategic training plan MEF, involving about 160 rses. velop and implement an ormation technology plan in the F, including procurement and allation of hardware and ware. plement website and corporate anet. pare and implement an itutional communication plan MEF.	Consulting services: US$ 368,320 Equipment and software: US$ 560,600 Training: US$ 234,896 Other items: US$ 153,473 Counterpart: US$ 350,224 **Total: US$1,667,513**	• Budget execution	• Budget execution

PROPOSED RESOLUTION

ECUADOR. LOAN ____/OC-EC TO THE REPUBLIC OF ECUADOR
(Program for the Institutional Strengthening of the Ministry of Economic Affairs and Finance)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Republic of Ecuador, as Borrower, for the purpose of granting it a financing to cooperate in the execution of a program for the institutional strengthening of the Ministry of Economic Affairs and Finance. Such financing will be for an amount of up to five million one hundred and twenty thousand dollars of the United States of America (US$5,120,000) from the Single Currency Facility of the Ordinary Capital resources of the Bank, and will be subject to the "Financial Terms and Conditions" and the "Special Contractual Conditions" of the Executive Summary of the Loan Proposal.

PROPOSED RESOLUTION

ECUADOR. PARTIAL PAYMENT OF INTEREST ON LOAN ____/OC-EC TO THE REPUBLIC OF ECUADOR
(Program for the Institutional Strengthening of the Ministry of Economic Affairs and Finance)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such Representative as he shall designate, is authorized, in the name and on behalf of the Bank as administrator of the Intermediate Financing Facility Account (the "Account"), to enter into such contract or contracts as may be necessary with the Republic of Ecuador, as Borrower, and to adopt other pertinent measures to use the resources of the Account to pay a portion of the interest due by the Borrower on outstanding balances of the loan authorized by Resolution DE-__/__, in accordance with the provisions set forth in Document FN 263-2, as amended, approved by the Board of Executive Directors on December 21, 1983.