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ECUADOR

**PROGRAM TO SUPPORT IMPROVED FISCAL MANAGEMENT AND
PRODUCTIVE DEVELOPMENT**

(EC-L1252)

LOAN PROPOSAL

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LINKS	
REQUIRED	
1.	Policy Letter
2.	Means of verification
3.	Monitoring and evaluation plan
OPTIONAL	
1.	Empirical evidence
2.	International Monetary Fund (IMF) program
3.	Report on the optimization of public enterprise performance
4.	Summary analysis of the government's fiduciary capacity

ABBREVIATIONS

BCE	Banco Central del Ecuador [Central Bank of Ecuador]
BDE	Banco de Desarrollo de Ecuador [Development Bank of Ecuador]
CAF	Development Bank of Latin America
CCE	Constitutional Court of Ecuador
CMAA	Convention on Mutual Administrative Assistance
COPLAFIP	Código Orgánico de Planificación y Finanzas Públicas [Public Finance and Planning Code]
DNCGP	Dirección Nacional de Calidad del Gasto Público [National Public Expenditure Quality Directorate]
DNEP	Dirección Nacional de Empresas Públicas [National Public Enterprise Directorate]
ECG	Evaluation Cooperation Group
EFF	Extended Fund Facility
EMBI	Emerging Markets Bond Index
EMCO	Empresa Coordinadora de las Empresas Públicas [State Enterprise Holding Company]
IMF	International Monetary Fund
LFP	Ley para el Fomento Productivo, Atracción de Inversiones, Generación de Empleo y Estabilidad y Equilibrio Fiscal [Productive Development, Investment Attraction, Job Creation, and Fiscal Stability and Equilibrium Act]
LOEP	Ley Orgánica Empresas Públicas [State-owned Enterprises Act]
MEF	Ministry of Economy and Finance
NFPS	Nonfinancial public sector
OECD	Organisation for Economic Co-operation and Development
OVE	Office of Evaluation and Oversight
PBL	Policy-based loan
PGE	Presupuesto General del Estado [General State Budget]
PPP	Public-private partnership
PRE	Office of the President of the Republic
SENAE	Servicio Nacional de Aduana del Ecuador [National Customs Service of Ecuador]
SOE	State-owned enterprise
SRI	Servicio de Rentas Internas [Internal Revenue Service]
VAT	Value Added Tax

PROJECT SUMMARY

ECUADOR PROGRAM TO SUPPORT IMPROVED FISCAL MANAGEMENT AND PRODUCTIVE DEVELOPMENT (EC-L1252)

Financial Terms and Conditions						
Borrower			Flexible Financing Facility ^(a)			
Republic of Ecuador			Amortization period:		20 years	
Executing Agency			Disbursement period:		1 year	
Ministry of Economy and Finance			Grace period:		6 years ^(b)	
Source	Amount (US\$)	%	Interest rate:		LIBOR-based	
IDB (Ordinary Capital):	300,000,000	100	Credit fee:		(c)	
			Inspection and supervision fee:		(c)	
Total	300,000,000	100	Weighted average life:		12.33 years	
			Approval currency:		U.S. dollar	
Project at a Glance						
Project objective/description: The program’s general objective is to contribute to Ecuador’s fiscal stability by fostering sustainable growth and the stabilization of key social development indicators. The specific objectives are to: (i) strengthen macrofiscal management; (ii) improve expenditure quality and efficiency; and (iii) enhance the efficiency and transparency of tax policy and management. This policy-based loan is structured as a multi-tranche PBL with two tranches.						
Special contractual conditions precedent to the first and second disbursement of the loan: The two disbursements are contingent on fulfillment of the policy reform conditions set out in the Policy Matrix (Annex II), the Policy Letter, and the other conditions specified in the loan contract (see paragraph 3.3).						
Exceptions to Bank policies: None.						
Strategic Alignment						
Challenges: ^(d)	SI	<input type="checkbox"/>	PI	<input checked="" type="checkbox"/>	EI	<input type="checkbox"/>
Cross-cutting themes: ^(e)	GD	<input checked="" type="checkbox"/>	CC	<input type="checkbox"/>	IC	<input checked="" type="checkbox"/>

^(a) Under the terms of the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule as well as currency, interest rate, and commodity conversions. The Bank will take operational and risk management considerations into account when reviewing such requests.

^(b) Under the flexible repayment options of the Flexible Financing Facility, changes to the grace period are permitted provided that they do not entail any extension of the original weighted average life of the loan or the last payment date as documented in the loan contract.

^(c) The credit fee and the inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable policies.

^(d) SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

^(e) GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problem addressed, and rationale

- 1.1 **Macrofiscal challenges.** Ecuador's public finances continue to suffer from the fall in the average price of crude oil on international markets, which dropped from US\$97.5 per barrel between 2011 and 2013, to US\$40.8 per barrel between 2015 and 2017. Oil prices partially recovered in 2018, with the Ecuadorian blend averaging US\$60.4 per barrel that year, a level that has held steady in the first quarter of 2019. The oil shock hit Ecuador particularly hard because: (i) the oil sector previously contributed nearly a third of the income of the nonfinancial public sector (NFPS) and generated more than 50% of the country's export earnings; (ii) unlike other countries in the region that are affected by the end of the commodity boom, dollarization prevents Ecuador from devaluating the nominal exchange rate to cushion the shock; and (iii) the country arrived in this situation with very little fiscal headroom, having posted large overall deficits in both 2013 and 2014 (4.6% and 5.2% of GDP respectively).¹
- 1.2 The authorities responded to the abrupt fall in oil revenues by sharply reducing public investment, which in 2015 was cut by more than three percentage points of GDP. In fact, Ecuador reduced its primary expenditure in response to the fall in commodity prices by more than any other country in the region.² Despite this, however, the overall deficit grew again to 6.1% of GDP in 2015, and then to 8.2% in 2016. Since late 2017, the authorities have been implementing a variety of austerity measures which, in conjunction with the partial recovery of crude oil prices, made it possible to reduce the overall NFPS deficit to 4.5% of GDP in that year and to 0.9% of GDP in 2018. Nonetheless, the public sector's gross financing needs remain high. Despite falling substantially from their 2015-2017 levels, NFPS gross financing needs still amounted to 8.3% of GDP in 2018, while the current account deficit ended the year at 1.3% of GDP. In 2019, the country faces estimated gross financing needs of 5.6% of GDP, so the government must persevere in its efforts to strengthen public finances and reduce its financing needs to a sustainable level in the medium term.
- 1.3 **Rising level of debt.** The rapid increase in State spending that occurred before the fall in crude oil prices, compounded by the oil shock itself, increased the public debt burden, as the debt-to-GDP ratio rose from 20% in 2013 to 46.1% by the end of 2018. If other liabilities are added in (mainly Treasury Certificates, floating debt, and other liabilities related to the oil sector), the balance of which has only recently started to be published in debt statistics, then the State's total financial obligations amount to about 55% of GDP. This debt has accumulated under increasingly burdensome conditions, as a result of the greater use of sovereign bond issues on international markets in recent years, and the trend in Ecuador's country risk, with its Emerging Market Bond Indicator (EMBI) rising from an average of 510 basis points in 2014 to an average of 813 basis points between 2015 and 2018. Despite the fiscal austerity measures adopted, the EMBI averaged 745 basis points between November 2018 and January 2019, up from 497 basis points in the first

¹ Source: Central Bank of Ecuador (BCE).

² Inter-American Development Bank, 2016. *2016 Latin American and Caribbean Macroeconomic Report: Time to Act: Latin America and the Caribbean Facing Strong Challenges*.

quarter of last year. As a reflection of this deterioration in the country's financing conditions, the weighted average contractual interest rate on the public debt rose from 4.9% to 6.6% between 2009 and 2019 (with an increase of 4.3% to 6.9% for external debt being partially offset by a decrease in the cost of domestic borrowing from 6.5% to 5.8%). During the same period, the weighted average maturity of the debt shortened from 9.7 to 7.8 years.³ The most recent bond issue took place in January for an amount of US\$1 billion with a ten-year term and a coupon of 10.75%.

Table 1. Ecuador: main economic indicators

Indicators	2013	2014	2015	2016	2017	2018
Real GDP growth (total) (%)	4.9	3.8	0.1	-1.2	2.4	1.4
Real GDP growth (oil sector) (%)	-1.7	1.6	-2.6	3.2	-2.3	4.0
Real GDP growth (nonoil sector) (%)	6.0	4.5	1.2	-1.4	2.1	2.0
Total unemployment (%)	4.2	3.8	4.8	5.2	4.6	3.7
Total adequate employment (%)	47.9	49.3	46.5	41.2	42.3	40.6
NFPS income (% of GDP)	39.2	38.4	33.6	30.3	32.0	36.3
Public expenditure (% of GDP)	43.7	43.6	39.7	38.6	36.6	37.2
Primary balance (% of GDP)	-3.5	-4.2	-4.7	-6.7	-2.4	1.5
Overall balance (% of GDP)	-4.6	-5.2	-6.1	-8.2	-4.5	-0.9
Consolidated government debt (% of GDP)	20.0	27.1	33.8	43.2	44.6	46.1
Trade balance (% of GDP)	-1.1	-0.7	-2.1	1.2	0.1	-0.5
Oil trade balance (% of GDP)	8.7	6.8	2.8	3.0	3.6	4.1
Nonoil trade balance (% of GDP)	-9.8	-7.5	-4.9	-1.7	-3.5	-4.6
Current account balance (% of GDP)	-1.0	-0.7	-2.2	1.3	-0.4	-0.7
Inflation at end of period (%)	2.7	3.7	3.4	1.1	-0.2	0.3
Credit to the private sector (% of GDP)	28.2	28.7	28.4	29.9	33.4	37.2
Financial system inflows (% of GDP)	30.9	32.2	29.5	35.0	36.7	37.6

Sources: Central Bank of Ecuador (BCE), International Monetary Fund (IMF), Ministry of Economy and Finance (MEF), National Statistics and Census Institute of Ecuador.

- 1.4 Weakened growth expectations.** The oil shock and the adjustment measures adopted by the government have had a major impact on economic activity in Ecuador. GDP growth has slowed from a robust average of 5.6% between 2011 and 2014 to just 0.1% in 2015, followed by a contraction of 1.2% in 2016 in the deepest recession the country has experienced since its monetary system was dollarized in the early 2000s. Although economic growth rebounded to 2.4% in 2017, GDP growth stood at just 1.4% at the end of 2018. The International Monetary Fund (IMF) is forecasting a contraction of 0.5% in 2019.⁴
- 1.5** This low-growth context is having a negative impact on the domestic labor market, with the proportion of Ecuador's economically active population that has adequate

³ Source Ministry of Economy and Finance (MEF).

⁴ The Ecuadorian government's projections are more optimistic, placing growth in a range of -0.5% and +0.5%. IMF, *World Economic Outlook*, October 2018.

employment having slipped from 49.3% to 40.6% since the oil shock.⁵ As a result, following significant improvements prior to the shock, the country's social indicators have since stagnated, and the poverty and extreme poverty rates have even ticked up slightly (from 22.5% and 7.7% in December 2014 to 23.2% and 8.4% in December 2018, respectively).

- 1.6 The government has launched an extensive program of structural reforms aimed at restoring macrofiscal stability and creating the conditions needed to encourage private investment and thus boost the economy, which it hopes will counterbalance the impact that fiscal consolidation will have on aggregate demand and the adjustment of expenditure and public investment. The new public policy stance has been reflected in the [2018-2021 Prosperity Plan](#) and in the passing of the Productive Development, Investment Attraction, Job Creation, and Fiscal Stability and Equilibrium Act (LFP).
- 1.7 **The Prosperity Plan.** In August 2018, the government approved the Prosperity Plan, thereby making public its roadmap for dealing with the complex situation the country is currently experiencing. The plan is anchored in a series of measures, which include important fiscal actions, such as: (i) downsizing the State through the elimination and merger of public entities; (ii) strengthening the public procurement system; (iii) optimizing the State-owned enterprise (SOE) system and fixing SOE wage distortions; (iv) promoting a public-private partnership (PPP) program to sustain investment in infrastructure and ensure the proper maintenance of State assets; (v) improving external financing access conditions; (vi) implementing a targeted reduction of fossil fuel subsidies; and (vii) pairing fiscal austerity measures with efforts to strengthen the social protection system to help meet the needs of the most vulnerable groups.
- 1.8 The recently passed LFP is the main legal instrument through which the government is changing its economic policy orientation. The passing of this legislation made it possible to overcome the impasse produced by a ruling from the State Comptroller General's Office early in the year that kept the MEF from pursuing new financing operations. The LFP temporarily lifted the legal debt ceiling, while a process to reform Ecuador's fiscal responsibility framework was launched.⁶ The LFP also banned the BCE from purchasing treasury certificates and bonds, established commitments to reduce the fiscal deficit (including cuts to fossil fuel subsidies), and enhanced the transparency of public debt statistics, among other measures.
- 1.9 **Support from multilateral organizations.** The government's reform program has received support from multilateral organizations, particularly the IMF. On 11 March 2019, the IMF approved an Extended Fund Facility (EFF) for approximately US\$4.2 billion, and its first disbursement took place on 15 March 2019. The reform program will also receive funding of up to US\$6 billion from other international organizations over the next three years. As part of this support, the Bank's contribution would consist of roughly US\$1.68 billion in new approvals between

⁵ Source: National Survey of Employment, Unemployment, and Underemployment.

⁶ The LFP also included several additional measures, such as: (i) the refund of interest payments, fines, and surcharges to taxpayers who voluntarily settle their tax liabilities; (ii) provisions to expedite implementation of the social housing policy being promoted by the government; and (iii) a ban on the central bank from purchasing securities issued by the MEF.

2019 and 2021. The multilateral financing package being negotiated by the government will be complemented by funding of approximately US\$1.8 billion from the Development Bank of Latin America (CAF), and about US\$1.744 billion from the World Bank, as well as contributions from other organizations, including the European Investment Bank, the Latin American Reserve Fund, the French Development Agency, and the United Nations Development Programme. In total, the authorities expect to raise around US\$10 billion in financing over the next three years, which could enable them to avoid returning to the market until the fiscal situation has been consolidated, institutional investor confidence has been restored, and appetite for sovereign debt securities issued by Ecuador has increased.

- 1.10 One of the main goals of the EFF is to restore fiscal sustainability, for which the government has set a goal of reducing the NFPS primary nonoil deficit (including fuel subsidies) by five percentage points of GDP between 2019 and 2021. The fiscal and structural reform measures incorporated in the EFF are expected to reduce the deficit successively from 5.3% in 2018, to 3.3% in 2019, 1.3% in 2020 and 0.3% in 2021. As a result of this adjustment, the NFPS will attain overall balance in 2019 and generate surpluses of 3.8% of GDP in 2020 and 2.9% in 2021. This would make it possible to reverse the rising trend of public debt and bring it back below the legal ceiling of 40% of GDP in 2023. The key elements of the EFF, which update and deepen the reforms contained in the Prosperity Plan, are to: (i) strengthen dollarization; (ii) boost competitiveness, growth and job creation, including the implementation of labor market and tax reforms, among other measures; (iii) protect the poor and vulnerable from the effect of the adjustment by increasing social spending in 2019 and maintaining a social spending floor from 2020 onward; and (iv) promote transparency and good governance, including the passing of a new anticorruption law. More specifically, strengthening the dollarization system will require: (i) restoration of prudence to fiscal policy (including a tax reform in late 2019, State downsizing, better targeting of energy subsidies, elimination of unnecessary expenses, strengthening of the public procurement system and improvement of the transparency of SOE management); (ii) strengthening of the BCE's institutional framework (by reinforcing its technical capacities and increasing the stock of international reserves, and by publishing its financial statements in accordance with International Financial Reporting Standards); and (iii) enhancement of the soundness of the financial system through the adoption of various regulatory reforms. If the government's reform program is properly implemented, the potential growth of the Ecuadorian economy could increase to an estimated 3% per year.
- 1.11 **Problems and their causes.** The main problem is fiscal instability and weak public finance management, which hinders sustainable growth and threatens the tenability of the social gains that have been achieved. The specific problems and key causes are: (i) inefficient macrofiscal management; (ii) poor-quality public expenditure; and (iii) weaknesses in revenue administration.
- 1.12 **Inefficient macrofiscal management.** Toward the end of the last decade, Ecuador introduced the following two fiscal rules: (i) except in situations requiring exceptional health, education, and justice expenditures, the government's permanent expenditures can only be financed by permanent revenues, thus limiting the scope for public borrowing or the sale of nonrenewable natural

resources to finance current spending; and (ii) the total public debt may not exceed 40% of GDP. As shown by the trend of fiscal indicators described above, this set of rules has proven ineffective in imposing a budgetary constraint hard enough to contain the trend of public debt. It has also failed to help Ecuador generate fiscal headroom during prosperous times to be able to implement macroeconomic stabilization policies to deal with changes in the cyclical position of the economy, which is another desirable impact of a system of fiscal rules.⁷ In fact, the correlation between the fiscal stimulus and the business cycle was clearly positive between 2008 and 2016, revealing the procyclical nature of public finance management in Ecuador.⁸ In addition, public debt statistics are not transparent. The special review of the public debt performed by the Comptroller General's Office ruled that the government's decision to exclude various financial liabilities (mainly domestic debt contracted with the Ecuadorian Social Security Institute and advance oil sales) from the public debt calculation was illegal. Once these items were included, public debt exceeded the ceiling of 40% of GDP. This fueled uncertainty as to the potential legal implications for the MEF and its officials arising from the assumption of new financial obligations.

- 1.13 The fiscal rule that requires that permanent revenues exceed permanent expenditures has not allowed for adequate expenditure accounting. The rule has been weakened by the inclusion of current expenditure items as investment components. Moreover, it does not truly apply the golden rule and is not in line with best practices for controlling expenditure growth.⁹ The progressive worsening of the structural fiscal deficit since 2008 is evidence of a lack of compliance with the rules and of their deficient technical definition. The permanent revenues and expenditures rule also lacks escape clauses and effective monitoring mechanisms. The second fiscal rule, which imposes a 40% ceiling on the public-debt-to-GDP ratio, has also been breached (see paragraph 1.3), and the calculation methodology has changed since 2016, excluding items that are considered necessary under best accounting practices.¹⁰
- 1.14 **Weaknesses in public expenditure management.** Ecuador's strongly expansionary fiscal policy stance inflated the NFPS from 35% of GDP in 2008 to 44% in 2014. From 2015 onward, as a result of the fall in the price of crude oil, the size of the Ecuadorian State began to shrink, dropping to around 37% of GDP by 2018. The expenditure growth mainly took the form of an ambitious public investment program (which grew to 14.8% of GDP in 2013 before slipping back to 6% as a result of the fiscal consolidation process), together with an expansion of the coverage of social spending programs, sometimes without adequate targeting,

⁷ Schaechter, A., T. Kinda, N. Budina, and A. Weber. 2012. *Fiscal Rules in Response to the Crisis: Toward the "Next-Generation" Rules. A New Dataset*. Working paper WP/12/187. Washington, D.C.: IMF.; Ter-Minassian, T. 2010. *Preconditions for a successful introduction of structural balance-based rules in Latin America and the Caribbean: a framework paper*. Discussion Paper IDB-DP-157. Washington, D.C.: IDB.

⁸ S. Cueva, R. Mosquera and MC Ortiz. 2018. "Ciclicidad de la política fiscal desde la dolarización". In Díaz-Cassou and Ruiz-Arranz (Eds.) *Reformas y desarrollo en el Ecuador contemporáneo*. IDB, IDB-BK-202.

⁹ Kopits, G. 2013. *Restoring Public Debt Sustainability. The Role of Independent Fiscal Institutions*. United Kingdom: Oxford University Press.

¹⁰ IMF, 2016. *External Debt Statistics: Guide for Compilers and Users*. Washington DC.

and public sector wage hikes, particularly in SOEs attached to the government.¹¹ Ecuador faces major challenges in terms of the allocative efficiency of State resources, including the following:

- 1.15 The MEF's National Public Expenditure Quality Directorate (DNCGP) has insufficient resources, tools, and access to information from other ministries and government agencies to evaluate spending programs. As a result: (i) there is extensive information asymmetry between the public finance regulator and the ministries with the capacity to spend, particularly in the case of social spending programs; and (ii) the MEF does not have an agenda or methods for a cross-sector evaluation of the public sector's current and investment expenditure, including monitoring of transfer, subsidy, and tax expenditure leakages and the tax effect of public spending. The lack of such information on the impact and results of spending programs undermines the efficiency of the budgeting process.
- 1.16 Scant private-sector contribution to investment in public infrastructure. In the context of the medium-term fiscal adjustment that the country is going through, the government hopes to increase private participation in public infrastructure through PPPs. However, Ecuador still has little capacity to attract and manage private contributions to public infrastructure projects,¹² owing to: (i) an incomplete legal framework for PPP projects,¹³ including: (a) lack of clarity in interagency coordination processes for the identification, evaluation, and management of fiscal risks arising from PPPs¹⁴; processes for structuring deconcentrated projects that do not allow for economies of scale or the uniform application of technical standards; (b) lack of guidelines in the procedures for implementing "brownfield"¹⁵ projects,¹⁶ including asset recycling processes; and (c) lack of clarity in the management of unsolicited private initiatives. Similarly, in terms of technical regulations, the PPP program has shortcomings in its treatment of both firm and

¹¹ In terms of the technical efficiency of expenditure, Ecuador has underperformed compared to other countries in the region. In 2016, employee compensation inefficiencies and transfer leakages amounted to 2.2% and 1.7% of GDP respectively. Taken together, they are higher than the average rates for Latin American countries (4.4% of GDP and 15% of total consolidated spending) ([Better Spending for Better Lives: How Latin America and the Caribbean can Do More with Less](#), Izquierdo, Pessino, and Vuletin, 2018).

¹² The annual public investment gap (defined as public investment expenditure needs) for 2019-2023 is estimated at US\$30.25 billion (MEF 2018). The MEF estimates that projects worth US\$6.1 billion, or 20% of the gap, will be structured as PPPs. The 2017 Infrascopes evaluation of the environment for public-private partnerships ranked Ecuador 18th out of 19 Latin American countries.

¹³ The regulatory framework for public investment through PPPs includes the Law Establishing Incentives for PPPs and Foreign Investment and its corresponding regulations (Executive Decree 1040).

¹⁴ Of the PPPs currently under execution, only the Seven-Huaquillas River project has been subject to a comprehensive analysis of firm and contingent liabilities, which were estimated at US\$100 million combined (US\$65 million in contingent liabilities), or approximately 0.1% of GDP.

¹⁵ Public infrastructure organized under management contracts delegated to a private company.

¹⁶ Current legislation does not have any regulations for a scenario in which the government receives an advance payment from a private investor that obtains a delegated management contract for a public infrastructure asset, as payment for its use.

contingent liabilities arising from these projects;¹⁷ and there is a lack of instruments to facilitate their financial viability;¹⁸ (ii) the lack of regulation of the processes for multiyear certification of fiscal commitments under PPP projects; (iii) a lack of PPP projects among the decentralized autonomous governments; and (iv) the lack of adequate environmental management plans in preliminary studies for PPP projects.

- 1.17 The high fiscal burden of SOE management: (i) excluding the SOEs attached to the decentralized autonomous governments or Ecuadorian universities (approximately 400 entities in all), the 22 SOEs within the executive branch structure impose a significant fiscal burden on the State. The capital of these 22 SOEs amounts to 34% of GDP; and the estimated amount of funding needed for their management (in terms of budgetary allocations) was approximately 4.2% of GDP in 2018. The SOEs in the NFPS recorded a surplus of roughly 2% of GDP (2011-2017), based on the earnings of the oil companies, the telecom operator Corporación Nacional de Telecomunicaciones, and the power company Corporación Eléctrica del Ecuador, while the remaining 19 SOEs reported an average deficit of 1% during that period.¹⁹ Even the enterprises that generate surpluses lack financial statements audited under international accounting standards; and their costs and revenues cannot be accurately assessed due to the lack of appropriate instruments in their budgetary relationship with the MEF. The fiscal burden for the State generated by SOEs in deficit reflects the following: (a) the State Enterprise Holding Company (EMCO) assumes SOE management functions that should not fall under its mandate, it is overstaffed, and its competencies overlap with those of the MEF and the SOE boards of directors; (b) weak corporate governance among the SOEs,²⁰ which do not have professionalized boards and do not adhere to international best practices of corporate governance; (c) a tax regime that is not comparable to that of the private sector, with exemption from corporate income tax, and which does not provide incentives to partially reinvest dividends in the growth of the enterprise, instead letting any surpluses produced be absorbed into the public coffers;²¹

¹⁷ Initially, none of the four PPP projects underwent an evaluation to identify, quantify, and mitigate fiscal risks (MEF, 2018). Seven-Huaquillas River (US\$700 million), Puerto Posorja (US\$360 million), Puerto Manta (US\$170 million) and Puerto Bolívar (US\$750 million). MEF (2017). Through technical cooperation operation ATN/FI-14625-EC, the Bank has completed the fiscal impact analysis of the Seven-Huaquillas River project, setting the total amount of firm and contingent liabilities at US\$100 million (roughly 0.1% of GDP, including US\$65 million in contingent liabilities and US\$35 million in firm or noncontingent liabilities).

¹⁸ Commercial banks in Ecuador cannot lend more than 5% of their equity in the form of uncollateralized project loans.

¹⁹ MEF-National Public Enterprise Directorate (DNEP) (2018).

²⁰ Sector ministers chair the boards of directors, which impairs the separation of functions and decreases the frequency of meetings. In 2017, 21% of meetings held were ordinary meetings, while 72% were extraordinary-urgent meetings. Escobar, B. *Optimización del Rendimiento de Empresas Públicas de la República del Ecuador*. IDB, September 2018.

²¹ International experience shows that the absence of a rules-based tax regime for SOEs is associated with a soft budget constraint that encourages inefficient spending. Ter-Minassian, 2017; Musacchio, Pineda and Garcia, 2015.

(d) inadequate transparency requirements,²² as there is no obligation for SOEs to publish their audited financial statements; and (e) scant participation by women in top management bodies: only two of the 66 SOE board positions are occupied by women, and only because they had been previously appointed as ministers in the sector associated with the SOEs in question; (ii) there are no efficient budgeting processes in place,²³ and the total amount of disposable income that SOEs receive from all sources is unknown; (iii) the payroll is bloated,²⁴ imposing a high fiscal burden on the State; and (iv) the State obtains little value from the energy sector due to the inefficiency of the state-owned oil companies, since the sector's strategy is poorly aligned with the country's energy matrix and board and management decision-making processes are deficient.

- 1.18 **Weaknesses in public revenue policy and management.** Despite displaying significant resilience during the macrofiscal crisis, Ecuador still only collects 14.2% of GDP in taxes (20.5% if social contributions are included, but still below the 22.8% average for Latin America and the Caribbean), without reaching the 15% threshold that is conventionally considered a sufficient level for financing a basic set of public services.²⁵ The Internal Revenue Service (SRI) displays adequate levels of efficiency, since the financial expenditure of tax administration in Ecuador at 0.144% of GDP is lower than both the regional average of 0.153% and the average among countries of the Organisation for Economic Co-operation and Development (OECD) (0.192%).²⁶ The main weaknesses are: (i) Ecuador's integration into the international tax system remains tenuous, as the country does not exchange financial data for tax purposes under the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes; (ii) the country has not approved the disclosure of beneficial ownership information pursuant to the Global Forum's transparency standards; (iii) it has not developed a tax base for digital services; (iv) there is weak institutional coordination among national agencies with tax responsibilities (the SRI and the National Customs Service of Ecuador (SENAE)), which erodes the base of the main taxes (the value-added tax (VAT) and the income tax);²⁷ and (v) there are bureaucratic obstacles and little use of new technologies to assist taxpayer interaction and tax compliance.²⁸ The

²² The State-owned Enterprises Act (LOEP) delegates the task of hiring of external auditors for SOE financial statements to the State Comptroller General's Office. However, the audit service is not provided on a timely basis; calls for bids are not issued on time, and often the auditors do not issue an opinion on the financial statements in question.

²³ The system for transferring/capturing surpluses between the MEF and the SOEs is discretionary, generates transaction costs, and creates incentives for inefficiency. MEF-DNEP (2018).

²⁴ EMCO has a workforce of 71 people and a portfolio of 22 SOEs. The Chilean Enterprise System has a staff of 23 and 20 SOEs. The 22 SOEs employ 39,881 civil servants (20,043 excluding the oil companies), whose average wage is 40% higher than the employees of private-sector firms in similar industries (MEF, 2018).

²⁵ Adam, C. and D. Bevan: *Fiscal policy design in low-income countries*. In Addison, T. and A. Roe (Eds.) *Fiscal Policy for Development*. Palgrave MacMillan, 2004, IMF: [Monetary and Fiscal Policy Design Issues in Low-Income Countries](#). 8 August 2005, p. 15, and European Union; [Tax Revenue Mobilisation in Developing Countries: Issues and Challenges](#). April 2014, p. 10.

²⁶ OECD: *Government at a Glance, Latin America and The Caribbean*, 2014, p. 47.

²⁷ IDB Group Strategy with Ecuador 2018-2021, p. 15. The VAT and the income tax, combined, have accounted for an average of roughly 80% of tax revenue intake over the last five years.

²⁸ *Doing Business Report* (2019).

Paying Taxes 2019 index ranks Ecuador 143rd out of 190 countries; and the total time spent on compliance is high, at 664 hours per year, compared to a regional average of 330. The costs of the tax administration absorb 1.30 monetary units for every 100 collected, somewhat lower than the regional average of 1.37, but clearly higher than the OECD's 0.92, which suggests that there is room for complementary savings.²⁹

- 1.19 **Rationale and summary of the reforms.** Underpinned by the recently approved IMF program, the Bank's program of support to Ecuador includes a combination of emergency support (special development lending), support for structural reforms in fiscal management in its normative and institutional aspects (policy-based lending), and investment loans that help to make reform efforts sustainable (paragraph 1.20). The proposed sequence of support allows the Bank to address Ecuador's urgent reform needs in the short, medium, and long terms. The operation is designed to help close important regulatory gaps, including: (i) the alignment of Ecuadorian laws on SOE and PPP management with international best practices; (ii) the integration of Ecuadorian tax management in international cooperation forums; and (iii) the implementation of best practices in public expenditure control and fiscal transparency. Within this framework, the first tranche of this operation aims to lay the regulatory and institutional foundations for the fiscal reforms. The second tranche deepens the regulatory reforms and incorporates measures to assist in their implementation.
- 1.20 **Complementary programs.** This operation is complemented by the following programs: (i) the Emergency Program for Macroeconomic Sustainability and Prosperity (loan 4771/OC-EC), under the category of special development lending, in the amount of US\$500 million. The program's structure and content are aligned with the EFF (paragraphs 1.10 and 1.19), and it was approved by the Bank on 24 April 2019. At the same time, the Bank is in the process of preparing: (ii) an investment loan to support reform of the SOE system, with the basic objective of reducing the fiscal burden on the State generated by its ownership of inefficient SOEs (through improvements to their corporate governance, transparency regime, development of a tax regime comparable to that of the private sector, and the sale of SOEs in which the presence of the State is not justified); and (iii) an investment loan to help increase the efficiency of the tax administration, by improving coordination of the processes of agencies that have taxation responsibilities and enhancing the efficiency of tax audit, control, and compliance processes. In addition, operation ATN/OC-17299-EC supports the design of this operation and the investment loan to support SOE reform.
- 1.21 **The Bank's experience in the country and lessons learned.** The Bank has developed a wide portfolio of operations in support of tax reforms in Ecuador through different financial support instruments and technical cooperation operations. It has been supporting development of the PPP program in Ecuador since 2015, including technical assistance for the formulation of the program's regulatory and institutional framework³⁰ and support for project structuring studies

²⁹ OECD and IDB (2014). *Government at a Glance. Latin America and the Caribbean. Towards Innovative Public Financial Management*. OECD Publishing.

³⁰ Regional Public-Private Partnerships Advisory Program (operation ATN/ME-13378-RG).

in the energy and transportation sectors.³¹ With operation ATN/FG-16265-EC, the Bank is supporting the institutional development of the PPP program at Banco de Desarrollo del Ecuador (BDE).³² Through the Program to Enhance Fiscal Capacity for Public Investment (loan 4670/OC-EC), the Bank is supporting the participation of private resources in public infrastructure projects through PPPs. With the Internal Revenue Service Improvement Program (loan 3325/OC-EC), currently in execution, it is helping to boost tax revenue collection through greater compliance with tax obligations by strengthening the SRI's management capacity. The lessons learned in its execution include the need to support measures to improve tax compliance mechanisms with efforts in audit and control processes. More recently, the Bank has continued to support the SRI's institutional maturation processes through technical cooperation ATN/OC-17143-EC.

- 1.22 **The Bank's experience in the region and lessons learned.** The Bank has supported several of the region's governments in reforms to strengthen fiscal sustainability, with policy programs such as the Fiscal Consolidation Support Program in Honduras (loan 3590/BL-HO), the Public Finance Strengthening Program in Mexico (loans 3201/OC-ME and 3676/OC-ME), the Program to Deepen Fiscal Reform in Colombia (loan 4552/OC-CO), the Public Finance for Sustainable Development Program (loan 4667/OC-PR), and the Fiscal Strengthening for Inclusive Growth Program (loan 4542/OC-ES). The lessons learned from these programs have been instrumental in the formulation of this program and include the following: (i) the need to complement this policy-based loan operation with additional investment lending instruments (see paragraph 1.20) and with targeted technical cooperation operations; (ii) the need to address fiscal adjustment both from the public expenditure side (both current and investment spending) and from the revenue side (including policy and tax administration dimensions); (iii) the need to prevent the emphasis on fiscal adjustment from dominating the structural reform objectives and from diminishing the level of protection provided to poor and vulnerable population groups; and (iv) the need to maintain a constant dialogue with the government, supported by technical cooperation inputs, to facilitate the implementation of reforms, coordinated with the activities of other multilateral organizations. In addition, the program is aligned with the recommendations obtained from the evaluation of the Country Strategy 2012-2017 with Ecuador conducted by the Office of Evaluation and Supervision (OVE). These included prioritizing the Bank's efforts to support government proposals that facilitate the consolidation of public finances, through initiatives aimed at developing a fiscal responsibility framework and sector-level proposals that improve the efficiency of public spending. It was also recommended that greater emphasis be placed on the sustainability of the investments that are financed, including mechanisms to ensure the operation and maintenance of infrastructure works. This recommendation has been implemented through operation 4670/OC-EC, which supports the execution, operation, and maintenance of public infrastructure through PPPs.

³¹ Institutional Strengthening and Support for PPP Project Structuring (operation ATN/OC-15685-EC).

³² Support for the Identification and Development of Subnational Public-Private Partnership Projects (operation ATN/FG-16265-EC).

- 1.23 **Empirical evidence.** While there is extensive evidence of the impact of efficient fiscal management on growth,³³ which takes shape through multiple channels, the effects of borrowing on growth (through the rise in interest rates caused by an increase in sovereign risk; on the impact of cost cutting adjustment measures) have recently received more attention. Recent contributions also discuss the relationship that public expenditure has with growth and equity, best practices in managing SOEs and attracting private contributions for public investment, and the potential impact of improvements in tax administration on revenue intake. These contributions are discussed in detail in [optional link 1](#).
- 1.24 **Coordination with other donors.** During the preparation of this operation, the Bank coordinated with the IMF and other multilateral and bilateral financial institutions in structuring this policy-based loan (PBL). Coordination with the CAF, the World Bank, and other donors was implemented through coordination roundtables and senior management meetings led by the MEF and the Office of the President of the Republic. The IMF's quarterly visits and reports to assess the degree of compliance with the EFF will be used as a coordinated monitoring mechanism. The Bank will share its progress in implementing the initiatives it leads in the areas of fiscal management, including this PBL (see paragraph 2.8) with the IMF and other donors.
- 1.25 **Strategic alignment.** The program is consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008). It is aligned with the development challenge of productivity and innovation, since it promotes a balanced framework of competition that allows for efficient operation of SOEs and the presence and prosperity of private firms; and it strengthens processes and capacities to manage public investment, including the PPP modality, while also contributing to private sector development for sustainable economic growth. The program also aligns with the following crosscutting areas: (i) gender equality and diversity, by increasing women's participation in positions of leadership in the public sector; and (ii) institutional capacity and rule of law, by strengthening the legal and institutional framework for fiscal sustainability. In addition, the program will contribute to the Corporate Results Framework 2016-2019 (document GN-2727-6) through the following indicators: (i) government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery; and (ii) business environment reforms enacted. The program is aligned with the Sector Strategy on Institutions for Growth and Social Welfare (document GN-2587-2), in particular with the area of public sector management and finance, through improvements in revenue and expenditure management. It is also consistent with the Fiscal Policy and Management Sector Framework Document (document GN-2831-8), which underscores the importance of institutional strengthening for improving the quality of public spending and enhancing tax equity and social inclusion; with the Decentralization and Subnational Governments Sector Framework Document (document GN-2813-8), which proposes to improve institutional conditions for attracting strategic public-private investments at the subnational level; and with the Gender and Diversity Sector Framework Document (document GN-2800-8) in terms of strengthening women's voice and agency by

³³ Ter-Minassian, T. 2015. *Fiscal Policy and Economic Growth: An Overview of Theory and Empirical Evidence*. Mimeo.

promoting their leadership in the public sector. The program is also aligned with the IDB Group Country Strategy with Ecuador 2018-2021 (document GN-2924), in particular with the objectives of: (i) mitigating the fiscal risk associated with oil price volatility; generating efficiencies and increasing the quality of public expenditure; (ii) increasing the private share of investment in infrastructure and other public goods; (iii) boosting the contribution of private investment and productivity to economic growth; and (iv) facilitating access to investment financing. The operation is included in the 2019 Operational Program Report (document GN-2948). Lastly, it is aligned with the Ecuadorian government's 2018-2021 Prosperity Plan and 2017-2021 Development Plan, by contributing to the goals of macroeconomic and fiscal stabilization.

B. Objectives, components, and cost

- 1.26 This policy-based loan is structured as a multi-tranche PBL with two tranches. The program's general objective is to contribute to Ecuador's fiscal stability by fostering sustainable growth and the stabilization of key social development indicators. The specific objectives are to: (i) strengthen macrofiscal management; (ii) improve expenditure quality and efficiency; and (iii) enhance the efficiency and transparency of tax policy and management. This will be achieved through the following components:
- 1.27 **Component I. Macroeconomic stability.** The objective of this component is to maintain a macroeconomic context that is consistent with the program objectives as set out in the Policy Matrix and the Policy Letter.
- 1.28 **Component II. Strengthening of the fiscal responsibility framework and debt transparency.** The objective of this component is to restore fiscal sustainability by: (i) strengthening the fiscal responsibility framework; and (ii) strengthening the transparency of public debt statistics.
- 1.29 **Strengthening of the fiscal responsibility framework.** The following activities are planned for the first tranche: strengthening of the fiscal responsibility framework, by establishing: (a) a ceiling on the growth of central government public expenditure equal to the economy's long-term real growth rate; (b) escape clauses for the public expenditure growth rule, including scenarios of severe economic recession; and (c) mechanisms to monitor the fiscal rule on public expenditure growth every four months, including an analysis of noncompliance risk.
- 1.30 The following activities are planned for the second tranche: strengthening of the fiscal responsibility framework, by: (a) expanding the coverage of the central government's expenditure growth ceiling to include the NFPS; (b) redefining the methodology for applying the constitutional "golden rule" (income relative to permanent expenditure) to make it consistent with the new expenditure growth rule; and (c) publishing reports every four months to monitor compliance with the fiscal rule in 2019.
- 1.31 **Strengthening the transparency of public debt statistics.** The following activities are planned for the first tranche: strengthening the transparency of public debt statistics, through the: (a) modification of the public debt calculation to include liabilities resulting from advance oil sales, the central government's public debt with other State entities, and other obligations (including arbitration awards and floating debt); and (b) monthly publication of public debt statistics, including aggregate and

consolidated statements for the different institutional levels (public sector, NFPS, and central government).

- 1.32 The following activities are planned for the second tranche: strengthening the transparency of public debt statistics, through the: (a) extension of the scope of the public-debt-to-GDP rule, which will be consolidated at the level of the NFPS rather than the total public sector; and (b) monthly publication of debt bulletins using the new methodology for calculating debt at the NFPS level in 2019.
- 1.33 **Component III. Improvement of expenditure quality and efficiency.** The objective of this component is to improve the quality and efficiency of spending through: (i) institutional strengthening; (ii) improvement of the fiscal capacity for public investment with private-sector contributions through PPPs; and (iii) strengthening of State management and control over SOEs within the executive branch structure.
- 1.34 **Institutional strengthening.** The following activities are planned for the first tranche: strengthening of the MEF's DNCGP by making the MEF the coordinating entity for the executive branch's expenditure effectiveness and quality units, including: (a) mandatory reporting of expenditure statistics by central government agencies to the MEF; and (b) the definition of an agenda and methodologies for evaluating social spending, including ex ante and impact evaluations.
- 1.35 The following activities are planned for the second tranche: strengthening of the MEF's DNCGP by making the MEF the coordinating entity for the National Expenditure Quality System, including: (a) informational reports on social spending at three ministries (Education, Health, and Economic and Social Inclusion) received by the MEF; and (b) the launch of a pilot evaluation of at least one social expenditure program.
- 1.36 **Improvement of the fiscal capacity for public investment with private-sector contributions through PPPs.** The following activities are planned for the first tranche: improvement of the fiscal capacity for public investment with private-sector contributions, through the: (a) submission to the National Assembly of reforms to the PPP Incentives Act, which include: (i) improvements to the interagency coordination framework for the PPP program, including defined responsibilities for the identification, evaluation, and management of fiscal risks arising from such projects, as well as defined responsibilities for PPP structuring processes; (ii) the definition of a regulatory framework governing the monetization of public assets; and (iii) the definition of processes for managing unsolicited private initiatives; (b) establishment of regulations for handling contingent liabilities arising from PPP projects and for multiyear certification processes for fiscal commitments under PPP projects; (c) creation of a PPP Unit for subnational governments in the BDE; and (d) approval of the first PPP environmental impact management plan for the Puerto Posorja project.
- 1.37 The following activities are planned for the second tranche: improvement of the fiscal capacity for public investment with private-sector contributions, through: (a) approval of the regulations of the PPP Incentives Act, including regulations for: (i) the new institutional coordination framework for the program; (ii) the execution of infrastructure asset monetization initiatives; and (iii) processes for managing unsolicited private initiatives; (b) submission to the MEF, for its approval, of a

proposal to create a guarantee fund for subnational PPPs, to make such public investment projects more attractive to private-sector banks; (c) BDE PPP unit operational and processing requests for structuring PPP projects; and (d) preparation of quarterly reports on implementation of the Puerto Posorja Project Environmental Management Plan.

- 1.38 **Strengthening of State management and control over SOEs within the executive branch structure.** The following activities are planned for the first tranche: (i) strengthening of the State's management and control of SOEs within the executive branch structure, through enhancements to the institutional, operational, and tax framework, with the submission of the State-owned Enterprises Act (LOEP) to the National Assembly, to include reforms addressing: (a) the role of EMCO, making it an institution that safeguards the State's ownership role and upholds good corporate governance practices; (b) rules for membership on SOE boards of directors and selection methods, raising the professional requirements to serve as a director and ending the practice of appointing sector ministers as SOE board chairpersons; (c) the SOE tax regime, aligning it with international best practices,³⁴ including the definition of tax payment responsibilities and a surplus distribution policy grounded in clear and transparent rules; (d) SOE bidding and external audit processes, assigning execution authority to the SOEs themselves; and (e) makeup of SOE boards of directors, setting targets for women's participation; (ii) reforms to the process of allocating funds from the General State Budget (PGE) to SOE, including: (a) the inclusion of all SOE revenue sources in the budget formulation process; (b) mandatory reporting of SOE data in the MEF's integrated financial management system prior to consideration of the budget proposal; and (c) restriction of funding access to only those SOEs that demonstrate payment capacity; (iii) reduction of the fiscal burden for the State arising from SOE management, through the MEF's decision to cut payroll at SOEs within the executive branch structure by 10%; and (iv) improvement of the efficiency of the hydrocarbons sector through the Petroecuador-Petroamazonas merger, beginning with the delegation of responsibility for leading the merger process to the Ministry of Electricity and Renewable Energy (MEER).
- 1.39 The following activities are planned for the second tranche: (i) strengthening of State management and control over SOEs within the executive branch structure, through improvements to the institutional, operational, and tax framework, including the submission of the proposed LOEP regulations to the Office of the President and the approval of regulations that require SOEs to publish audited financial statements from fiscal year 2019 onward; (ii) reforms to the process of allocating funds from the PGE to SOEs, including the preparation of 2020 institutional budgets for SOEs in accordance with the regulatory reforms implemented; (iii) reduction of the fiscal burden on the State arising from SOE management, through: (a) the implementation of a 10% payroll cut in SOEs within the executive branch structure; and (b) the approval of the liquidation process for two non-strategic commercial SOEs; and (iv) the launch of the Petroamazonas-

³⁴ The OECD guidelines on Ownership and Governance of State-Owned Enterprises are a set of principles and practices for SOE management that OECD countries encourage governments to implement. Their objective is to improve the functioning of the State in general and optimize SOE performance. *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, 2015 Edition, OECD Publishing.

Petroecuador merger process, with a view to improving the efficiency of the hydrocarbons sector.

- 1.40 **Component IV. Improvement of the efficiency and transparency of tax policy and management.** The objectives of this component are to: (i) improvement of the transparency of tax management; and (ii) improvement of the efficiency of tax management.
- 1.41 **Improvement of the transparency of tax management.** The following activities are planned for the first tranche: (i) signing of the Convention on Mutual Administrative Assistance (CMAA) of the OECD Global Forum, including both the exchange of financial information for tax purposes on request (EOIR) and the automatic exchange of information (AEOL); and (ii) approval of the Global Forum on Transparency and Exchange for Tax Purposes beneficial ownership standard.
- 1.42 The following activities are planned for the second tranche: (i) implementation of the CMAA, including: (a) ratification of the CMAA, including legislation on common reporting standards; and (b) positive final assessment from the Global Forum (with a rating of “compliant” or “largely compliant”); and (ii) implementation of legal provisions of the standard on beneficial ownership information.
- 1.43 **Improvement of the efficiency of tax management.** The following activities are planned for the first tranche: (i) preparation of a technical proposal for a system for the taxation of digital services paid for by credit card; (ii) improvement of tax and customs administration management with the presentation of an action plan for the integration of taxpayer data management, control, and audit processes; and (iii) strengthening of the efficiency of tax compliance processes by putting services online, including: (a) technologies for submitting and receiving tax information (online forms) and an online tax payment system; (b) a process for registering online with the tax register; and (c) technologies that reduce the administrative costs of collecting outstanding tax debts.
- 1.44 The following activities are planned for the second tranche: (i) inclusion of the technical proposal for the taxation of digital services paid for by credit card in the proposed tax reform; (ii) implementation of measures to integrate tax agency processes in accordance with the diagnostic assessment and roadmap; and (iii) strengthening of the efficiency of tax compliance processes by implementing online services for: (a) business registration; (b) capital gains and mining royalties reporting; and (c) payment of vehicle registration fees.

C. Key performance indicators

- 1.45 The expected impact is an improvement in the NFPS fiscal balance, to be achieved by increasing the nonoil primary balance (including fuel subsidies) from -5.3% of GDP in 2018 to -0.4% in 2023. The main outcomes are: (i) a reduction in the public expenditure-to-GDP ratio from 34.7% in 2018 to 29.7% in 2023; (ii) an increase in the percentage of the value of national PPP projects structured and tendered from 2% in 2018 to 3% in 2023; (iii) an increase in the proportion of women serving on SOE boards of directors from 3% in 2018 to 40% in 2023; (iv) a shortening of the average time spent on tax compliance from 30 minutes in 2018 to six in 2023; and (v) an increase in VAT revenue intake from

6.05% in 2017 to 6.08% in 2023.³⁵ The expected outcomes and impact of the actions envisaged in the program are set out in the Results Matrix (Annex III).

- 1.46 **Beneficiaries.** The program will benefit: (i) the population at large, through an improvement in the allocation of fiscal resources to spending priorities and greater efficiency and transparency in expenditure management; (ii) the Government of Ecuador, especially the MEF, as a result of improvements in the areas of public finance management that will contribute to its consolidation and the creation of new fiscal headroom; (iii) the private sector, which will benefit from a stable macroeconomic and fiscal context that is conducive to investment; and (iv) taxpayers, who will have lower tax compliance costs.
- 1.47 **Economic Analysis.** OVE's recommendations in its 2011 Evaluability Review of Bank Projects³⁶ and on the findings of the review of evaluation practices and standards for PBLs by the Evaluation Cooperation Group (ECG, comprising the independent evaluation offices of the multilateral development banks),³⁷ as provided for in paragraph 1.3 of document GN-2489-5 (Review of the Development Effectiveness Matrix for Sovereign Guaranteed and Non-sovereign Guaranteed Operations) indicate that an analysis of efficiency in the use of financial resources is unnecessary.³⁸ It was therefore determined that an economic analysis would not be performed for this type of loan, as reported to the Bank's Board of Executive Directors. Accordingly, this loan operation does not include an economic analysis, and none is considered for the purposes of measuring the evaluability score in the program's Development Effectiveness Matrix.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing Instruments

- 2.1 At the client's request, this operation is structured as a multi-tranche PBL with two tranches, based on the document "Policy-based Loans: Guidelines for Preparation and Implementation. Update" (document CS-3633-2). This modality was chosen because the Bank has directly supported the essential measures of the reform process, through technical cooperation operations and investment programs. The government has made headway on its policy commitments, particularly those that are to be fulfilled under the first tranche. The reform measures included in the second tranche are defined in detail and represent an appropriate reform sequence.
- 2.2 **Dimensioning.** The amount of this operation will be US\$300 million, to be financed by the Bank from its Ordinary Capital resources. Each tranche of the PBL corresponds to 50% of the total financing amount. The first tranche would be

³⁵ The increase would come from the new VAT withholding on digital services imported from abroad.

³⁶ Document RE-397-1: Currently, the economic analysis section score is computed as the maximum between the cost-benefit analysis (CBA) and the cost-effectiveness analyses (CEA). Yet neither a CBA nor a CEA is applicable to PBLs.

³⁷ *Good Practice Standards for the Evaluation of Public Sector Operations*. Evaluation Cooperation Group, Working Group on Public Sector Evaluation, 2012 Revised Edition. February 2012.

³⁸ According to the ECG, PBLs should be evaluated according to their relevance, effectiveness, and sustainability. Efficiency was not included as a criterion, since the size of PBL is related to a country's financing gap, independent of the project's benefits.

disbursed in 2019, and arrangements would be made with the government as to the date of the second tranche, taking into account the progress made in fulfilling the measures. The operation is justified by the country's broad fiscal resource needs, although they are not directly related to the reform-associated costs to be borne by the borrower, as specified in paragraph 3.27(b) of document CS-3633-2. This operation would amount to 5.08% of the public sector's gross financing needs for 2019 and 7.04% of all financing obtained from multilateral organizations.

B. Environmental and social risks

- 2.3 In accordance with directive B.13 of the Bank's Environment and Safeguards Compliance Policy (document GN-2208-20 and operational policy OP-703), this operation does not require classification. The proposed reforms do not generate any adverse environmental or social impacts. The program will not finance any infrastructure or civil works components.

C. Fiduciary risks

- 2.4 The proceeds of this loan will be deposited directly in the Single Treasury Account to cover the country's financing needs. The analysis of the effectiveness of country financial management and procurement systems as part of this PBL operation does not foresee fiduciary risks in the execution and use of funds by the government.

D. Other key issues and risks

- 2.5 **Fiscal sustainability.** There is a medium risk that interest rate hikes and restricted access to borrowing will impair the sustainability of structural reform. Although international conditions are outside the program's control, the Government of Ecuador has developed a fiscal adjustment framework that is anchored in the 2018-2021 Prosperity Plan. As a mitigation measure, the government is executing an assistance program with the IMF; and the Bank and other multilaterals are also supporting the government's adjustment program through technical and financial assistance. This would mitigate the fiscal sustainability risks and the challenges of access to external financing. The risk that a fall in the price of oil will jeopardize the government's fiscal adjustment objectives and its growth pattern is rated medium. As a mitigation measure, the program's fiscal policy measures aim to broaden the scope of Ecuador's growth drivers, mainly through increased private-sector contributions, and they are robust to conservative growth scenarios.
- 2.6 **Public management and governance.** The risk that regulatory reforms to the SOE regime and public investment management through PPPs will not be approved is rated medium. The program will mitigate this risk by providing specialized technical assistance for structuring the reforms and by financing programs to communicate and publicize the measures' expected impacts on the general public.
- 2.7 **Development** There is a medium risk of delays in the implementation of the reforms set out in the policy matrix, owing to the high turnover of technical staff in public administration entities. In the first phase of the program, this risk will be mitigated through the Bank's ongoing technical support to the current government throughout 2019. For the second phase, the risk will be mitigated through dialogue with the authorities on the importance of the reforms and concerted multilateral

support for medium-term reforms. In addition, there is a medium risk of encountering difficulties in implementing the structural reforms contained in the policy matrix, owing to technical weaknesses in the institutions and a lack of financial support. To mitigate this risk, the country will be supported by an agenda of investment and technical cooperation projects.

- 2.8 **Sustainability.** The sustainability of the regulatory reforms envisaged in this operation will be facilitated by ongoing technical dialogue; the implementation of investment loans, such as loan 4670/OC-EC, an investment loan in support of SOE system reform, and an investment loan in support of improving tax administration efficiency (currently in preparation); and the associated technical-cooperation operations that will support and monitor the PBL reforms over the medium term (paragraphs 1.19 and 1.20).

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

- 3.1 **Borrower and executing agency.** The borrower is the Republic of Ecuador, with the MEF serving as executing agency. The executing agency has the following responsibilities: (i) maintaining official communication with the Bank and providing evidence that policy commitments have been fulfilled, and any other program-related evidence needed to approve the respective disbursement, as well as preparing the necessary reports within the timeframes established and agreed upon with the Bank; and (ii) monitoring and promoting compliance with the activities provided for in this operation, and providing the Bank with all information and indicators that have any bearing on the monitoring, measurement, and evaluation of the program's results.
- 3.2 **Institutional coordination.** Institutional coordination of the program is the responsibility of the MEF, which will coordinate with other entities that have responsibility for adopting policy measures (different areas of the MEF, EMCO, BDE, SRI and SENAE) for their fulfillment.
- 3.3 **Special contractual conditions precedent to the first and second disbursements of the loan.** The two disbursements are contingent on fulfillment of the policy reform conditions set forth in the Policy Matrix (Annex II), the Policy Letter, and the other conditions specified in the Loan Agreement.

B. Summary of arrangements for monitoring results

- 3.4 **Monitoring.** A [Monitoring and Evaluation Plan](#) was developed to monitor the results of the program, using the following tools: (i) the Policy Matrix (Annex II); (ii) the [Means of Verification Matrix](#); and (iii) the Results Matrix (Annex III). The executing agency and the Bank will meet periodically to monitor the results of the operation and to resolve technical difficulties that arise during its implementation.
- 3.5 **Evaluation** The ex post evaluation of the program will consist of an economic assessment of the public financial benefits derived from the reforms implemented through the program. The analysis will focus on estimating fiscal financial savings, defined as the reduction in a government's financial cost that results from a lower level of debt plus the consequently smaller interest payments, arising from the

implementation of public policy changes. This analysis of fiscal financial saving will be included in the project completion report.

- 3.6 Additionally, the operation's ex post evaluation will include an analysis of the system for withholding VAT on digital services paid for by credit card, which is expected to increase the VAT revenue obtained from services subject to this withholding. The evaluation of this measure will inform the analysis of Outcome 5 of the Results Matrix (increase in VAT revenue).

IV. POLICY LETTER

- 4.1 The Policy Matrix (Annex II), the Means of Verification Matrix, and the Results Matrix (Annex III) are aligned with the [Policy Letter](#) issued by the Republic of Ecuador, which reaffirms the government's commitment to implementing the activities agreed upon with the Bank.

Development Effectiveness Matrix		
Summary		
I. Corporate and Country Priorities		
1. IDB Development Objectives	Yes	
Development Challenges & Cross-cutting Themes	-Productivity and Innovation -Gender Equality and Diversity -Institutional Capacity and the Rule of Law	
Country Development Results Indicators	-Government agencies benefited by projects that strengthen technological and managerial tools to improve public service delivery (#)* -Business environment reforms enacted (#)*	
2. Country Development Objectives	Yes	
Country Strategy Results Matrix	GN-2924	(i) mitigate the fiscal risk associated with oil price volatility; (ii) generate efficiencies and increase the quality of public expenditure; (iii) increase the private share of investment in infrastructure and other public goods; (iv) boost the contribution of private investment and productivity to economic growth; and (v) facilitate access to investment financing.
Country Program Results Matrix	GN-2948	The intervention is included in the 2019 Operational Program.
Relevance of this project to country development challenges (If not aligned to country strategy or country program)		
II. Development Outcomes - Evaluability		Evaluable
3. Evidence-based Assessment & Solution		9.7
3.1 Program Diagnosis		3.0
3.2 Proposed Interventions or Solutions		4.0
3.3 Results Matrix Quality		2.7
4. Ex ante Economic Analysis		N/A
5. Monitoring and Evaluation		7.3
5.1 Monitoring Mechanisms		2.5
5.2 Evaluation Plan		4.8
III. Risks & Mitigation Monitoring Matrix		
Overall risks rate = magnitude of risks/likelihood		Medium
Identified risks have been rated for magnitude and likelihood		Yes
Mitigation measures have been identified for major risks		Yes
Mitigation measures have indicators for tracking their implementation		Yes
Environmental & social risk classification		B.13
IV. IDB's Role - Additionality		
The project relies on the use of country systems		
Fiduciary (VPC/FMP Criteria)	Yes	Financial Management: Budget, Treasury, Accounting and Reporting, External Control, Internal Audit. Procurement: Information System, Price Comparison, National Public Bidding.
Non-Fiduciary		
The IDB's involvement promotes additional improvements of the intended beneficiaries and/or public sector entity in the following dimensions:		
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	Yes	In 2019, the Bank is processing three new operations, which support structural reform initiatives incorporated in the SAF: (i) support for the reform of the public enterprises system of the executive function (investment loan EC-L1251), with the fundamental objective of reducing the tax burden for the state derived from the ownership of inefficient public enterprises (through improvements in its corporate governance, transparency regime, development of a fiscal regime comparable to the private sector, and enhancement of public enterprises where the presence of the State is not justified); (ii) the investment loan EC-L1253, with the objective of improving the efficiency of the tax administration through the better coordination of processes of the agencies with tax responsibility and improvements in the efficiency of inspection, control and compliance processes tax; and (iii) the current operation of lending fiscal management policies. Additionally, the ATN / OC-17299-EC supports the design of this operation and of the EC-L1251.

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

Evaluability Assessment Note:

The main goal of the operation is to contribute to the fiscal sustainability of the State of Ecuador. To achieve this end, the proposal defines three specific areas on which the project will intervene. The first area focuses on strengthening macro fiscal management. The second area focuses on improving the quality and efficiency of public expenditure. The third area aims to improve the efficiency and transparency of policies and tributary management. The document includes a description of the process gaps that lead to weaknesses in each of these three areas.

Regarding the macro fiscal management, the project proposal emphasizes in the diagnosis the amount of public expenditure at 35% of GDP (MEF, 2018). Regarding the quality and efficiency of public expenditure, the project identifies an amount of only 2% of GDP of PPP are structured and tendered (MEF, 2018). The diagnosis also dimensions as a proxy of the quality of expenditure the share of women in public enterprises at 3% (EMCO, 2018). Regarding efficiency and transparency of policy and tributary management, it establishes VAT collection at 6% of GDP (SRI, 2018). The cost to file is included in the diagnosis as the need to invest 30 minutes to file in magnetic format (SRI, 2018).

The project proposal diagnoses a primary balance as a share of the State PIB of -0.7 percent in 2017, and a Current Net Debt as a share of the State PIB of 4.5 Percent (STN, 2017). The diagnosis is based on the MD-GEFIS tool which analyzes processes in the three main areas which define the components. The Ministry of Finance provides a diagnosis for a total of seventeen sub areas. Each diagnosis identified the main restrictions for the Ministry to increase tax revenue, decrease running costs or improve efficiency in expenditures, and improve service delivery to citizens. However, the diagnosis does not quantify gaps in coordination, personnel, or capital investments. Rather, the document refers the reader to technical notes and the diagnosis focuses on 17 processes.

Economic analysis are not required for PBLs.

Monitoring relies on official reports by the Presidency and verification by the MEF among others. The project teams are responsible for monitoring. Some output products are not SMART. The ex post evaluation to verify the achievement of objectives consists of a reflexive methodology. The evaluation proposal also includes a proposal based on a differences in differences analysis to estimate the effect of the digital service retention system for transactions made using a credit card on VAT collection. The proposal is not clear about the assumptions to hold for the analysis to identify an unbiased program effect. There are no power calculations. The work plan associated to the evaluation is scant and includes a limited budget.

There are seven risks identified all classified as either medium or low.

POLICY MATRIX

Objective: The program's general objective is to contribute to Ecuador's fiscal stability by fostering sustainable growth and the stabilization of key social development indicators. The specific objectives are to: (i) strengthen macrofiscal management; (ii) improve expenditure quality and efficiency; and (iii) enhance the efficiency and transparency of tax policy and management.

Components/ Policy objectives	Policy conditions Tranche I	Status of fulfillment of the conditions Tranche I ¹	Policy conditions Tranche II
Component I. Macroeconomic stability			
Maintain a macroeconomic context that is consistent with the program objectives as set out in the Policy Matrix	1.1 Maintenance of a macroeconomic context that is consistent with the program objectives as set out in the Policy Matrix.	1.1 Fulfilled (2nd quarter, 2019).	1.1 Maintenance of a macroeconomic context that is consistent with the program objectives as set out in the Policy Matrix.
Component II. Strengthening of the fiscal responsibility framework and debt transparency			
Strengthening the fiscal responsibility framework	2.1 Strengthening of the fiscal responsibility framework, by establishing: <ul style="list-style-type: none"> a. A ceiling on the growth of central government public expenditure equal to the economy's long-term real growth rate. b. Escape clauses for the public expenditure growth rule, including scenarios of severe economic recession. c. Mechanisms to monitor the fiscal rule on public expenditure growth every four months, including an analysis of noncompliance risk 	2.1 Fulfilled (4th quarter, 2018).	2.1 Strengthening of the fiscal responsibility framework by: <ul style="list-style-type: none"> a. Expanding the coverage of the central government's expenditure growth ceiling to include the NFPS. b. Redefining the methodology for applying the constitutional "golden rule" (income relative to permanent expenditure) to make it consistent with the new expenditure growth rule. c. Publishing reports every four months to monitor compliance with the fiscal rule in 2019.

¹ This information is purely indicative as of the date of this document. Pursuant to document CS-3633-2 (Policy-based Loans: Guidelines for Preparation and Implementation), the fulfillment of all specified disbursement conditions, including the maintenance of an appropriate macroeconomic policy framework, will be verified by the Bank upon receipt of the disbursement request from the Borrower and reflected in the disbursement eligibility memorandum in a timely manner.

Components/ Policy objectives	Policy conditions Tranche I	Status of fulfillment of the conditions Tranche I ¹	Policy conditions Tranche II
Strengthening the transparency of public debt statistics	<p>2.2 Strengthening the transparency of public debt statistics, through the:</p> <ul style="list-style-type: none"> a. Modification of the public debt calculation to include liabilities resulting from advance oil sales, the central government's public debt with other State entities, and other obligations (including arbitration awards and floating debt). b. Monthly publication of public debt statistics, including aggregate and consolidated statements for the different institutional levels (public sector, NFPS, and central government). 	2.2 Fulfilled (4th quarter, 2018).	<p>2.2 Strengthening the transparency of public debt statistics, through the:</p> <ul style="list-style-type: none"> a. Extension of the scope of the public-debt-to-GDP rule, which will be consolidated at the level of the NFPS rather than the total public sector. b. Monthly publication of debt bulletins using the new methodology for calculating debt at the NFPS level in 2019.
Component III. Improvement of expenditure quality and efficiency			
Institutional strengthening	<p>3.1 Strengthening of the MEF's National Expenditure Quality Directorate (DNCGP) by making the MEF the coordinating entity for the executive branch's expenditure effectiveness and quality units, including:</p> <ul style="list-style-type: none"> a. Mandatory reporting of expenditure statistics by central government agencies to the MEF. b. Definition of an agenda and methodologies for evaluating social spending, including ex ante and impact evaluations. 	3.1 Pending (3rd quarter, 2019).	<p>3.1 Strengthening of MEF's DNCGP by making the MEF the coordinating entity for the National Expenditure Quality System, including:</p> <ul style="list-style-type: none"> a. Informational reports on social spending at three ministries (Education, Health, and Economic and Social Inclusion) received by the MEF. b. The launch of a pilot evaluation of at least one social expenditure program.

Components/ Policy objectives	Policy conditions Tranche I	Status of fulfillment of the conditions Tranche I ¹	Policy conditions Tranche II
Improvement of the fiscal capacity for public investment with private-sector contributions through public-private partnerships (PPPs).	<p>3.2 Improvement of fiscal capacity for public investment with private-sector contributions, through the:</p> <ul style="list-style-type: none"> a. Submission to the National Assembly of reforms to the PPP Incentives Act, which include: (i) improvements to the interagency coordination framework for the PPP program, including defined responsibilities for the identification, evaluation and management of fiscal risks arising from such projects, as well as defined responsibilities for PPP structuring processes; (ii) the definition of a regulatory framework governing the monetization of public assets; and (iii) the definition of processes for managing unsolicited private initiatives. b. Establishment of regulations for handling contingent liabilities arising from PPP projects and for multiyear certification processes for fiscal commitments under PPP projects. c. Creation of the PPP unit for subnational governments in Banco de Desarrollo de Ecuador (BDE). d. Approval of the first PPP environmental impact management plan for the Puerto Posorja project. 	<ul style="list-style-type: none"> a. Pending (3rd quarter, 2019). b. Fulfilled (4th quarter, 2018). c. Pending (3rd quarter, 2019). d. Fulfilled (4th quarter, 2018). 	<p>3.2 Improvement of the fiscal capacity for public investment with private-sector contributions, through:</p> <ul style="list-style-type: none"> a. Approval of the regulations of the PPP Incentives Act, including regulations for: (i) the new institutional coordination framework for the program; (ii) the execution of infrastructure asset monetization initiatives; and (iii) processes for managing unsolicited private initiatives. b. Submission to the MEF, for its approval, of a proposal to create a guarantee fund for subnational PPPs, to make such public investment projects more attractive to private-sector banks. c. BDE PPP unit operational and processing requests for structuring PPP projects. d. Preparation of quarterly reports on the implementation of the Puerto Posorja Project Environmental Management Plan.

Strengthening of State management and control over SOEs within the executive branch structure.	<p>3.3 Strengthening of the State's management and control of SOEs within the executive branch structure, through enhancements to the institutional, operational, and tax framework, with the submission of the State-owned Enterprises Act (LOEP) to the National Assembly, to include reforms addressing:</p> <ul style="list-style-type: none"> a. The role of the State Enterprise Holding Company (EMCO), making it an institution that safeguards the State's ownership role and upholds good corporate governance practices; b. Rules for membership on SOE boards of directors and selection methods, raising professional requirements to serve as a director and ending the practice of appointing sector ministers as board chairpersons; c. The SOE tax regime, aligning it with international best practices, including the definition of tax payment responsibilities and a surplus distribution policy grounded in clear and transparent rules; d. SOE bidding and external audit processes, assigning execution authority to SOEs themselves; e. Makeup of SOE boards of directors, setting targets for women's participation. 	3.3 Pending (3rd quarter, 2019).	3.3 Strengthening of State management and control over SOEs within the executive branch structure, through improvements to the institutional, operational, and tax framework, including the submission of the proposed LOEP regulations to the Office of the President and the approval of regulations that require SOEs to publish audited financial statements from fiscal year 2019 onward.
	<p>3.4 Reforms to the process of allocating funds from the General State Budget (PGE) to SOEs, including:</p> <ul style="list-style-type: none"> a. Inclusion of all SOE revenue sources in the budget formulation process. b. Mandatory reporting of SOE data in the MEF's integrated financial management 	3.4 Fulfilled (4th quarter, 2018).	3.4 Reforms to the process of allocating funds from the PGE to SOEs, including the preparation of 2020 institutional budgets for SOEs, in accordance with the regulatory reforms implemented.

Components/ Policy objectives	Policy conditions Tranche I	Status of fulfillment of the conditions Tranche I ¹	Policy conditions Tranche II
	<p>system prior to consideration of the budget proposal.</p> <p>c. Restriction of funding access to only those SOEs that demonstrate payment capacity.</p> <p>3.5 Reduction of the fiscal burden for the State arising from SOE management, through the MEF's decision to cut payroll at SOEs within the executive branch structure by 10%.</p> <p>3.6 Improvement of the efficiency of the hydrocarbons sector through the Petroecuador-Petroamazonas merger, beginning with the delegation of responsibility for leading the merger process to the Ministry of Electricity and Renewable Energy (MEER).</p>	<p>3.5 Fulfilled (1st quarter, 2019).</p> <p>3.6 Fulfilled (2nd quarter, 2019).</p>	<p>3.5 Reduction of the fiscal burden on the State arising from SOE management, through:</p> <p>a. Implementation of a 10% payroll cut at SOEs within the executive branch structure.</p> <p>b. Approval of the liquidation process for non-strategic commercial SOEs.</p> <p>3.6 Launch of the Petroamazonas-Petroecuador merger process, with a view to improving the efficiency of the hydrocarbons sector.</p>
Component IV. Improvement of the efficiency and transparency of tax policy and management			
Improvement of the transparency of tax management	<p>4.1 Signing of the Convention on Mutual Administrative Assistance (CMAA) of the Organisation for Economic Co-operation and Development (OECD) Global Forum, including both the exchange of financial information for tax purposes on request (EOIR) and the automatic exchange of information (AEOI).</p> <p>4.2 Approval of the Global Forum on Transparency and Exchange for Tax Purposes beneficial ownership standard.</p>	<p>4.1 Fulfilled (4th quarter, 2018).</p> <p>4.2 Fulfilled (3rd quarter, 2018).</p>	<p>4.1 Implementation of the CMAA, including:</p> <p>a. Ratification of the CMAA, including legislation on common reporting standards.</p> <p>b. Positive final assessment from the Global Forum (with a rating of "compliant" or "largely compliant"); and</p> <p>4.2 Implementation of legal provisions of the standard on beneficial ownership information.</p>

Components/ Policy objectives	Policy conditions Tranche I	Status of fulfillment of the conditions Tranche I ¹	Policy conditions Tranche II
Improvement of the efficiency of tax management	<p>4.3 Preparation of a technical proposal for a system for the taxation of digital services paid for by credit card.</p> <p>4.4 Improvement of tax and customs administration management, with the presentation of an action plan for the integration of taxpayer data management, control, and audit processes.</p> <p>4.5 Strengthening of the efficiency of tax compliance processes by putting services online, including:</p> <ul style="list-style-type: none"> a. Technologies for submitting and receiving tax information (online forms) and an online tax payment system. b. A process for registering online with the tax register. c. Technologies that reduce the administrative costs of collecting outstanding tax debts. 	<p>4.3 Pending (3rd quarter, 2019).</p> <p>4.4 Pending (3rd quarter, 2019).</p> <p>4.5 Fulfilled (1st quarter, 2019).</p>	<p>4.3 Inclusion of the technical proposal for the taxation of digital services paid for by credit card in the proposed tax reform.</p> <p>4.4 Implementation of measures to integrate tax agency processes in accordance with the diagnostic assessment and roadmap.</p> <p>4.5 Strengthening of the efficiency of tax compliance processes by implementing online services for:</p> <ul style="list-style-type: none"> a. Business registration; b. Capital gains and mining royalties reporting. c. Payment of vehicle registration fees.

RESULTS MATRIX

Project objective	The program's general objective is to contribute to Ecuador's fiscal stability by fostering sustainable growth and the stabilization of key social development indicators. The specific objectives are to: (i) strengthen macrofiscal management; (ii) improve expenditure quality and efficiency; and (iii) enhance the efficiency and transparency of tax policy and management.
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EXPECTED IMPACT

Indicators	Unit of measure	Baseline	Baseline year	Final target 2023	Means of verification	Comments
General objective: To contribute to fiscal stability						
Nonfinancial public sector (NFPS) nonoil primary balance (including fuel subsidies) / GDP	% US\$/US\$	-5.3	2018	-0.4	Annual financial report, Ministry of Economy and Finance (MEF).	Source: Extended Fund Facility (EFF) with the International Monetary Fund (IMF) approved on 11 March 2019.

EXPECTED OUTCOMES

Indicators	Unit of measure	Baseline	Baseline year	Final target 2023 ¹	Means of verification	Comments
Specific objective 1: Strengthen macrofiscal management						
Public expenditure / GDP	% US\$/US\$	34.7	2018	29.7	Annual financial report, MEF.	Source: EFF program.
Specific objective 2: Improve expenditure quality and efficiency						
Value of national public-private partnership (PPP) projects structured and tendered relative to GDP	% US\$/US\$	2.0	2018	3	Annual PPP project management report, MEF.	Baseline: 2.0 = Amount of structuring PPP projects already tendered (US\$2.121 billion) / GDP (US\$104.296 billion).

¹ The target year is the year when the project completion report will be prepared, according to the Bank's internal guidelines applicable to policy-based loan (PBL) operations. However, the outcomes are expected to continue materializing beyond the values projected for 2023.

Indicators	Unit of measure	Baseline	Baseline year	Final target 2023 ¹	Means of verification	Comments
Number of women on the boards of directors of State-owned enterprises (SOEs) / Total number of members of SOE boards of directors	Number of women / Total members	3	2018	40	Annual report of the SOE ownership entity (the State Enterprise Holding Company (EMCO) or the entity that replaces it).	Baseline: 3 = Number of women on SOE boards (2) / Total number of members of SOE boards (66).
Specific objective 3: Enhance the efficiency and transparency of tax policy and management						
Time needed to process the electronic filing of a tax return	Minutes	30	2018	6	Annual report, Internal Revenue Service (SRI).	Baseline: an estimated 30 minutes for processing.
Value-added tax (VAT) revenue intake / GDP	% US\$/US\$	6.05	2018	6.08	Annual report, SRI.	Baseline: 6.05% = VAT collected (US\$ 6.315 billion) / GDP (US\$104.296 billion). The increase would come from the new withholding of VAT on imports of digital services from abroad.

OUTPUTS

Output	Unit of measure	Baseline	Baseline year ²	Final target	Means of verification	Comments
Component II. Strengthening of the fiscal responsibility framework and debt transparency						
Tranche 1: 2.1 Productive Development Act (LFP) that strengthens the fiscal responsibility framework, published.	Law	0	2017	1	Official Registry of the Constitutional Court of Ecuador (CCE).	Includes: a. A ceiling on the growth of central government public expenditure equal to the economy's long-term real growth rate. b. Definition of escape clauses for the public expenditure growth rule, including for scenarios of severe economic recession. c. Establishment of mechanisms to monitor the fiscal rule on public expenditure growth every four months, including an analysis of noncompliance risk.
Tranche1: 2.2 Regulations to the LFP that strengthen the fiscal responsibility framework, published.	Regulations	0	2017	1	Official Registry, Office of the President of the Republic of Ecuador (PRE).	

² The base year was defined as 2017 because some outputs were attained in 2018.

Output	Unit of measure	Baseline	Baseline year ²	Final target	Means of verification	Comments
Tranche 2: 2.1 Strengthening of the fiscal accountability framework, through:						
<ul style="list-style-type: none"> a. and b. Draft law amending the Public Finance and Planning Code (COPLAFIP), sent to the National Assembly. 	Draft law	0	2018	1	Draft amendatory law submitted and certification of its submission to the National Assembly, PRE.	Includes expanding the coverage of the central government public expenditure growth ceiling to include the NFPS and redefining the methodology for applying the constitutional “golden rule” (income relative to permanent expenditure) to make it consistent with the new expenditure growth rule.
<ul style="list-style-type: none"> c. Reports to monitor compliance with the fiscal rule on expenditure growth in 2019 published every four months. 	Reports	0	2017	3	Reports published on the MEF website, MEF.	
Tranche 1: 2.2 a. LFP that strengthens the transparency of public debt statistics, published.	Law	0	2017	1	Official Registry of the CCE.	Includes: a. Modification of the public debt calculation to include liabilities resulting from advance oil sales, the central government’s public debt with other State entities, and other obligations (including arbitration awards and floating debt). b. Monthly publication of public debt statistics, including aggregate and consolidated statements for the different institutional levels (public sector, NFPS, and central government).
Tranche 1: 2.2 b: Regulations to the LFP that strengthen the transparency of public debt statistics, published.	Regulations	0	2017	1	Official Register, PRE.	

Output	Unit of measure	Baseline	Baseline year ²	Final target	Means of verification	Comments
Tranche 2: 2.2 Strengthening the transparency of public debt statistics:						
<ul style="list-style-type: none"> a. Draft law amending the COPLAFIP, submitted, including the extension of the scope of the public-debt-to-GDP rule, which will be consolidated at the level of the NFPS rather than the total public sector. 	Draft Law	0	2018	1	Draft law amending the COPLAFIP submitted and certification of its submission to the National Assembly, PRE.	
<ul style="list-style-type: none"> b. Debt bulletins using the new NFPS debt calculation methodology, published each month from May 2019 onward. 	Bulletins	0	2018	8	BCR monthly debt bulletin.	
Component III. Improvement of expenditure quality and efficiency						
Tranche 1: 3.1 Decree strengthening the MEF's National Public Expenditure Quality Directorate (DNCGP), by making the MEF the coordinating entity for the executive branch's expenditure effectiveness and quality units, published.	Decree	0	2017	1	Official Register, PRE.	Includes the mandatory reporting of expenditure statistics by central government agencies to the MEF and the definition of an agenda and methodologies for evaluating of social spending, including ex ante and impact evaluations.
Tranche 2: 3.1 Strengthening of the MEF's DNCGP by making the MEF the coordinating entity for the executive branch's expenditure quality and effectiveness units, including:						
<ul style="list-style-type: none"> a. Informational reports on social spending at three ministries (Education, Health, and Economic and Social Inclusion) received by the MEF. 	Reports	0	2018	3	Certificate of receipt, MEF.	Certificate on the reports sent to the MEF by the Ministries of Education, Health, and Economic and Social Inclusion.
<ul style="list-style-type: none"> b. Report on the launch of the pilot evaluation of at least one social expenditure program, approved. 	Report	0	2018	1	Certificate of receipt, MEF.	Certificate of receipt of the preliminary evaluation report sent to the MEF by the ministry responsible for the pilot evaluation project.

Output	Unit of measure	Baseline	Baseline year ²	Final target	Means of verification	Comments
Tranche 1: 3.2 Improvement of the fiscal capacity for public investment with private-sector contributions, through:						
<ul style="list-style-type: none"> a. Proposed reforms to the PPP Incentives Act, submitted to the National Assembly. 	Draft Law	0	2017	1	Amendments to the Law submitted and certification of their submission to the National Assembly, PRE.	Reforms include: (i) improved interagency coordination framework for the PPP program, including defined responsibilities for the identification, evaluation, and management of fiscal risks arising from such projects, as well as defined responsibilities for PPP structuring processes; (ii) the definition of a regulatory framework governing the monetization of public assets; and (iii) the definition of processes for managing unsolicited private initiatives; submitted to the National Assembly for approval.
<ul style="list-style-type: none"> b. LFP regulations published, regulations for handling contingent liabilities arising from PPP projects and for multiyear certification processes for fiscal commitments under PPP projects. 	Regulations	0	2017	1	Official Register, PRE.	
<ul style="list-style-type: none"> c. PPP unit for subnational governments in Banco de Desarrollo de Ecuador (BDE), created. 	Program Operating Regulations	0	2017	1	Program Operating Regulations approved, BDE.	Copy of the Operating Regulations for the Program to Enhance Fiscal Capacity for Public Investment (EC-L1230), approved by BDE.
<ul style="list-style-type: none"> d. Report on the first PPP environmental impact management plan for the Puerto Posorja project, approved. 	Report	0	2017	1	Approved copy, IDB.	Refers to the environmental and social plan for the Posorja port PPP project (2018).

Output	Unit of measure	Baseline	Baseline year ²	Final target	Means of verification	Comments
Tranche 2: 3.2 Improvement of the fiscal capacity for public investment with private-sector contributions through:						
▪ a. Regulations of the PPP Incentives Law approved, including regulations for: (i) the new institutional coordination framework for the program; (ii) the execution of infrastructure asset monetization initiatives; and (iii) processes for managing unsolicited private initiatives.	Regulations	0	2018	1	Official Register PRE.	
▪ b. Report on the proposal to create a guarantee fund for subnational PPPs, submitted to the MEF.	Report	0	2018	1	Certificate of receipt, BDE.	
▪ c. BDE PPP unit operational and processing requests for structuring PPP projects.	Report	0	2018	1	Receipt of report, MEF.	The functioning of the unit will be verified through the annual report prepared by the BDE for submission to the MEF.
▪ d. Quarterly reports on implementation of the Posorja project environmental management plan, finalized.	Reports	0	2018	4	Certificates of compliance, independent environmental consultant.	
Tranche 1: 3.3 Strengthening of State management and control of SOEs within the executive branch structure through enhancements to the institutional, operational, and tax framework, submitted to the National Assembly, including:						
Reform of the State-owned Enterprises Act (LOEP) to strengthen State management and control of SOEs within the executive branch structure, through improvements to the institutional, operational, and tax framework, submitted to the National Assembly.	Law	0	2017	1	Certificate of submission of the draft law to the National Assembly, PRE.	Including reforms addressing: a. The role of the SOE holding company (EMCO), making it an institution that safeguards the State's ownership role and upholds good corporate governance practices; b. Rules for membership on SOE boards of directors and selection methods,

Output	Unit of measure	Baseline	Baseline year ²	Final target	Means of verification	Comments
						<p>raising the professional requirements to serve as a director and ending the practice of appointing sector ministers as SOE board chairpersons;</p> <p>c. SOE bidding and external audit process, assigning execution authority to the SOEs themselves;</p> <p>d. The SOE tax regime, aligning it with international best practices, including the definition of tax payment responsibilities and a surplus distribution policy grounded in clear and transparent rules.</p> <p>e. Makeup of SOE boards of directors, setting targets for women's participation.</p>
Tranche 2: 3.3 Proposed LOEP Regulation for the strengthening of State management and control of SOEs within the executive branch structure through improvements to the operational and institutional framework submitted to the Office of the President.	Regulations	0	2018	1	Certification of submission of the proposed regulations to the PRE, MEF.	
Tranche 2: 3.3.2 Regulations that require SOEs to publish audited financial statements from fiscal year 2019 onward, approved	Ministerial Agreement	0	2018	1	Ministerial Agreement published, MEF	

Output	Unit of measure	Baseline	Baseline year ²	Final target	Means of verification	Comments
Tranche 1: 3.4 Ministerial Agreement reforming the process of allocating funds from the General State Budget (PGE) to SOEs.	Ministerial Agreement	0	2017	1	Ministerial Agreement published, MEF.	The Agreement includes: a. The inclusion of all SOE revenue sources in the budget formulation process. b. Mandatory reporting of SOE data in the MEF's integrated financial management system prior to consideration of the budget proposal. c. Restriction of funding access to only those SOEs that demonstrate payment capacity.
Tranche 2: 3.4 2020 institutional budgets for SOEs, prepared in accordance with the regulatory reforms made to the SOE allocation process.	Budget	0	2018	1	Certificate of receipt, MEF.	
Tranche 1: 3.5 Provision issued by EMCO mandating a 10% payroll cut in SOEs within the executive branch structure.	Provision	0	2018	1	Provision published, EMCO.	
Tranche 2: 3.5 a: Report on the implementation of the provision mandating a 10% payroll cut in SOEs within the executive branch structure.	Report	0	2017	1	Certificate of receipt, MEF.	The EMCO report includes details of layoffs at each SOE.
Tranche 2: 3.5 b: Decrees for the liquidation of two non-strategic commercial SOEs, published.	Decrees	0	2017	2	Official Register, PRE.	
Tranche 1: 3.6 Petroecuador- Petroamazonas merger decree	Decree	0	2018	1	Official Register, PRE.	
Tranche 2: 3.6 Preliminary diagnostic report on the Petroecuador- Petroamazonas merger.	Report	0	2018	1	Certificate of receipt, Temporary Oil Company Merger Unit.	Report prepared by the contracted consultant.

Output	Unit of measure	Baseline	Baseline year ²	Final target	Means of verification	Comments
Component IV. Improvement of the efficiency and transparency of tax policy and management						
Tranche 1: 4.1 Convention on Mutual Administrative Assistance (CMAA) of the Organisation for Economic Co-operation and Development (OECD) Global Forum signed by State declaration, including both the exchange of financial information for tax purposes on request (EOIR) and the automatic exchange of information (AEOI)	Convention	0	2017	1	Signed CMAA, SRI.	
Tranche 2: 4.1 a: CMAA ratified by the National Assembly.	Convention	0	2018	1	Certificate of submission of the CMAA to the National Assembly, PRE.	
Tranche 2: 4.1 b: Positive CMAA final assessment from the Global Forum completed (with a rating of "compliant" or "largely compliant").	Document	0	2018	1	Publication of the Global Forum Final Evaluation, SRI.	
Tranche 1: 4.2 Economic Revitalization Act and SRI Resolution for application of the beneficial ownership standard, in accordance with the transparency standards of the Global Forum on Transparency and Exchange of Information for Tax Purposes, approved.	Law and Resolution	0	2017	1	Official Registry, CCE, and Resolution, SRI.	
Tranche 2: 4.2 Legal provisions of the standard on beneficial ownership information, implemented	Report	0	2018	1	Report, SRI.	Implementation will be verified through the SRI's Participant, Partner, and Fee Monitoring report
Tranche 1: 4.3 Report with the technical proposal for a system for the taxation of digital services paid for by credit card, prepared.	Report with Proposal	0	2017	1	Certificate of receipt, MEF	Certificate of submission of the SRI's proposal for the taxation of digital services

Output	Unit of measure	Baseline	Baseline year ²	Final target	Means of verification	Comments
Tranche 2: 4.3 Technical proposal for the taxation of digital services paid for by credit card included in the proposed Tax Reform Act submitted to the National Assembly.	Draft law	0	2018	1	Certificate of submission of the draft law, PRE.	
Tranche 1: 4.4 Inter-institutional cooperation agreement on the integration of the taxpayer data management, control, and inspection processes of the SRI and the National Customs Administration (SENAE), presented.	Agreement	0	2017	1	Receipt of delivery, MEF.	
Tranche 2: 4.4 Measures to integrate SRI and SENAE processes, implemented.	Report	0	2018	1	Receipt of delivery, MEF.	Implementation will be verified through a semiannual report produced by the SRI and SENAE.
Tranche 1: 4.5 SRI resolutions to strengthen the efficiency of tax compliance processes by putting services online, issued.	Resolutions	0	2017	3	Published resolutions, SRI.	Resolutions include: a. Technologies for submitting and receiving tax information (online forms) and online tax payment system. b. Process for registering online with the tax register. c. Technologies that reduce the administrative costs of collecting outstanding tax debts.
Tranche 2: 4.5 SRI resolutions to strengthen the efficiency of tax compliance processes by putting services online, published.	Resolutions	0	2018	3	Published resolutions, SRI.	Resolutions included: a. Business registration; b. Capital gains and mining royalties reporting. c. Online payment of vehicle registration fees

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/19

Ecuador. Loan ____/OC-EC to the Republic of Ecuador
Program to Support Improved Fiscal Management
and Productive Development

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 the Program to Support Improved Fiscal Management and Productive Development. Such financing will be for the amount of up to US\$300,000,000 from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on ____ 2019)