

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

ECUADOR

SOCIAL SECTOR REFORM PROGRAM

(EC-0216)

LOAN PROPOSAL

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BASIC SOCIOECONOMIC DATA

For basic socioeconomic data, including public debt information, please refer to the following address:

English:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

Spanish:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

ABBREVIATIONS

BDH	<i>Bono de Desarrollo Humano</i> [Human Development Benefit]
CAF	Andean Development Corporation
CFCN	Consejo Nacional de Capacitación y Formación Profesional [National Council on Vocational Training]
ECV	Quality-of-Life Survey
FEIREP	Fund for Stabilization, Social and Productive Investment and Public Debt Reduction
FISE	Emergency Social Investment Fund of Ecuador
FODI	Childhood Development Fund
GDP	Gross Domestic Product
IDB	Inter-American Development Bank
IESS	Ecuadorian Social Security Institute
IMF	International Monetary Fund
INEC	National Statistics and Census Institute of Ecuador
INNFA	National Institute for Children and the Family
MBS	Ministry of Social Welfare
MEC	Ministry of Education and Culture
MEF	Ministry of Economy and Finance
MSP	Ministry of Public Health
OC	Ordinary Capital
OCP	Heavy Crude Oil Pipeline
ORI	<i>Operación Rescate Infantil</i> ["Operation Save the Children"]
PAE	School Meals Program
PANN	National Food and Nutrition Program
PDI	Childhood Development Program
PRADEC	Food Program for Community Development
SBA	Stand-By Agreement
SECAP	Ecuadorian System of Vocational Training
SELBEN	Social Program Beneficiary Selection System
SIAN	Integrated Food and Nutrition System
SIGEF	Economic and Financial Management System
SIISE	Integrated System of Social Indicators for Ecuador
STFS	<i>Secretaría Técnica del Frente Social</i> [Technical Secretariat for the "Social Front"]



ECUADOR

IDB LOANS

APPROVED AS OF MAY 1, 2003

	US\$Thousand	Percent
TOTAL APPROVED	3,819,576	
DISBURSED	3,611,161	94.54 %
UNDISBURSED BALANCE	208,415	5.45 %
CANCELATIONS	532,312	13.93 %
PRINCIPAL COLLECTED	1,644,865	43.06 %
APPROVED BY FUND		
ORDINARY CAPITAL	2,797,221	73.23 %
FUND FOR SPECIAL OPERATIONS	934,293	24.46 %
OTHER FUNDS	88,061	2.30 %
OUTSTANDING DEBT BALANCE	1,966,296	
ORDINARY CAPITAL	1,369,071	69.62 %
FUND FOR SPECIAL OPERATIONS	590,434	30.02 %
OTHER FUNDS	6,791	0.34 %
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	1,097,504	28.73 %
INDUSTRY, TOURISM, SCIENCE AND TECHNOLOGY	458,360	12.00 %
ENERGY	319,475	8.36 %
TRANSPORTATION AND COMMUNICATIONS	322,777	8.45 %
EDUCATION	209,144	5.47 %
HEALTH AND SANITATION	370,141	9.69 %
ENVIRONMENT	96,110	2.51 %
URBAN DEVELOPMENT	237,447	6.21 %
SOCIAL INVESTMENT AND MICROENTERPRISE	296,562	7.76 %
REFORM AND PUBLIC SECTOR MODERNIZATION	382,368	10.01 %
EXPORT FINANCING	0	0.00 %
PREINVESTMENT AND OTHER	29,689	0.77 %

* Net of cancellations with monetary adjustments and export financing loan collections.



Inter-American Development Bank
Regional Operations Support Office
Operational Information Unit



Ecuador

Tentative Lending Program

2003

Project Number	Project Name	IDB US\$ Millions	Status
EC0216	Social Sector Program	200.0	
EC0193	Coastal Resource Management Program II	13.0	
EC0213	Deepening Rural Financial Services	3.5	
EC0101	Strengthening of the Seguro Social Campesino	5.0	
* EC0214	Pichincha Bank	18.0	
* EC0208	Interagua (Guayaquil Water and Sanitation Project)	N/A	
EC0211	Rural Road Program	40.0	
Total - A : 7 Projects		279.5	
TOTAL 2003 : 7 Projects		279.5	

2004

Project Number	Project Name	IDB US\$ Millions	Status
EC0205	Innovation and Technological Development Program	20.0	
EC0199	Citizenship Security National Townships	10.0	
EC0139	Municipal Development II (PDM II)	40.0	
EC0185	Porte Medio Urban Transport	15.0	
EC0132	National Road Rehabilitation Program I	35.0	
Total - A : 5 Projects		120.0	
TOTAL - 2004 : 5 Projects		120.0	
Total Private Sector 2003 - 2004		18.0	
Total Regular Program 2003 - 2004		381.5	

* Private Sector Project



ECUADOR

STATUS OF LOANS IN EXECUTION AS OF MAY 1, 2003

(Amount in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROYECTS	AMOUNT APPROVED*	AMOUNT DISBURSED	% DISBURSED
<u>REGULAR PROGRAM</u>				
Antes de 1997	2	61,610	60,213	97.73 %
1997 - 1998	7	205,300	151,890	73.98 %
1999 - 2000	4	36,400	22,053	60.59 %
2001 - 2002	7	140,120	1,747	1.25 %
TOTAL	20	\$443,430	\$235,903	53.20 %

* Net of cancellations. Excludes export financing loans.

SOCIAL SECTOR REFORM PROGRAM

(EC-0216)

EXECUTIVE SUMMARY

Borrower and guarantor:	Republic of Ecuador	
Executing agency:	Ministry of Economy and Finance (MEF)	
Amount and source:	TOTAL IDB:	US\$200 million
	OC/FFI:	US\$ 65 million
	OC:	US\$135 million
	Local:	US\$ 0
	Total:	US\$200 million
Financial terms and conditions:	Amortization period:	25 years
	Grace period:	5.5 years
	Disbursement period:	Minimum 18 months, maximum 24 months
	Interest rate:*	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency:	U.S. dollars from the Single Currency Facility
Objectives:	The objective of the program is to introduce reforms to consolidate the social protection system for the poorest segments of the population, and to improve the quality and efficiency of social spending. The Bank will thereby contribute to implementation of the new government's social strategy.	
Description:	<p>The program consists of three components: (i) achieving a stable macroeconomic framework; (ii) consolidating the social safety net for the poorest segments of the population; and (iii) maintaining a minimum level of social spending and improving its efficiency.</p> <p>The social safety net system will be consolidated through introduction of the Human Development Benefit (BDH), through reforms to the</p>	

* The country has indicated that it is exploring the possibility of using the Libor.

existing cash transfer program (Bono Solidario) and the education grant (Bono Escolar) with a view to raising the effectiveness of nutrition and child-support programs; and providing additional countercyclical financing for the social protection system. The program will seek to ensure a minimum level of financing for basic social services (education, health and social welfare), and for a group of priority social programs, during the years 2003, 2004 and 2005, and will improve the efficiency of the way education and vocational training funds are used.

In the education field, budgetary allocation will be based on criteria that include school-age population density and student vulnerability and/or poverty indicators, and a plan for upgrading human resources in the sector will be launched. For vocational training, the Ecuadorian Vocational Training System (SECAP) will be modernized, and a quality assurance system for training institutions will be created. As well, the institution responsible for social policy coordination (Secretaría Técnica del Frente Social, STFS) will be strengthened. A technical assistance package will be provided in support of the program's activities and policies.

**The Bank's
country and
sector strategy:**

The country strategy for 2000-2002 identified the following areas of Bank support for the country: (i) improving governance and seeking mechanisms to overcome political and regional fragmentation; (ii) stabilizing the economy in the context of dollarization; (iii) poverty alleviation; (iv) investment and competitiveness; and (v) environmental preservation and sustainable development. The new strategy now in preparation is consistent with the analysis underlying the previous strategy, but focuses on three development challenges: (i) improving governance, (ii) increasing competitiveness, and (iii) alleviating poverty.

**Coordination
with other
multilateral
agencies:**

The design of this operation has been coordinated with the International Monetary Fund (IMF) and the World Bank. The program is part of a series of measures that the country has agreed with the IMF through the recently-signed Stand-by Agreement (SBA), designed to stabilize the fiscal situation and introduce public sector reforms, among other things. Coordination with the World Bank, which is negotiating a social sector program loan, will ensure that the two operations are complementary and mutually reinforcing (see paragraph 1.48).

**Environmental
and social
review:**

The program will have a significant social impact. In the first place, it will create a formal system of social assistance for people in poverty, it will improve the quality of current programs and the transparency with which they are targeted, and it will rationalize and increase the efficiency of social safety net programs, thereby creating conditions

for responding more effectively to structural poverty and the social impact of repeated economic crises. As well, these activities will be more directly focused on vulnerable and excluded groups. Secondly, measures to improve the volume and efficiency of social spending will benefit the entire population, but in particular the two poorest quintiles, because of the progressive nature of their design.

Given the nature of the operation, which involves reforming social protection systems and improving the quality and efficiency of social expenditure, the proposed program will have no direct environmental impacts.

Benefits:

The program will help to consolidate a social safety net system that will guarantee a minimum level of consumption for households in the two poorest quintiles of the population. The school-attendance condition attached to the Human Development Benefit will help to enhance beneficiaries' human capital. As well, the reforms to nutritional and child support programs will serve to broaden their coverage and improve their coordination, efficiency and targeting on behalf of the neediest groups. Budgetary protection for social expenditure will ensure the sustainability of investments and programs that are central to the country's social strategy. The programs that will be protected have a great impact on living conditions among the poorest. In addition, reforms to education and occupational training will help to make more efficient use of resources, and will introduce appropriate incentives for expanding educational coverage, and for matching training programs with the needs of the labor market.

Risks:

This program presents the following risks: (i) political sustainability of the reforms; (ii) institutional weaknesses in terms of executing and coordinating the proposed measures; (iii) fiscal sustainability of social expenditure targets; and (iv) fiscal sustainability of the public debt (paragraphs 4.3 to 4.6). To mitigate these risks the program will support: (i) social marketing efforts to inform people about the benefits of the reforms; (ii) technical assistance to support their implementation; (iii) implementation of the fiscal measures contained in the stand-by agreement with the IMF, in particular the elimination of revenue earmarking, which will make it easier to maintain social spending levels in bad economic times as well as good; (iv) implementation of the fiscal transparency law, which limits the real growth in primary public spending to 3.5%, as a way of making the public debt fiscally sustainable.

Special contractual clauses:	Disbursements under each tranche of the program will be conditional on fulfillment of the policy actions described in the Policy Matrix (Annex I) and in paragraph 3.4 of this document.
Poverty-targeting and social sector classification:	This operation qualifies as a social-equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704).
Exceptions to Bank policy:	None.
Procurement:	Not applicable.

I. FRAME OF REFERENCE

A. Macroeconomic and fiscal situation

- 1.1 Ecuador is recovering from the crisis of 1998-2000, when the convergence of domestic and external factors caused output to decline by more than 7% and sparked the collapse of 50% of the financial system. Those same years saw a generalized macroeconomic crisis and the loss of control over monetary policy, as the Central Bank attempted to shore up the financial system by bailing out problem banks, and the Sucre's devaluation accelerated. In that context, the government announced the suspension of payments on the Brady bonds in July 1999, thereby closing the free capital market. The dollarization of the economy was adopted in 2000 in response to the crisis.
- 1.2 The stability resulting from dollarization of the economy, together with high oil prices, were the main factors behind the economic recovery that took place in 2000-2002. Output rose by 5.1% in 2001, and 3.0% in 2002. Inflation declined to 22% in 2001 and 9% in 2002, and is expected to converge gradually with international levels, even though the dollarization-induced adjustment of relative prices is not yet completed.
- 1.3 Economic growth was made possible not only by this favorable context, but also by government efforts in support of the recovery process: (i) it negotiated construction of the new Heavy Crude Pipeline (OCP), which will double the country's oil transportation capacity; (ii) it successfully renegotiated the debt represented by the Brady bonds and replaced it with "global bonds", at the same time reducing the debt stock by 30%; and (iii) it obtained approval of the fiscal transparency law, which limits the growth in primary real public expenditure to 3.5% a year, and creates a savings fund with the new revenues generated by the OCP, dedicated to reducing the debt, preventing volatility and oil revenues, and increasing expenditure on education and health.
- 1.4 Despite these positive developments, the macroeconomic risk rose significantly in 2002: (i) economic competitiveness continued to decline, and inflation for 2002 stood at 9%, compared to 1.9% in the USA; (ii) the public debt amounted to 57% of GDP, and debt service required 27% of fiscal revenues; and (iii) the public wage bill rose 57% over the previous year, to 10.1% of GDP.
- 1.5 The effect of higher public expenditure in 2002, plus the high payment commitments on the public debt, including arrears, indicate that the government will face a shortfall this year of US\$574 million. The new government's economic team has prepared an Economic Plan for Human Development 2003-2006, which includes measures of fiscal adjustment and structural reform for 2003 designed to correct the inherited fiscal deficit and lay the foundation for macroeconomic stability and growth over the medium term. The measures that the government will take during 2003 and the first quarter of 2004 are set out in a letter of intent sent to

the IMF in February, and are reflected in the 13-month Stand-by Agreement (SBA) that was approved on March 21, 2003, for US\$200 million.

- 1.6 **The IMF agreement.** The government's program with the IMF is based on four pillars: a package of short-term fiscal measures to control public spending; structural reforms to maintain fiscal balance; liquidation of the assets and liabilities of the banks that are still in government hands as a result of the 1998-2000 financial crisis; and reforms to public enterprises.
- 1.7 For the short-term, the program calls for fiscal measures to control public spending and to deal with the government's liquidity problem (see Table 1), while leaving room for the financing of social programs targeted at the poorest. The government has imposed a wage freeze for 2003. The budget approved by Congress sets the objective of a total surplus of 1.9% for 2003. If public spending can be held to these levels, the goal of gradually reducing total public debt to 37% by 2006, as established in the fiscal transparency law, is likely to be achieved.

Table 1

Government finances 2003-2004 (US\$ millions)	2003	2004
Financing needs	1,976	1,810
Financing identified	1,402	1,470
Financing gap	574	340
Financing	574	340
Paris Club debt restructuring	84	0
Inter-American Development Bank (IDB)	100	100
World Bank	130	100
Andean Development Corporation (CAF)	100	100
IMF	160	40

- 1.8 The second pillar of the program involves structural measures that are designed to reinforce the fiscal balance over the medium term, with a particular focus on reforming the public sector by cutting the number of salary levels in government, and reducing the number of public employees during 2004.
- 1.9 The third pillar of the SBA is intended to resolve the problem generated by the 1998-2000 financial crisis. The fourth and final pillar of the strategy seeks to make public-sector electricity, oil and telecommunications enterprises more efficient. The agreement includes the deregulation of utility rates, so that some of these enterprises can be let under concession to the private sector.
- 1.10 In short, the government intends, with the SBA, to resolve its immediate liquidity problems, settle outstanding payment arrears, reduce inflation, reorganize the government finances, and control public spending, while ensuring adequate funding for the social sector and for programs designed to protect the poorest segments of

the population. The current program, together with similar operations by other multilateral agencies, is intended to help the government implement those reforms.

B. The social situation

- 1.11 A series of political and economic crises during the decade 1990-2000 impacted negatively on the country's social situation: on one hand, especially between 1995 and 2000, there was a sharp increase in indicators of poverty and indigence or extreme poverty; on the other hand, the social development indicators, which had shown substantial improvements in previous decades, stagnated or improved only slowly, and are still below the regional average. The major social problems facing the country can be described as follows:

1. Rising poverty and inequality

- 1.12 The percentage of the population living in poverty rose from 34% in 1995 to 56% in 1999.¹ The indigent population rose from 12% to 21% over the same period. Unemployment and underemployment reached levels without precedent in the country's recent history, standing at 14.4% and 55% respectively at the end of 1999, further compressing incomes among the poor. The incidence of poverty is strongest in rural areas (77%) and among indigenous peoples (89%) and Afro-Ecuadorians (more than 73%). Recent studies suggest that urban poverty has declined since 2000, with the revival of the economy, although it is still more prevalent than it was before the 1998-1999 crisis.²
- 1.13 Besides unemployment, the other factors that have the heaviest influence on the growth of poverty include accelerating inflation, the sudden rise in the exchange rate, and falling GDP, which declined by 7.6% in 1999 alone, dragging down incomes per capita (which fell from \$1,570 in 1995 to \$1,110 in 1999). At the same time, there was a decline in social spending, in particular on health and education.
- 1.14 The worsening of the poverty indicators was accompanied by an increase in inequality. The Gini index rose from 0.43 in 1995 to 0.47 in 1999: the rural Gini went from 0.39 to 0.42, and the urban from 0.41 to 0.45. The groups most vulnerable to poverty are the rural population, indigenous and Afro-Ecuadorian households, those with high numbers of children under six years, those with undernourished children, households with pregnant women, people with low levels of education, and the elderly.

¹ Poverty is defined here as the percentage of people living in households where consumption falls below the basic basket of goods and services. The social indicators mentioned in this section come from the Integrated System of Social Indicators for Ecuador (SIISE), which is part of the *Frente Social* Technical Secretariat.

² It should be noted that the studies cited, one from the National Statistics and Census Institute (INEC) and the other from the Central Bank, use a methodology that measures poverty by income, while data for 1998 and 1999 come from the Quality of Life Survey, using the consumption-based poverty methodology.

2. Lack of a social safety net

- 1.15 Ecuador has still not succeeded in establishing a national social safety net. There are a number of recent programs designed to alleviate the situation of people affected by the different crises, principally through cash transfers. The *Bono Solidario* is the most important cash transfer, and in 2002 it covered about 1.2 million households with a budget of US\$153 million. Other social protection programs include the *Bono Escolar* (a transfer that is conditional upon school attendance) and the “production benefit” (*Bono Productivo*), but their coverage and funding are minimal: the *Bono Escolar* applies to 50,000 students, while the *Bono Productivo* benefits 6,500 families, with an annual budget of only US\$1 million.
- 1.16 The *Bono Solidario* deserves particular attention. It was created in October 1998 to compensate families for the elimination of certain subsidies on fuel and energy. The delivery mechanisms of this state aid were designed and implemented within a few months, it was delivered with administrative efficiency and low operating costs, and managed to reach an important percentage of the low-income population. While the *Bono Solidario* has become the most significant social protection program in the country, because of its coverage and its budget, it has severe problems in terms of its targeting, its purposes, and the level of its benefits: given its origin and its objectives, that program excluded and continues to exclude a large portion of the poor rural population, and a significant number of urban indigents; it has no clear beneficiary selection mechanisms, the transfer is not conditional on school attendance or health-protection activities; and the amount of the benefit is too low to have a real impact on the incomes of poor households.
- 1.17 There are programs that are targeted at the most vulnerable population, such as those for the elderly and for children under six years, and various food programs. Yet those programs are not sufficiently articulated and coordinated to constitute a real social safety net. They are managed by different government organizations, they use different targeting strategies, and they have different implementation approaches. In particular, all of them, with the exception of the *Bono Escolar*, have serious problems of under-coverage and targeting. In addition, there is virtually no evaluation of their impact.

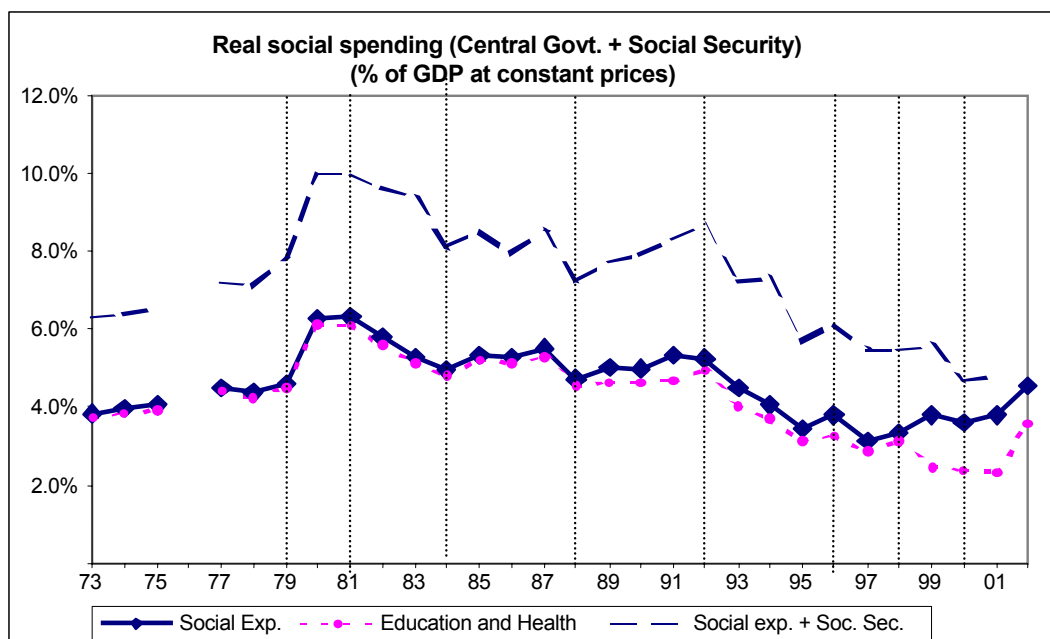
3. Social spending is insufficient, fragmented and not progressive

- 1.18 Over the last 20 years, social spending has fallen alarmingly in Ecuador: social spending by the central government (not including Social Security) amounted to 6.3% of GDP in 1981, but had fallen to 4.5% in 2000-2002.³ The slight recovery that took place under the previous government still left the level of social spending

³ See Vos et al., “*Política social y tendencias del gasto social: Ecuador 1970-2002*”, October 2002.

below that of the 1980s (Graph 1).⁴ The reduction in social spending has affected all areas of the education and health sectors. The central government's education spending fell from 3.7% of GDP in 1984 to 1.7% in 2000. Moreover, social spending is "procyclical", which means that it contracts at times of economic recession or natural disasters, just when increases are needed to extend protection to the neediest.

Graph 1



Source: Rob Vos, Mauricio León and René Ramírez. *Política social y tendencias en el gasto social: Ecuador 1970-2002*. October 2002.

- 1.19 The makeup of social spending has varied over the last two decades. In the 1980s, nearly all social expenditure went to pay for education and public health services. In the 1990s, an increasing share of social expenditure went to programs that provided direct assistance to vulnerable groups, as well as to drinking water and housing programs. In particular, since 1998, spending under the *Bono Solidario* and food programs has accounted for nearly one-quarter of budgetary allocations for the social sector.
- 1.20 Since 2001 efforts have been made to improve the level of social spending. The current government has reallocated funding to provide greater resources to the social ministries: this resulted in an increase of about 23% in nominal terms in the

⁴ Public social spending in Ecuador is among the lowest in Latin America, where the average is 14% of GDP (including Social Security).

joint budgets for education, health and social welfare between 2002 and 2003, representing an important step towards improved financing for the sector.

- 1.21 Social spending in Ecuador is not only low, but it is not very progressive. The redistributive effect of social spending is limited: it improves the per capita consumption Gini by only 3% (from 0.469 to 0.434). The poorest 20% receive only 13% of social spending, while the richest 20% receive 27.5%. As can be seen from Table 2, among universal programs the only ones that are clearly progressive are primary education, rural social insurance, and the school meals program. Primary education focuses more than 60% of spending on the poorest 40% of the population. Under the rural social insurance program, 67% of expenditure flows to the poorer half of the population.⁵

Table 2
Direct distributive impact of social spending

	Direct distributive effect ⁶		
	Progressive	Regressive	Neutral
Primary education (fiscal)	X		
Secondary education (fiscal)			X
Tertiary education		X	
Instituto Ecuatoriano de Seguridad Social (IESS)		X	
Rural Social Insurance	X		
Ministry of Public Health (MSP)			X
Hospitals		X	
Health centers		X	
Health stations			X
School meals program	X		
Free food program			X
Child support	X		
<i>Bono Solidario</i> (cash transfer)	X		
Cooking gas subsidies		X	
Gasoline subsidy		X	
Total social spending		X	

Source: Rob Vos et al. *¿Quién se beneficia del gasto social en Ecuador?* October 2002.

- 1.22 Among programs targeted at the neediest population, the only progressive ones are the *Bono Solidario*, the school breakfast, and certain child care programs. The poorest 40% of households receive 53% of benefits under the *Bono Solidario*. The school breakfast program benefits the poorest (38%) and the third income quintiles

⁵ The figures and graphs in this section are taken from Vos et al., “¿Quién se beneficia del gasto público social en Ecuador?”, October 2002.

⁶ In this section, programs are defined as "progressive" if more than 50% of the benefits go to the poorer 50% of the population. Otherwise, programs are considered regressive.

(33%). The child care centers of the National Institute for Children and the Family (INNFA) spend 54% of their funds on the poorest 40% of the population.

- 1.23 The least progressive programs are: tertiary education and the Ecuadorian Social Security Institute (IESS), where 68% of spending benefits the richest 40% of the population; 56% of hospital spending benefits the two richest quintiles; spending at health centers tends to benefit the better-off (51% goes to the highest-income 40% of households); and gas and gasoline subsidies are highly regressive. Neutral programs are: secondary education, spending at health substations, and the various free food distribution programs of INNFA and the Ministry of Social Welfare (MBS), where most of the benefits go to the third and fourth income quintiles.
- 1.24 Social spending is also highly fragmented: there are a great number of programs, projects and activities, for which there is no follow-up or evaluation. In many areas there is duplication and overlapping. For example, when it comes to child support there are five different national programs (Child Development Program, PDI; “Operation Save the Children”, ORI; INNFA; the National Food and Nutrition Program, PANN; *Nuestros Niños* (“Our Children”)), run by different institutions, with differing unit costs, serving similar populations with comparable services. In the area of food and nutrition there are four national programs: the school breakfast, food distributed by INNFA, food actions by the Ministry of Health, and the MBS food program.

4. Programs are poorly targeted

- 1.25 Only recently have efforts been made to target social programs. Since 1996, thanks in particular to the Integrated System of Social Indicators (SIISE), financed by the Bank, there has been an improvement in geo-referenced social statistics, and there are increasingly reliable poverty maps broken down by parish. More recently, again with Bank financing, the Social Program Beneficiary Selection System (SELBEN)⁷ was created as the technical tool for selecting social program beneficiaries, but it is still in limited use.
- 1.26 Most social programs have no objective targeting criteria or standards, nor do they use any specific methods for allocating their resources. For example, given the urgency of implementing the *Bono Solidario* in 1998, an ad hoc system for selecting beneficiaries was designed, based on a declaration of income sworn before a parish priest and the cross-checking of that information against the IESS database and the banking system. While that system was useful in allowing the subsidy to be awarded promptly, the result in terms of targeting has not been very satisfactory: nearly half of the beneficiaries of the transfer should not be receiving it

⁷ The SELBEN is a welfare index based on the concept of unmet basic needs (which includes environmental variables), income and other socioeconomic variables (for example language) under which each households and its members are awarded a poverty score.

(because they do not belong to the two poorest quintiles of the population), while a sizable and very vulnerable group has been excluded from the program.

- 1.27 On the other hand, some new programs have begun to use geographic targeting instruments for purposes of locating collective benefits such as schools, health centers or drinking water systems, and SELBEN is doing the same for the distribution of subsidies, as in the case of the *Bono Escolar*. The use of poverty maps for selecting beneficiaries of the Ecuadorian Emergency Social Investment Fund (FISE), for example, has allowed that institution to focus its efforts on the poorest parishes and on indigenous and Afro-Ecuadorian communities.

5. Basic social services suffer from low coverage, poor quality, and problems with resource allocation

- 1.28 **Education.** The main problems here are inequitable coverage, low quality, shortcomings in governance, and inefficient allocation of resources. In terms of equity, educational opportunities are unevenly distributed, to the detriment of the rural areas and the poorer population groups. Average schooling among the rural population is only 4.8 years, compared to 7.5 years for the national average: this rate is even lower among indigenous groups (3.7 years). While there is virtually universal coverage of primary education in urban areas, 20% of rural children of school age do not go to school. Of every 100 rural children who enter primary school, only 36 complete it. When it comes to secondary school, classroom seats in the rural areas are scarce, and the coverage rate is only 29%, while in urban areas it is 65%. Educational opportunities are also unequally distributed by income level: while the richest quintile has almost universal school coverage, nearly 20% of children between 6 and 15 years in the poorest quintile do not go to school, and only 12% of those who enroll in basic education complete grade 9.
- 1.29 The poor quality of teaching is another major problem, as has been demonstrated in the results of academic achievement tests. Those results reinforce the findings on problems of inequity in the sector, by showing that the most vulnerable groups (rural and indigenous people) have the worst results. Quality problems are to a large extent responsible for the system's failure to retain students at the primary level, and to expand coverage at the secondary. This situation reflects a number of factors, among them: malnutrition among children, a short school day, the low level of teacher training, lack of teaching materials, and infrastructure that is degraded through lack of maintenance. This entire situation is aggravated by the unequal and inefficient allocation of human, financial and teaching resources, which tends in particular to penalize rural and single-teacher schools, and pupils from the poorest areas.
- 1.30 When it comes to governance of the system, the Ministry of Education and Culture (MEC) suffers from a number of shortcomings that undermine the impact of investments in education. Among the main problems are: (i) duplication of

functions and lack of coordination among the different levels; (ii) limited communication with primary and secondary schools, which makes it difficult to monitor and supervise their activities; (iii) high turnover among senior authorities, which disrupts the continuity of policies and long-term analysis; (iv) a weak system of coaching and support for teachers; and (v) ineffective and non-transparent management of teachers and directors. The MEC does not have proper tools for fulfilling some of its responsibilities: the information system on students, teachers, schools and financial resources is weak, and there is no system for evaluating the quality of education that students are receiving in the schools.

- 1.31 Moreover, the problem posed by shrinking funding is compounded by the fact that the current system for allocating education resources is designed to pay for inputs (salaries for teaching and administrative staff, operating expenses, etc.) but not to guarantee the quality of the education services provided. Funds allocated to basic education are distributed among the various geographic zones (Provincial Departments) according to the number of teaching positions. Yet those teaching positions bear little relation to the number of students served. Thus, although the overall number of public school teachers would seem to be sufficient, there are schools that have no teachers at all, and certain rural and isolated areas face a shortage of teachers while some urban areas have a surplus.
- 1.32 Recently, the *Redes Amigas* (roughly “friendship networks”) rural education program, financed by the Bank, has been conducting a demonstration experiment as an alternative to the conventional way of allocating funding. The program assigns resources directly to rural school systems according to the number of students enrolled, and teaching positions belong to the schools themselves, which ensures them against teacher turnover by giving them the funds to hire replacements without disrupting service. In schools of the *Redes Amigas* the teaching and administrative staff are accountable to a governing board with majority community representation. A recent study shows that students in these schools perform better in mathematics and language skills than do those in the conventional schools.
- 1.33 **Vocational training.** Besides the poor quality of education, a further obstacle to enhancing the productivity of the labor force is the failure of businesses to invest in training for their workers. Both the level and the coverage of worker training in Ecuador are low in comparison with other countries of the region. One reason for this is the incentives that currently induce businesses to opt for temporary workers, a factor that discourages greater business investment in training and professional development.
- 1.34 The vocational training system consists of a great variety of institutions, among which quality levels are uneven and generally low, and for which there is no regular evaluation against standards of efficiency, quality and relevance. The lack of any accreditation and evaluation system creates problems in terms of information. Among these problems: (i) there is little information available to students and

- parents or to workers for making training decision; (ii) training institutions have little information on the needs of businesses; and (iii) businesses are unable to determine the actual capacities of the various vocational training institutions.
- 1.35 The Ecuadorian Vocational Training System (SECAP), the public institution responsible for occupational training, suffers from high administrative costs, it has little relationship to the business sector, and it is not sufficiently responsive to the demands of its target population. It has guaranteed or earmarked funding, which serves as a disincentive to efforts to make its programs more relevant and useful.
- 1.36 **Health and nutrition.** Despite the improvements that were made in previous decades, public health conditions in Ecuador have stagnated since 1995. The infant mortality rate has remained at around 30 deaths per thousand live births, well above the Latin American average; moreover, 78% of that rate is attributable to preventable diseases. Chronic malnutrition afflicts nearly one of every four children under five years of age. A significantly higher proportion of rural children are undersize, especially in the mountains (the sierra), where the rate exceeds 40%, reflecting the poor living conditions (in particular, low food consumption), the low education levels of mothers, the impact of ethnicity on living standards, and the absence of basic services.
- 1.37 This situation is due in part to a distribution of public funds that is highly inequitable and inconsistent with the profile of health and nutrition needs. Nearly one-third of the population has no access to health services, and the situation is even worse for poor and rural people. As well, schemes for extending health services to the poor, such as the Rural Social Security Program and services under the Free Maternity Law, are underfunded, reflecting Latin America's lowest rate of public health expenditure.

6. Institutional weakness in the social sector

- 1.38 Despite the number and the size of government ministries and agencies in the social area, the sector is characterized by institutional weakness: it is not integrated, it has little experience with coordination, it has limited capacity to target its services, it is rigid when it comes to allocating resources, it is highly centralized, and it is highly bureaucratized, which makes program execution expensive. At the same time, it is highly susceptible to fallout from labor and political disputes.
- 1.39 To address these problems, efforts have been made recently to strengthen the *Frente Social* Technical Secretariat (STFS), a unit under the Ministry of Social Welfare that is responsible for coordinating government action in the social sector. The STFS has incorporated the SIISE as its information office, and the SELBEN as one of its instruments for selecting social program beneficiaries, and it has attempted to create mechanisms for coordinating social institutions. Yet it has had very little success in articulating social policies with economic and fiscal policies,

and it has no instruments to influence the allocation of the budget, nor any mechanisms for monitoring or evaluation.

C. Rationale for the program

1.40 This sector program is designed to help the country to implement a comprehensive social strategy that will be consistent with the new government's economic and social program. In particular, it will support:

- Consolidation of the social protection system for the poorest groups, through establishment of the Human Development Benefit (BDH), which is conditional upon school attendance and medical check-ups for children, and improving the strategies for food and nutrition, and for child care.
- Improving the quality, equity and efficiency of social spending by ensuring adequate levels of funding; reforming the way resources are allocated in education and vocational training; promoting the use of technical targeting techniques (poverty map and SELBEN); and strengthening the STFS, as the coordinating entity for the social activities of the central government and MEC.

1.41 The new government's Economic Plan for Human Development 2003-2007 seeks to address the problems described in the previous section. The social chapter of the plan, entitled *Juntos Podemos* (roughly " Together we can do it "), presents the government's strategy, the main elements of which are:

- Immediate actions to address extreme poverty by establishing a social safety net that consists of: (i) cash transfers, the Human Development Benefit; (ii) subsidies in-kind (food and nutrition programs); and (iii) comprehensive support programs for children, the elderly, and the disabled.
- Medium-term actions to reduce and prevent poverty through: (i) improving the models for providing basic social services (education, vocational training and health); and (ii) applying innovative models for employment generation and microfinance.
- Actions to improve the targeting of social programs and to strengthen social sector institutions.

1.42 The program's measures will be strengthened and supplemented by the social program loan from the World Bank, which is now under negotiation. That operation also contains efforts to strengthen the social protection system for the poorest, and to protect and improve the efficiency of social spending, but in addition it includes actions to improve the provision of basic health services and to reform the pension

system. These two operations constitute a comprehensive package of support for the country's social reforms over the period 2003-2005.

D. Bank strategy in the country

- 1.43 The current country strategy for 2000-2002 identified the following areas of Bank support for the country: (i) improving governance and seeking mechanisms to overcome political and regional fragmentation; (ii) stabilizing the economy in the context of dollarization; (iii) poverty alleviation; (iv) investment and competitiveness; and (v) environmental preservation and sustainable development. The new strategy now in preparation is consistent with the analysis underlying the previous strategy, but focuses on three development challenges: (i) improving governance, (ii) increasing competitiveness, and (iii) alleviating poverty.
- 1.44 The proposed program comes at a time of transition between the existing strategy and the strategy now in preparation. Its characteristics make it consistent with both strategies, since it has been designed to promote reforms that will consolidate social programs and enhance the efficiency of public expenditure. The operation is also consistent with the strategy now in preparation, which not only identifies poverty reduction as a challenge but is more specific in regarding the consolidation of the social safety net and the improved targeting of social programs as fundamental to achieving that goal. This operation will also contribute to governance in the social sector, by consolidating a series of overlapping programs and encouraging more efficient use of government resources.

E. Bank experience with similar programs in the country

- 1.45 The Bank began in the early 1990s to provide funding to borrowing countries through sector or emergency loans. The first operations of this kind for Ecuador came in 1994. Since then, the Bank has approved loans to Ecuador totaling US\$1.365 billion, of which US\$515 million (38%) was provided through five sector operations. Four of these date from 1994. They are a financial sector program (US\$110 million); an agriculture sector loan and technical-cooperation funding (US\$92 million); a debt reduction facility (US\$79 million); and a restructuring of the transportation sector (US\$29 million). The most recent sector operation, an investment sector program (US\$122 million), was approved in 2000.
- 1.46 The Bank's experience with sector programs in Ecuador presents a complex picture. Some operations suffered delays and partial cancellations (although about 85% of the funds approved have been disbursed). The complexity of the measures, in particular, made it difficult to qualify for second and subsequent disbursements. Nevertheless, those operations have established a legal and regulatory basis in their respective sectors. The agriculture sector program, for example, succeeded in dismantling a top-heavy institutional structure that fostered interventionist policies affecting both input and product markets. In the case of the transportation sector,

although only the first tranche was disbursed, the measures helped to modify the government role in the sector, replacing it as a direct service provider, strengthening its regulatory, planning and supervisory functions, and fostering conditions favorable to private investment. The financial sector loan, which was reformulated in 2000, achieved progress toward two fundamental objectives for the economy: macroeconomic stabilization based on dollarization, and a start at restructuring the financial system. Finally, although the final tranche of the investment sector loan (US\$28 million, for privatization of electricity distribution) is about to be formally canceled, that loan succeeded in establishing a regulatory framework in the electricity and telecommunications sectors to encourage private participation in new projects, and it helped with stabilization and the transition to a dollarized economy. As well, the social component of that operation was satisfactorily executed, protecting the budget for a group of priority social programs aimed at the poorest segments of the population, and establishing SELBEN as a targeting mechanism for government social programs.

- 1.47 The lessons learned with sector loans in Ecuador and other countries indicate that their probability of success is greatest when: (i) there is a high commitment on the part of the different players within government; (ii) there is effective coordination among the various authorities involved in the reforms; (iii) there is continuous monitoring of implementation; (iv) programs are accompanied by ongoing dialogue with stakeholders, and systematic promotional efforts; and (v) operations include technical cooperation or assistance to help the government coordinate the implementation and monitoring of reforms. Those lessons have been taken into account in the design of this operation.

F. Coordination with other multilateral agencies

- 1.48 The new country strategy paper for Ecuador is still at the design stage. It is being prepared in coordination with the World Bank, whose assistance strategy for the country is also in the process of discussion. Both strategies should be ready for the third quarter of 2003, and both will include freely available credit programs. The World Bank is planning to approve two program loans for 2003-2005, totaling US\$300 million. The first relates to fiscal and competitiveness issues, and will provide support in 2003 for the reforms called for in the SBA with the IMF. This operation would disburse US\$50 million in 2003. The second operation is a social program loan, referred to earlier, the contents of which are being designed in coordination with this program, so that their conditions will be consistent or complementary. The World Bank's social program loan contains policies to improve the efficiency of the health and pensions sectors, while this operation emphasizes education and vocational training. Both operations will support the consolidation of the social protection system and will guarantee adequate levels of social spending. Efforts are also being coordinated for evaluating the impact of selected programs. The World Bank operation is expected to disburse US\$50 million during 2003, and the same amount in the following two years. There is also

close coordination with the CAF, and regular meetings are held to exchange information on the respective areas of work.

II. THE PROGRAM

A. Objective

- 2.1 The objective of the program is to introduce reforms to consolidate the social protection system for the poorest and to improve the quality and efficiency of social spending. The Bank will thereby contribute to implementation of the new government's social strategy.

B. Description

- 2.2 This operation consists of a package of policies supported by a sector loan that will be disbursed in two equal tranches. Disbursements will be subject to compliance with the policy measures and goals agreed between the Bank and the country. These activities are summarized in the attached policy matrix (see Annex I).
- 2.3 The program consists of the following components: achieving a stable macroeconomic framework; consolidating the social safety net for the poorest segments of the population; and maintaining a minimum level of social spending and improving its efficiency.

1. First component: a stable macroeconomic framework

- 2.4 In order for disbursements to be made, the Government of Ecuador will need to maintain a macroeconomic framework consistent with the program's goals. This means that the fiscal program will have to be consistent with the dual purposes of ensuring macroeconomic stability and sustainable financing for social programs. The first disbursement will require that the SBA with the IMF be progressing satisfactorily. The second disbursement will be dependent upon satisfactory progress with a subsequent IMF agreement, if there is one. If there is no agreement, the IMF will be consulted about the macroeconomic framework.

2. Second component: consolidating the social protection system for the poorest

- 2.5 The objective of this component is to create a targeted social safety net in order to ensure a minimum level of consumption for people living in poverty, and to prevent the deterioration of human capital. This will be achieved through the following actions:

a. Reform of existing cash transfer systems and creation of the Human Development Benefit (BDH).

- 2.6 The BDH will be created on the basis of the *Bono Solidario* and the *Beca Escolar*. The main objective of the BDH is to guarantee a minimum level of consumption for households in the two poorest quintiles of the population (between 1 and 1.1 million people). The BDH beneficiaries will be selected via the SELBEN, in order to reduce "leakage" and to extend coverage among the poorest population.
- 2.7 Some 400,000 households who currently receive the *Bono Solidario* and the *Bono Escolar*, and who belong to these two quintiles (i.e. who are in the SELBEN database), will be included automatically in the BDH. The BDH will be gradually expanded over the next 12 months to cover the entire target population, and new benefits will be added as the *Bono Solidario* and the *Bono Escolar* are dismantled.
- 2.8 Families with children under 15 years of age⁸ will receive the BDH in return for keeping their children in school, as a way of making the transfer more effective in increasing human capital accumulation, consistent with the current enrollment capacity of the education system. The amount of the BDH will be US\$15 per month, per household, for families in the first quintile,⁹ and US\$11.50 for families in the second quintile.¹⁰
- 2.9 For the first tranche, the government will issue a decree creating the BDH and approving its regulations, including: (i) description of the program, including the institutional framework, objectives, goals, beneficiaries and types of subsidy; (ii) the organizational structure of the program (which will be similar to that of the *Bono Solidario*); (iii) the program operating cycle, including criteria for gradual expansion of coverage, ex-ante evaluation of the availability of education services, the registration process, the payment process, verification of eligibility, claims and complaints procedures, promotional efforts, and the monitoring and evaluation system; (iv) the financial flow for the program, including accounting requirements; and (v) rules governing program audit.
- 2.10 At the same time, the government will present, to the Bank's satisfaction, the terms of reference for evaluating the BDH process and its impact, and an action plan for converting the existing transfers into the BDH, defining the actions, goals and timetables for: (i) expanding the SELBEN; (ii) gradual elimination of the *Bono Solidario* and the *Bono Escolar*; and (iii) retargeting within the BDH of eligible beneficiaries under the *Bono Solidario* and the *Bono Escolar*. The targets agreed

⁸ Childless households, elderly couples and disabled people in the first and second quintiles will also be eligible to receive the BDH, without conditions of any kind.

⁹ This amount represents approximately 20% of current family expenditure in the poorest quintile, and 30% of the gap between current consumption and the basic basket.

¹⁰ This represents 15% of current average expenditure by households in the second quintile.

with the government for the first disbursement are: to have the BDH cover at least 450,000 families; to cut back the *Bono Solidario* to fewer than 700,000 beneficiaries; and to expand the SELBEN database by 50,000 families. The process of implementing the BDH¹¹ will also be evaluated and monitored constantly, to allow for the program's impact to be evaluated and adjustments to be made to enhance its effectiveness.

- 2.11 For the second disbursement, the government will ensure that the BDH is the only cash transfer mechanism in the social protection system for the poorest, that it has a coverage of at least one million families, and that the *Bono Solidario* and the *Bono Escolar* have been completely eliminated. As well, the SELBEN will have a database on 2 million families, the BDH will have been submitted to an operational evaluation, and any necessary adjustments to the program will have been made.

b. Enhancing the effectiveness of food and nutrition programs

- 2.12 Food and nutrition programs, such as PANN 2000, the Food Program for Community Development (PRADEC) and the School Meals Program (PAE) will be reorganized with creation of the Integrated Food and Nutrition System (SIAN), to improve their nutritional impact, eliminate overlapping coverage and improve targeting. The resources from those programs will be channeled through the National Fund for the Integrated Food System. The activities of the Fund will be targeted at the country's poorest groups, using the poverty map. The Fund will also finance nutritional education for BDH-eligible households.
- 2.13 For the first disbursement, a presidential decree will be issued, creating the SIAN and the Fund, and specifying: (i) the objective of improving the nutritional status of the groups most vulnerable to malnutrition; (ii) creation of the Fund for the system; (iii) sources of financing for the Fund; (iv) description of the organizational and financial structure of the Fund; and (v) a provision that the resources of the Fund must be targeted at the country's poorest people. As well, Operating Regulations for the Fund must be approved, channeling resources from PRADEC, PANN and PAE into the Fund; targeting criteria will be defined, as well as the poverty map for the allocation of resources; and the operating procedures of the SIAN programs will be organized in light of their objectives and of international experience (reducing top-ups in order to cut costs and induce greater acceptance, etc.).
- 2.14 The Fund must be fully operational by 2004. For the second disbursement, the Fund must be devoting at least 33% of its resources to food and nutrition programs for poor children under five years.

¹¹ The monitoring of BDH implementation will focus on the effectiveness of targeting, the feasibility of the arrangements for paying the benefit, the enrollment capacity of the education system, the supply of health and nutrition services, and other program procedures (incorporation of beneficiaries, verification of eligibility, systems for supervision and auditing, etc.). This monitoring will be financed with technical assistance resources (see paragraph 3.3).

c. Enhancing the effectiveness of programs for children

- 2.15 The child support programs will be reorganized through creation of the Child Development Fund (FODI), through which all child support resources from the Ministry of Social Welfare will be channeled. A unified and transparent resource allocation system will be established, on a competitive basis, and targeting will be improved by use of the poverty map, in order to direct funding to the country's poorest people.
- 2.16 For the first disbursement, FODI will be created by ministerial order, specifying that: (i) all child support resources of the MBS will be channeled through the FODI; (ii) resources will be allocated on a competitive basis; and (iii) Fund support will be targeted at the poorest population. In addition, regulations will be approved, detailing: (i) establishment of the management board and selection criteria for the technical committee; (ii) procedures for providing service; (iii) competitive auction procedures; (iv) the process of accreditation, evaluation and award; and (v) coverage and targeting criteria. For the second tranche, FODI must be fully operational and managing the MBS resources, as well as at least 50% of public funding devoted to children.

d. Introduction of countercyclical mechanisms for additional financing of the social protection system.

- 2.17 In order to make further progress with introducing supplementary and countercyclical financing mechanisms to the social protection system, and on the basis of regulations in Article 17 (2) of the Fiscal Stabilization and Transparency Act (which refers to the Fund for Stabilization, Social and Productive Investment and Public Debt Reduction, FEIREP), an account will be established for additional financing of the social protection system at times of economic recession and/or social crisis.
- 2.18 For the first tranche, the regulations in the law (already implemented by the government) will suffice. For the second tranche, an account will be established within FEIREP, specifically earmarked for the social protection system, and Operating Regulations will be approved for the use of those funds. Those regulations must contain the following elements: (i) definition of events that will trigger use of the funds, and the maximum amount to be used in each such event; (ii) eligible uses of the account's resources, specifying the characteristics of the potential programs and targeting them at the most vulnerable population, consistent with the purposes of the country's social protection system; and (iii) the operational and institutional framework that will govern use of the resources in the account.

3. Third component: ensuring a minimum level of social spending and enhancing its efficiency

- 2.19 This component will guarantee a minimum level of funding for basic social services, introduce measures to enhance the efficiency of resource allocation in the education sector, reform the SECAP and strengthen institutions in the sector. The following specific measures are planned:

a. Minimum level of social spending

- 2.20 To guarantee the minimum level of funding needed to maintain the coverage of basic social services, a budgetary allocations floor will be established for the ministries of education (not including higher education), health and social welfare. That floor will be calculated on the basis of allocations for 2003 plus annual real increments of 3.5%, consistent with a stable macroeconomic framework (Annex IV, Table 1). The government has also undertaken to effectively transfer resources to those ministries in an amount no less than 90% of the annually budgeted amounts.
- 2.21 A minimum floor for budgetary allocations will be established for a group of priority social investment programs aimed at the vulnerable population in the country's poorest areas, with a view to improving the delivery of basic social services in the years 2003, 2004 and 2005. Table 2 of Annex IV lists the programs and their annual amounts. The overall budgetary increase for these programs exceeds 4% per year in real terms, and will be financed through increases and reallocations from within and beyond the social sector. At the same time, the government is committed to effectively transferring at least 80% of the budgeted funds for those programs, during those three budgetary years.
- 2.22 In this way, public spending on the basic social sectors will increase in real terms, and as a proportion of GDP (from 5.4% in 2002 to 5.6% in 2005) and of total public spending (from 22.6% in 2002 to 23.6% in 2005). The share of these priority investment programs within ministry budgets will also increase (from 21% in 2002 to 25% in 2005). In both cases, the floor established for social spending and for priority investment programs will be maintained in real terms in the years following 2005.
- 2.23 The government has also reviewed the portfolio of social investment projects, in order to eliminate those that do not meet the efficiency criteria, or that duplicate activities in other programs, or that do not respond to the country's social policy priorities.

b. Improving the efficiency of education and vocational training

- 2.24 The following measures will be taken to increase the efficiency of spending devoted to education and vocational training.¹²
- 2.25 The MEC will update records on all teaching and administrative positions. Once this is completed, the government will take two steps to make more efficient use of available resources. First, it will ensure that those positions are actually filled by people performing teaching or administrative functions. This will be done for all positions that are considered essential to meeting the school coverage goals. Secondly, savings will be generated for the education sector by deleting positions that are not considered necessary to meeting coverage targets.
- 2.26 The MEC and the MEF will allocate resources for primary education (grades 2 to 7), beginning in 2004, on the basis of the density of the school age population (6 to 12 years), as a function of coverage targets, student vulnerability and/or poverty criteria, and type of educational institution. This allocation of resources will involve two levels. At the first level, resources will be allocated to each local educational district on the basis of a formula, agreed with the Bank, using criteria of: (i) the density of school age population; (ii) coverage targets; and (iii) student vulnerability and/or poverty. At the second level, within each local district, funds will be allocated to individual schools using as criteria: (i) number of students served; (ii) student vulnerability and/or poverty; and (iii) type of educational institution.
- 2.27 Basing allocations on these criteria will make it possible to: (i) relate financial and human resources to the number of students and not to the number of teaching positions, which will provide incentives in the proper direction, especially for those local school districts that do not yet offer universal coverage for primary education; (ii) devote more funds to students with the greatest indices of poverty and/or vulnerability, discriminating positively in favor of those with the greatest initial difficulties; and (iii) direct more funding to those schools (essentially rural and single-teacher schools) that currently suffer the greatest shortages in terms of human and educational resources.
- 2.28 The SECAP will be reformed and modernized, introducing incentives to encourage a closer match between the courses and programs offered by that institution and the vocational training needs of its clients. This process of modernizing the SECAP will involve replacing a portion of its currently earmarked funding by competition-based resources provided from public training funds, and from the direct sale of its courses or programs. In this way, public transfers to the institution in 2004 will not exceed 60% of funding earmarked for 2003. In turn, SECAP will have to compete

¹² The World Bank's social program loan contains activities to improve the efficiency of resource allocation in the health sector, in a manner complementary to the educational efforts discussed here.

with other vocational training institutions for resources that will be pooled in general training program fund. That vocational training fund will be financed in part with savings from the reduction in SECAP's earmarked resources. The resources of this fund will be allocated to various occupational training programs through periodic competitions, based on: (i) the relevance of the program to its target group and the training objectives established for the different competitions (curriculum, methodology); (ii) the capacity of the applicant institution (financial, institutional, pedagogical), and (iii) cost. The fund will be administered by the Ministry of Labor and resource allocation will be monitored against these criteria by a board composed of private and public sector representatives who are independent of the training institutions competing for the resources. These changes will help to replace the current model whereby SECAP is guaranteed a large part of its operating funds, regardless of its effectiveness in satisfying the demands of its target market. These measures will be supplemented by introduction of a quality assurance system, as described below.

- 2.29 A quality assurance system will be established for occupational training institutions. This system will have at least the following components: (i) general policies and rules governing the activity of institutions; (ii) quality criteria or standards that must be met by institutions and programs participating in the system; (iii) mechanisms, both internal (self-evaluation) and external, for verifying that quality criteria are being met; (iv) mechanisms for making quality adjustments indicated by the evaluations and for encouraging the continuing development of institutions and programs; (v) mechanisms to provide public assurance that quality criteria, including improvement plans, are being fulfilled (accreditation); and (vi) an information system that will cover the elements necessary not only for managing the occupational training system, but also for institutional management and public information. This quality assurance system will be empowered to accredit all training institutions, public and private.¹³ Among other issues, the system will need to determine that accreditation is compulsory for institutions that receive public funding.

c. Institutional strengthening of the MEC and the *Frente Social*

- 2.30 Improvement of the MEC's educational statistics and information system. This will involve integrating the various information subsystems within the MEC, and improving the management information available for monitoring local districts, schools, teachers and students, consistent with the new system of allocating resources for primary education.¹⁴ The condition for the first disbursement will be the submission of an action plan for strengthening the MEC's educational management information system, covering at least the following topics:

¹³ There is currently a National Training and Vocational Education Council (CFCN), which has conducted experiments in accrediting some of the programs its finances.

¹⁴ These activities will be financed in part with funds from the *Redes Amigas* Program (Loan 1142-OC/EC).

- (i) activities planned for strengthening the information system (Gantt chart); (ii) the executing unit and the officials responsible within the MEC; (iii) baseline data, and a diagnostic instrument with the principal indicators; (iv) definition of areas needing strengthening within the information system (statistics on coverage, internal efficiency, external efficiency, teachers, financial indicators, schools, local districts, etc.); and (v) information improvement indicators in the selected areas. The condition for the second disbursement will be an external evaluation report on improvements to the system.
- 2.31 Institutional strengthening of the TSFS in terms of technical evaluation and the monitoring of social investment programs. The condition for the first disbursement is a decision by the Council of Ministers of the *Frente Social* giving the STFS responsibility for the following, in addition to its existing functions: (i) the technical evaluation of social investment programs, before their inclusion in the budget; and (ii) monitoring technical and budgetary execution of priority programs. For the second disbursement, the STFS must be conducting pre-budget evaluations of at least 50% of social investment projects.

III. PROGRAM EXECUTION

A. Execution

- 3.1 The executing agency for the program will be the MEF, through the Vice Ministry of Economy (Sub-Secretariat of Public Investment). The Sub-Secretariat will be the coordinator for the program and will have a unit for monitoring program activities. Its functions will include: (i) helping to meet the conditions for the various components of the program; (ii) coordinating program activities and reforms with those responsible in the various ministries and institutions; (iii) coordinating the timely allocation of resources for the social spending protection component, with the MEF; and (iv) coordinating the compilation and provision of information in support of program disbursements.
- 3.2 The MEF monitoring unit will rely on the STFS to perform the following activities: advisory services to ministries in implementing the policy matrix; monitoring progress against program objectives; participating in national dialogue with civil society and nongovernmental organizations; and enlisting the cooperation of technical personnel from the various social ministries to help in the conduct of program activities.
- 3.3 **Technical support.** As part of the program, the borrower will allocate sufficient funds to finance technical assistance in support of reforms under the program. Those activities are detailed in Annex V, and are intended to: (i) support the monitoring unit for the program; (ii) finance monitoring and evaluation work for the sector program; (iii) evaluate the BDH process; (iv) finance the technical evaluation of a group of social investment programs; (v) undertake information, communication and social marketing activities relating to program policies and actions; (vi) support the MEC and the MEF in implementing the new education funding allocation scheme; (vii) support the Ministry of Labor in modernizing the SECAP and in establishing the quality assurance system for vocational training institutions; and (viii) support implementation of the FODI (child support programs). The cost of these technical support activities is US\$950,000.
- 3.4 The loan contract will include a clause in which the borrower undertakes to establish a special account to finance the technical assistance indicated in Annex V. The borrower has presented an operating plan for the Bank's approval, complete with timetables, costs and responsibilities for all the technical assistance activities. The MEF program monitoring unit will be responsible for administration of the special account, but it may delegate responsibility to the STFS for monitoring and for advisory services to the social ministries. The Bank will monitor execution of that operating plan on a quarterly basis. The technical assistance activities enumerated in the previous paragraph will supplement the activities for which the STFS is responsible, and those called for under the World Bank program.

B. Monitoring and evaluation

- 3.5 **Rationale and topics for evaluation.** An ex post evaluation of the program is considered essential in order to document the effects that the reforms introduced in this sector loan will have on the welfare of the poorest population. That evaluation will be designed to answer fundamental questions relating to the social conditions in the policy matrix: (i) whether consolidation of the social protection system has an impact on the welfare of the target population; (ii) whether a more appropriate level of spending on basic social services can increase the coverage and effectiveness of those services, particularly for the target population; and (iii) whether reforms to enhance the efficiency of education and vocational training result in better outcomes in terms of the coverage and quality of education, and the returns on training in the labor market.
- 3.6 **Financing of the ex post evaluation.** The national authorities have undertaken to provide the information necessary for an ex post evaluation of the program. The indicators will be documented, compiled and reported by the Economic and Financial Management System (SIGEF), Social Indicators System of Ecuador (SIISE) and the Quality of Life Surveys (ECV) of the National Statistics Institute (INEC). For purposes of the ex post evaluation, the Bank will pay for a consultant or consulting firm who will be responsible for compiling and interpreting the behavior of the performance indicators and the results of the studies specified in the following paragraph and in Annex IIIA.
- 3.7 **The evaluation framework.** Annex IIIA summarizes the objectives, policy actions, results and impacts expected for each component of the program. The expected results and impacts have specific indicators that will be measured between six months and one year after the last disbursement, and three to five years following that disbursement. The baseline for these indicators is presented in Annex IIIB. It should be noted, however, that in the design of this framework, which is limited to monitoring the indicators over time, it will not be possible to establish any causal link between program activities and the changes recorded in those indicators. To establish such a link in the case of the social protection programs (BDH, food and children), independent impact evaluations will have to be performed. The BDH will be evaluated as part of the World Bank operation, and the child support and food programs will be evaluated with technical assistance resources from this program.

C. Disbursement period

- 3.8 The first disbursement, of US\$100 million, will be made after signature of the loan contract, once the policies and activities in the matrix had been fulfilled. The second disbursement will be made at least 18 months after the loan contract comes into force.

D. Policy Letter

- 3.9 The country and the Bank have agreed on a Policy Letter, which presents the program in the broader context of the government's economic and social strategy (see Annex VI).

E. External audit

- 3.10 The Bank reserves the right to request the borrower to provide financial reports on use of the resources from the loan, audited by independent auditors agreed in advance by the Bank.

F. Inspection and supervision

- 3.11 The Bank will establish inspection procedures as necessary for satisfactory execution of this operation. The borrower will cooperate with the Bank in this regard, providing the necessary assistance and information.

IV. BENEFITS AND RISKS

A. Benefits

- 4.1 The program will help to consolidate a social safety net system that will guarantee a minimum level of consumption for households in the two poorest quintiles of the population. The school attendance and medical checkup conditions attached to the transfers (the Human Development Benefit) will help to enhance beneficiaries' human capital. Other activities included in the social safety net program will help to improve the coordination, efficiency and targeting of those activities, with the consequent resource savings. Budgetary protection for social expenditure will ensure the sustainability of investments and programs that are central to the country's social strategy. The programs that will be protected, moreover, have a great impact on living conditions for the poorest groups, among which there is a high proportion of ethnic minorities.
- 4.2 The reforms to education and occupational training will help to make investments in both areas more efficient and more equitable. The allocation of financial and human resources to basic education, as a function of the level of students' vulnerability and the type of educational establishment, will have a significant impact on the equity of the system and will introduce incentives to improve educational management at the regional level and in the individual schools. Linking resource allocation with coverage will improve incentives to achieve the goal of universal coverage at the primary school level. As well, the measures proposed in the area of occupational training will introduce appropriate incentives for improving the relevance of those programs, and thereby increasing the productivity of the workforce.

B. Risks

- 4.3 **Political sustainability of the proposed measures.** The measures proposed under the program will generate greater efficiency and equity and will improve the well-being of major groups of beneficiaries. For this reason, those measures enjoy wide support within the government. Nevertheless, some groups will see themselves adversely affected by the proposed activities. This may be the case, in particular, with the measures relating to the BDH, the new approach to allocating education resources, or occupational training issues. To mitigate this risk, and to socialize the benefits that the program will produce among the major beneficiary groups, the program will provide technical assistance funding for social marketing efforts designed to: (i) inform the public about the benefits of the program; (ii) foster support for the proposed measures on the part of their principal beneficiaries; and (iii) work with those groups that may feel themselves disadvantaged by the program. As well, when it comes to converting the existing transfers (the *Bono Solidario* and the *Bono Escolar*) into the BDH, this has been planned to take place

over a twelve-month period during which households that are now receiving benefits, but that will not be eligible under the new allowance, will be gradually excluded.

- 4.4 **Execution and coordination of the proposed measures.** Several of the proposed measures, especially those relating to transformation of the *Bono Solidario* and the *Bono Escolar* into the BDH, as well as those for monitoring the program, pose challenges of execution and coordination in light of the current capacities of the executing agencies and institutions. In order to ensure efficient implementation and monitoring of the proposed policy measures, technical assistance will be provided to support the design and implementation of measures needed to ensure that program objectives are reached.
- 4.5 **Fiscal sustainability of the social expenditure goals.** The government recognizes the need to consolidate the process that was undertaken in 2001 to restore social spending. To this end, the government has committed itself to increasing the basic social services budget by at least 3.5% per year in real terms, over the period 2003-2005. There is a very low risk that those increases will not be achieved. Assuming compliance with the IMF program, the share of social spending within total spending would have to rise only slightly, from 22.6% in 2002 to 23.6% in 2005. Under a different macroeconomic scenario, with slower growth and lower oil prices, maintaining the social spending levels proposed would imply a slightly greater but still moderate effort: social spending would have to rise to 26% of total government spending in 2005.¹⁵
- 4.6 **The high level of public debt.** Although the level of public debt has declined, it is still high (57% of GDP) and represents a considerable fiscal burden (27%). This operation, however, is indispensable in the context of the SBA agreement, because Ecuador has no access to free capital markets, and it must be seen in the context of measures designed to maintain fiscal sustainability and reduce the public debt. Chief among those measures is the fiscal transparency law, which limits the growth in primary real public spending 3.5%, and establishes the target of reducing the public debt to 37% of GDP by 2006.¹⁶

C. Environmental and social strategy

- 4.7 The social impact of this program will be significant. In the first place, by creating a formal system of social protection for the poorest, improving the quality, transparency and targeting of program benefits, and rationalizing the programs that make up the social safety net and making them more efficient, conditions will be created for responding more effectively to structural poverty and to the welfare impact of successive economic crises. As well, these actions imply a more effective

¹⁵ See "Impact of this operation on Ecuador's fiscal sustainability", available on the program files.

¹⁶ See "Impact of this operation on Ecuador's fiscal sustainability", available on the program files.

relationship with vulnerable and excluded groups. Secondly, efforts to improve social spending and increase its efficiency will benefit all users, but they will be particularly helpful, because of their progressive nature, to the two poorest quintiles, which contain a high proportion of ethnic minorities. Many program activities will also have a direct benefit on poor women: the BDH represents a direct transfer to mothers, and the child care programs will help women to enter the labor force. These effects will be measured in the course of the impact evaluation described above.

- 4.8 Given the nature of the operation, which involves reforming social protection systems, improving the quality and efficiency of social expenditure, protecting the budget for priority social programs, strengthening social agencies institutionally, and modernizing the occupational training system, the proposed program will have no direct environmental impacts. This program also qualifies as a social-equity enhancing project, because it is designed to promote reforms that will benefit the poorest segments of the population. Annexes III A and B specify explicit performance indicators for measuring poverty reduction and promoting social equity.

SOCIAL SECTOR REFORM PROGRAM (EC-0216)

Policy Matrix

Component	First Tranche	Second Tranche
I. Macroeconomic framework		
A macroeconomic framework that is consistent with program objectives	Agreement with the IMF and satisfactory progress in implementing it.	Agreement with the IMF and satisfactory progress in implementing it. ¹
II. Consolidation of the social protection system for the poorest		
a. Human Development Benefit (<i>Bono de Desarrollo Humano</i>, BDH)		
<p><i>Objective:</i></p> <ul style="list-style-type: none"> ➤ To reform existing cash transfers (<i>Bono Solidario</i> and <i>Beca Escolar</i>) by creating the BDH. 	<ul style="list-style-type: none"> ➤ Decree creating the BDH and its Operating Regulations. ➤ BDH has at least 450,000 beneficiary families and an action plan approved for converting the <i>Bono Solidario</i> and <i>Beca Escolar</i> to the BDH and expanding the SELBEN. 	<ul style="list-style-type: none"> ➤ BDH has at least one million beneficiary families, and is the only cash transfer mechanism of the Social Protection System. ➤ SELBEN has a database with 2 million families. ➤ Operational evaluation of the BDH completed and an action plan in place to adapt it accordingly.
b. Food and nutrition programs		
<p><i>Objective:</i></p> <ul style="list-style-type: none"> ➤ To enhance the effectiveness of food and nutrition programs. 	<ul style="list-style-type: none"> ➤ Decree creating the Integrated Food and Nutrition System (SIAN) and the National Fund for the SIAN and its operating regulation. 	<ul style="list-style-type: none"> ➤ The National Fund for the Integrated Food and Nutrition System is operating and more than 33 percent of its resources is devoted to children under five years, by 2004.
c. Child support programs		
<p><i>Objective:</i></p> <ul style="list-style-type: none"> ➤ To enhance the effectiveness of child support programs. 	<ul style="list-style-type: none"> ➤ Ministerial order creating the Childhood Development Fund (FODI) and its Operating Regulations approved. 	<ul style="list-style-type: none"> ➤ FODI manages at least 50 percent of public funding for children.

¹ If there is no formal program with the IMF, the IMF will be consulted on the macroeconomic framework to ensure its consistency with program objectives.

Component	First Tranche	Second Tranche
d. Additional funds for social protection		
<p><i>Objective:</i></p> <ul style="list-style-type: none"> ➤ <i>To ensure countercyclical financing for the Social Protection System.</i> 	<ul style="list-style-type: none"> ➤ The general regulations to the Fiscal Responsibility and Transparency Act. 	<ul style="list-style-type: none"> ➤ Account for financing of extended activities under the social protection system in times of economic recession and/or natural disaster is functioning, using resources provided under article 17 (2) of the Fiscal Responsibility and Transparency Act.
III. Social spending at a higher level and more efficient		
a. Level of social spending		
<p><i>Objective:</i></p> <ul style="list-style-type: none"> ➤ <i>To achieve minimum expenditure levels on basic social services (education, health and social welfare) in 2003, 2004 and 2005, and in a group of selected social investment programs.</i> 	<ul style="list-style-type: none"> ➤ Minimum level of resources allocated to social sectors in 2003, according to Table 1 of Annex IV. ➤ Minimum level of resources allocated to social sectors in the pro-forma budget for 2004, according to Table 1 of Annex IV. ➤ Minimum level of resources allocated to selected social investment programs for 2003 and 2004, according to Table 2 of Annex IV. 	<ul style="list-style-type: none"> ➤ Budgetary transfers to social sectors in 2003 and 2004 no less than 90 percent of amounts shown in Table 1, Annex IV. ➤ Budget approved for social sectors for 2005 based on figures in Table 1, Annex IV. Assuming delays in program execution in subsequent years, budgetary allocations in 2005 for social sectors will need to be maintained in real terms, and transfers will need to be at least 90 percent of 2005 allocations. ➤ Budgetary transfers to selected social investment programs in 2003 and 2004 at least 80 percent of the amounts shown in Table 2, Annex IV. ➤ Budget approved for selected social investment programs for 2005, according to the amounts shown in Table 2 of Annex IV. Assuming delays in program execution, in subsequent years, both budgetary allocations for 2005 for selected social investment programs will need to be maintained in real terms and

Component	First Tranche	Second Tranche
		transfers will need to be at least 80 percent of 2005 allocations.
b. Efficient allocation of resources in education and vocational training		
<p><i>Objective:</i></p> <ul style="list-style-type: none"> ➤ <i>To improve efficiency in the use of education and vocational training resources</i> 	<ul style="list-style-type: none"> ➤ Plan for updating teaching and administrative positions for all provinces, and those positions actually updated in at least two provinces. ➤ Agreement of the Ministries of Economy and Finance and of Education on funding for primary education (grades 2 to 7) based on: density of school-age population (6 to 12 years), as a function of coverage goals, student vulnerability/poverty criteria, and type of establishment. ➤ SECAP decision to reform and modernize the institution, including: (i) gradual reduction of funds currently earmarked for the institution, and (ii) the creation of a competitive fund for vocational training and professional development. ➤ Decree creating a quality assurance system for vocational training institutions. 	<ul style="list-style-type: none"> ➤ 90 percent of teaching and administrative positions in all provinces actually updated. ➤ Resources in the budget for 2004 and subsequent years allocated to primary education (grades 2 to 7) on the basis of: density of school-age population (6 to 12 years), as a function of coverage goals, student vulnerability/poverty criteria, and type of establishment. ➤ Direct public transfers to SECAP in 2004 and subsequent years do not exceed 60 percent of funds earmarked in 2003. ➤ Competitive fund in operation for vocational training and professional development, financed in part by the reduction of earmarked funding for SECAP. ➤ Quality assurance system for vocational training institutions in operation for at least 3 accredited institutions, and 10 self-evaluated institutions.
c. Institutional strengthening in the sector		
<p><i>Objective:</i></p> <ul style="list-style-type: none"> ➤ <i>Support institutional strengthening of the Frente Social and the Ministry of Education</i> 	<ul style="list-style-type: none"> ➤ Resolution of the Council of Ministries of the Frente Social to strengthen the role of the Secretaria Técnica del Frente Social (STFS) in planning for the social sector. ➤ Action plan for strengthening the Integrated Information System for education management in the MEC. 	<ul style="list-style-type: none"> ➤ STFS is evaluating investment projects submitted by the social ministries before they are approved by the MEF. ➤ Integrated information system for management of the MEC in operation.

SOCIAL SECTOR REFORM PROGRAM (EC-0216)

Means of Verification

COMPONENT / CONDITION	MEANS OF VERIFICATION	RESPONSIBLE AGENCY
FIRST DISBURSEMENT		
I. MACROECONOMIC FRAMEWORK		
➤ Agreement with the IMF and satisfactory progress in implementing it.	➤ Successful completion of the first review of the IMF agreement.	➤ MEF (Ministry of Economy and Finance)
II. CONSOLIDATION OF THE SOCIAL PROTECTION SYSTEM FOR THE POOREST		
a. Human Development Benefit (Bono de Desarrollo Humano, BDH)		
➤ Decree creating the BDH Operating Regulations. ➤ BDH has at least 450,000 beneficiary families and an action plan approved for converting the Bono Solidario and Beca Escolar to the BDH and expanding the SELBEN.	➤ Decree approved by the President of the Republic creating the BDH and abolishing the Bono Solidario and the Beca Escolar, specifying use of SELBEN for targeting the benefits of the BDH. ➤ Operating regulations of the BDH approved by the MBS. ➤ Terms of reference for evaluating the process and the impact of the BDH, for contracting an independent entity. ➤ MBS report certifying the number of families receiving and no longer receiving the BDH, the Bono Solidario and the Beca Escolar. ➤ Action plan signed by the Minister of Social Welfare establishing the timetable for gradual extension of the BDH, gradual elimination of the Bono Solidario and the Beca Escolar and expansion of the SELBEN.	➤ MEF, MBS (Ministry of Social Welfare), Presidencia (Office of the President) ➤ MEF, MBS ➤ MBS ➤ MBS ➤ MBS
b. Food and nutrition programs		
➤ Decree creating the Integrated Food and Nutrition System (SIAN).	➤ Decree approved by the President of the Republic creating the SIAN. ➤ Operating regulations approved for the SIAN Fund.	➤ MEF, MBS, Presidencia ➤ MBS

COMPONENT / CONDITION	MEANS OF VERIFICATION	RESPONSIBLE AGENCY
c. Child support program		
➤ Ministerial order creating the Childhood Development Fund (FODI) and its Operating Regulations approved.	➤ Ministerial order creating the FODI. ➤ Operating regulations approved for the FODI.	➤ MBS ➤ MBS
d. Additional funds for social protection		
➤ The general regulations to the Fiscal Responsibility and Transparency Act.	➤ Regulations approved for the Fiscal Responsibility and Transparency Act.	➤ MEF
III. SOCIAL SPENDING AT A HIGHER LEVEL AND MORE EFFICIENT		
a. Level of social spending		
➤ Minimum level of resources allocated to social sectors in 2003, according to Table 1 of Annex IV. ➤ Minimum level of resources allocated to social sectors in the pro-forma budget for 2004, according to Table 1 of Annex IV. ➤ Minimum level of resources allocated to selected social investment programs for 2003 and 2004, according to Table 2 of Annex IV.	➤ National budget law for 2003. ➤ The government's commitment, expressed in an official letter from the Minister of Economy and Finance to the Bank, to the effect that the allocations in the 2004 budget for the ministries of education, health and social welfare will be consistent with the figures in Table 1 of Annex IV. ➤ National budget law for 2003 (sections describing allocations to selected investment programs, according to figures in Table 2 of Annex IV). ➤ The government's commitment, expressed in an official letter from the Minister of Economy and Finance to the Bank, to the effect that the allocations in the 2004 budget for selected investment programs will be consistent with the figures in Table 2 of Annex IV.	➤ MEF ➤ MEF ➤ MEF ➤ MEF
b. More efficient use of resources in education and vocational training		
➤ Plan for updating teaching and administrative positions for all provinces, and those positions actually updated in at least two provinces.	➤ Updating plan containing, as a minimum, the following topics: (i) identification of the two provinces that will be considered; (ii) activities plan for conducting the update (Gantt chart) for the entire country; (iii) executing unit and responsible officials within the MEC; (iv) teaching and civil service positions not effectively filled by professors, teachers, or civil servants in the two provinces selected; and (v) report on financial impact of point (iv) above.	➤ MEF, MEC

COMPONENT / CONDITION	MEANS OF VERIFICATION	RESPONSIBLE AGENCY
<ul style="list-style-type: none"> ➤ Agreement of the Ministries of Economy and Finance and of Education on funding for primary education (grades 2 to 7) based on: density of school-age population (6 to 12 years), as a function of coverage goals, student vulnerability/poverty criteria, and type of establishment. ➤ Agreement on SECAP to reform and modernize the institution, including: (i) gradual reduction of funds currently earmarked for the institution, and (ii) the creation of a competitive fund for vocational training and professional development ➤ Creation of a quality assurance system for vocational training institutions. 	<ul style="list-style-type: none"> ➤ Interministerial agreement (MEF and MEC) on resource allocation, using a formula agreed with the Bank, based on: density of school-age population (6 to 12 years), as a function of coverage goals, student vulnerability/poverty criteria, and type of establishment ➤ Resolution of the SECAP Board on reform and modernization of SECAP. ➤ Decree creating a quality assurance system. 	<ul style="list-style-type: none"> ➤ MEF, MEC ➤ MEF, MT (Ministry of Labor) ➤ MEF, MT, Presidencia
c. Institutional strengthening in the sector		
<ul style="list-style-type: none"> ➤ Resolution of the Council of Ministries of the Frente Social to strengthen the role of the Secretaría Técnica del Frente Social (STFS) in planning for the social sector. ➤ Action plan for strengthening the Integrated Information System for education management in the MEC. 	<ul style="list-style-type: none"> ➤ Resolution of the Council of Ministries of the Frente Social on new functions for the STFS. ➤ Agreement of the Minister of Social Welfare (as chair of the FS) on new functions for the STFS. ➤ Action plan for strengthening the education management information systems of the MEC. 	<ul style="list-style-type: none"> ➤ MEF, MBS, Presidencia ➤ MBS ➤ MEC
SECOND DISBURSEMENT		
I. MACROECONOMIC FRAMEWORK		
<ul style="list-style-type: none"> ➤ Agreement with the IMF and satisfactory progress in implementing it. 	<ul style="list-style-type: none"> ➤ Satisfactory progress with the IMF agreement, or; ➤ If there is no formal program with the IMF, consultation with that institution on the macroeconomic framework to ensure its consistency with program objectives. 	<ul style="list-style-type: none"> ➤ MEF

COMPONENT / CONDITION	MEANS OF VERIFICATION	RESPONSIBLE AGENCY
II. CONSOLIDATION OF THE SOCIAL PROTECTION SYSTEM FOR THE POOREST		
a. Human Development Benefit (Bono de Desarrollo Humano, BDH)		
➤ BDH has at least one million beneficiary families, and is the only cash transfer mechanism of the Social Protection System.	➤ Preliminary impact evaluation report on the BDH demonstrating coverage of at least one million families in SELBEN 1 and 2 (or the two lowest-income quintiles).	➤ MEF, MBS
➤ SELBEN has a database with 2 million families.	➤ STFS report showing that the SELBEN database contains socioeconomic data on at least 2 million families.	➤ MEF, MBS
➤ Operational evaluation of the BDH completed and an action plan in place to adapt it accordingly.	➤ Final process evaluation report on the BDH and an action plan for adjusting the program on the basis of those findings.	➤ MEF, MBS
b. Food and nutrition programs		
➤ The National Fund for the SIAN is operating and more than 33% of its resources is devoted to children under five years, by 2004.	➤ STFS report on actions taken pursuant to the decree and evidence that at least 33% of allocations for 2004 and subsequent years is devoted to children under five years of age in the poorest cantons, according to the poverty map.	➤ MBS
c. Child support programs		
➤ FODI manages at least 50% of public funding for children.	➤ Presidential decree expanding the scope of action of the FODI so that it can channel public funding to children. ➤ Evidence that the pro forma budgets for 2004 and subsequent years are channeling at least 50% of child-targeted public funds through FODI.	➤ MBS ➤ MBS, MEF
d. Additional funds for social protection		
➤ Account for financing extended activities under the social protection system in times of economic recession and/or natural disaster is functioning, using resources provided under article 17 (2) of the Fiscal Responsibility and Transparency Act.	➤ Evidence that the account has been established and that Operating Regulations governing use of the fund in the account have been approved.	➤ MEF

COMPONENT / CONDITION	MEANS OF VERIFICATION	RESPONSIBLE AGENCY
III. SOCIAL SPENDING AT A HIGHER LEVEL AND MORE EFFICIENT		
a. Level of social spending		
<ul style="list-style-type: none"> ➤ Budgetary transfers to social sectors in 2003 and 2004 no less than 90% of amounts shown in Table 1, Annex IV. ➤ Budget approved for social sectors for 2005 based on figures in Table 1, Annex IV. Assuming delays in program execution in subsequent years, budgetary allocations in 2005 for social sectors will need to be maintained in real terms, and transfers will need to be at least 90% of 2005 allocations. ➤ Budgetary transfers to selected social investment programs in 2003 and 2004 at least 80% of Table 2, Annex IV. ➤ Budget approved for selected social investment programs for 2005, according to the amounts in Table 2 of Annex IV. Assuming delays in program execution, for subsequent years budgetary allocations from 2005 must be maintained, in real terms, for social investment programs, and transfers must be at least 80% of 2005 allocations. 	<ul style="list-style-type: none"> ➤ Evidence that transfers by the MEF to the ministries of education, health and social welfare in 2003 and 2004 are no less than 90% of the figures shown in Table 1 of Annex IV, according to information from the SIGEF. ➤ Letter from Ministry of Economy and Finance to the Bank, outlining budgetary allocations for 2005 for Ministries of Education, Health, and Social Welfare that are not less than the figures in Table 1 of Annex IV. Assuming delays in program execution, in subsequent years levels, and verified using official budgets or SIGEF, budgetary allocations for 2005 for Ministries of Education, Health, and Social Welfare must be maintained in real terms and transfers must be at least 90% of 2005 allocation. ➤ Evidence that MEF has transferred at least 80% of amounts shown in Table 2 of Annex IV to selected investment programs in 2003 and 2004, according to SIGEF data. ➤ Letter from Minister of Economy and Finance to the Bank, outlining budgetary allocations for 2005 for selected social investment programs that are not less than the figures in Table 2, Annex IV. Assuming delays in program execution, for subsequent years, budgetary allocations for 2005 for selected social investment programs must be maintained in real terms, and verified using official budgets or SIGEF, and transfers must be at least 80% of 2005 allocation. 	<ul style="list-style-type: none"> ➤ MEF ➤ MEF ➤ MEF ➤ MEF
b. More efficient use of resources in education and vocational training		
<ul style="list-style-type: none"> ➤ 90% of teaching and administrative positions in all provinces actually updated. 	<ul style="list-style-type: none"> ➤ Report validated by the MEF on: (i) updating of 90% of teaching and administrative positions in public education in the country as a whole; and (ii) the number of teaching and administrative positions filled; and (iii) possible savings generated by teaching and administrative positions unfilled. 	<ul style="list-style-type: none"> ➤ MEF, MEC

COMPONENT / CONDITION	MEANS OF VERIFICATION	RESPONSIBLE AGENCY
<ul style="list-style-type: none"> ➤ Resources in the budget for 2004 and subsequent years allocated to primary education (grades 2 to 7) on the basis of: density of school-age population (6 to 12 years), as a function of coverage goals, student vulnerability/poverty criteria, and type of establishment. ➤ Direct public transfers to SECAP in 2004 and subsequent years do not exceed 60% of funds earmarked in 2003. ➤ Competitive fund in operation for vocational training and professional development, financed in part by the reduction of earmarked funding for SECAP. ➤ Quality assurance system for vocational training institutions in operation for at least 3 accredited institutions, and 10 self-evaluated institutions. 	<ul style="list-style-type: none"> ➤ Budget for 2004 and subsequent years with education funding allocated by formula. ➤ Decree specifying the public funding transferred directly to SECAP for 2004 and following years. ➤ Decree creating a fund for vocational training programs, financed in part with savings from staff reductions in public enterprises. ➤ 3 vocational training institutions accredited. ➤ 10 training institutions that have completed their self-evaluation process. 	<ul style="list-style-type: none"> ➤ MEF, MEC ➤ MEF, MT ➤ MEF, MT ➤ MT ➤ MT
c. Support for institutional strengthening in the “Social Front” and the Ministry of Education		
<ul style="list-style-type: none"> ➤ STFS is evaluating investment projects submitted by the social ministries before they are approved by the MEF. ➤ Integrated information system for management of the MEC in operation. 	<ul style="list-style-type: none"> ➤ Report from the MBS and MEF certifying that the STFS is evaluating at least 50% of social investment projects prior to inclusion in the budget. ➤ External evaluation report on improvements to the information system, consistent with the indicators defined in the plan of operations. 	<ul style="list-style-type: none"> ➤ MEF, MBS ➤ MEC

SOCIAL SECTOR REFORM PROGRAM (EC-0216)

Sector Results Indicators

Areas of Action		Proposed Measures		Results Indicators	
Problem	Cause	Objective	Policy Actions (at end of program) “Output”	Short Term (6 months to 1 year after) “Outcome”	Medium Term (3-5 years after) Impact
Consolidation of the social protection system for the poorest					
Lack of social protection mechanisms for the poorest population, resulting in low levels of consumption that do not allow for adequate investment in human capital.	Non-use of targeting mechanisms, lack of articulation among programs, ineffective programming methods	Reform existing cash transfers (<i>Bono Solidario</i> and <i>Bono Solidario</i>) by creating the <i>Bono de Desarrollo Humano</i> (BDH).	BDH has at least one million beneficiary families; SELBEN has a database on 2 million families; operational evaluation of BDH completed and action plan for adjustment based on those findings.	Outcome: increased consumption by the poorest families and greater use of education and health services. Indicators: (a) average consumption by households in the first and second quintiles; (b) school attendance rate for children 6-14 years in the first and second quintiles; (c) utilization rate of health services by households in the first and second quintiles; (d) efficiency in the targeting of the BDH (standard error I and II).	Impact: poverty reduced and human capital increased for the poorest families. Indicators: (a) % poor and extremely poor population according to the consumption-based poverty line; (b) average years of schooling completed by children 6-14 in the first and second quintiles; (c) global malnutrition rate among children 0-6 in the first and second quintiles; (d) infant mortality rate.
		Enhance the effectiveness of food and nutrition programs.	National Fund for the Integrated Food and Nutrition System (SIAN) in operation with the bulk of allocations for 2004 targeted at children under five years	Impact: increase in food consumption for the poorest families. Indicators: (a) average consumption by households in the first and second quintiles; (b) efficiency in the targeting of the SIAN (standard error I and II).	Impact: less malnutrition among the poorest groups. Indicator: (a) the global malnutrition rate among children under 5 years.
		Enhance the effectiveness of child support programs.	Childhood Development Fund (FODI) managing 50% of child-targeted public funds.	Outcome: increase in the proportion of poor children receiving child support. Indicators: (a) the number of poor children between 3 and 5 years benefiting from government-financed child support services; (b) proportion of poor children benefiting from child support services.	Impact: higher levels of schooling for the poorest children and greater labor force participation by women Indicators: (a) impact on learning tests by income quintile; (b) rate of female participation in the labor force.

Areas of Action		Proposed Measures		Results Indicators	
Problem	Cause	Objective	Policy Actions (at end of program) “Output”	Short Term (6 months to 1 year after) “Outcome”	Medium Term (3-5 years after) Impact
		Ensure countercyclical financing for the Social Protection System.	A special account in place for financing extension of the social protection system at times of economic or social crisis	Outcome: special fund constituted and functioning with transparent rules. Indicators: (a) the amount of resources saved; (b) resources used only during economic or social crises.	Impact: consumption levels among the poorest do not fall catastrophically at times of economic or social crisis Indicators: (a) average consumption of households in the first and second quintiles.
Level of social spending					
Social expenditure is extremely low, limiting the potential extension of basic services to the poorest population.	Low political priority	Achieve adequate and timely levels of expenditure on basic social services and a group of priority programs for selected social investment.	See Tables 1 and 2	Outcome: maintenance of an adequate and macroeconomically sustainable level of expenditure on basic social services. Indicators: (a) social spending (excluding social security) as % of GDP; (b) social spending (excluding social security) as % of central government expenditure; (c) per capita social spending (excluding social security); (d) spending on education as % of GDP; (e) spending on health as % of GDP; (f) spending on social welfare as % of GDP.	Impact: increase in the level and efficiency of basic social services. Indicators: (a) school enrollment rate; (b) infant mortality rate; (c) global malnutrition rate
Efficient allocation of education and vocational training funds					
Financial, human and teaching resources are unevenly allocated to primary schools.	Funds are allocated on the basis of the number of teaching positions.	Enhance efficiency and equity in the allocation of funding to primary schools.	Allocate primary education funding according to a formula based on: density of school-age population, as a function of coverage goals, student poverty/vulnerability, and type of institution	Outcome: greater equity in public spending on primary education. Indicators: (a) public spending per student for each income quintile (b) public expenditure per type of school. (c) number of students per teacher for each income quintile. (d) number of students per teacher for each type of school; (e) coverage for each income quintile.	Impact: improved learning levels among the lowest-income students Indicators: (a) impact on learning tests by income quintile; (b) impact on learning tests by type of school.

Areas of Action		Proposed Measures		Results Indicators	
Problem	Cause	Objective	Policy Actions (at end of program) “Output”	Short Term (6 months to 1 year after) “Outcome”	Medium Term (3-5 years after) Impact
Update teaching and administrative resources.	No monitoring or supervision to ensure that teachers are performing their functions.	Allocate resources efficiently	Better utilization of teaching and administrative staff and resources.	Outcome: greater numbers of active teachers and administrators Indicators: (a) number of active teachers per student; (b) number of active administrators per student; (c) savings achieved by leaving positions unfilled.	Impact: greater efficiency in the use of education resources. Indicators: (a) number of active teachers per student; (b) number of active administrators per student.
The poor quality of vocational training offered.	There is no quality assurance system.	Improve the quality of vocational training	Accreditation system for vocational training institutions.	Outcome: information on the quality of vocational training institutions. Indicators: (a) number of institutions accredited; (b) number of programs accredited; (c) ranking of institutions and programs as evaluated by the accreditation system; (d) number of institutions that have completed their self-evaluation process.	Impact: improved quality of vocational training. Indicators: (a) skills level of trainees; (b) occupational attitudes; (c) productivity level; (d) occupation level; (e) salary level
SECAP is out of touch with the needs of the business sector and the target population.	There are no incentives for the institution to relate more effectively to its market.	Generate incentives for the institution to improve its efficiency and relevance	Modernization and reform of the SECAP.	Outcome: improved levels of efficiency and relevance for the SECAP. Indicators: (a) % of funds obtained through sales or competition (b) % of public funds transferred to the institution.	Impact: SECAP positions itself as the leading institution among those providing vocational training. Indicators: (a) productivity level of trainees; (b) occupation level; (c) salary level; (d) number of centers and programs accredited.
Institutional strengthening of the sector					
Weak capacity to coordinate, articulate and direct social policy, resulting in inefficiencies.	Little control over budgeting and expenditure in the sector, little technical capacity to	Support institutional strengthening for the Frente Social and the Ministry of Education.	STFS evaluates investment projects submitted by social ministries before they are approved by the MEF; integrated management information systems for the MEC in operation.	Outcome: better priority setting for social investments. Indicators: greater % of investment funds for programs targeted at the poorest.	Impact: better priority setting for social investments. Indicators: greater % of investment funds for programs targeted at the poorest

Areas of Action		Proposed Measures		Results Indicators	
Problem	Cause	Objective	Policy Actions (at end of program) “Output”	Short Term (6 months to 1 year after) “Outcome”	Medium Term (3-5 years after) Impact
	evaluate and monitor social policy.				

SOCIAL SECTOR POLICY REFORM (EC-0216)
Program performance indicators: baseline values and source

Condition/Indicator	Base line (circa 2000)	Source
POVERTY:		
% Poor population (by poverty line, consumption)	55.90	ECV 1999
% Extremely poor population, by consumption	20.50	ECV 1999
BDH:		
BDH beneficiaries (individuals)	-	"Bono de Desarrollo Humano" National Program
Average household consumption, first quintile	92,527.59	ECV 1999 (sucres)
Average household consumption, second quintile	165,820.10	ECV 1999 (sucres)
School attendance rate, children 6-14 years		
broken down by:		
Total	89.37	ECV 1999
Rural	82.62	ECV 1999
Urban	94.73	ECV 1999
Girls	89.55	ECV 1999
Boys	89.21	ECV 1999
Income quintiles		
20% poorest	83.70	ECV 1999
Second quintile	86.95	ECV 1999
Third quintile	90.36	ECV 1999
Fourth quintile	93.45	ECV 1999
20% richest	95.54	ECV 1999
NUTRITION:		
Global malnutrition rate, children 0 to 5 years		
Broken down by:		
Total	13.54	ECV 1999
Rural	17.38	ECV 1999
Urban	10.20	ECV 1999
Girls	14.93	ECV 1999
Boys	12.22	ECV 1999
Income Quintiles:		
20% poorest	21.24	ECV 1999
Second quintile	12.74	ECV 1999
Third quintile	13.02	ECV 1999
Fourth quintile	10.62	ECV 1999
20% richest	4.29	ECV 1999
Child support		
No. of children 3- 5 years benefiting from government-financed child support services	17,000.00	EMEDINHO 2000
% of children with child support services	3.90	EMEDINHO 2000
SOCIAL SPENDING:		
Social spending (exl. social security) as % of GDP	5.10	Social spending module (2001)
Social spending (exl. social security) as % of central government spending	21.76	Social spending module (2001)
Social spending (exl. social security) per capita	88.26	Social spending module (2001)
Education spending as % of GDP	2.16	Social spending module (2001)
Health spending as % of GDP	0.66	Social spending module (2001)
Welfare spending as % of GDP	1.45	Social spending module (2001)

Condition/Indicator	Base line (circa 2000)	Source
EDUCATION:		
No. of students in primary education:		
Total	1,925,420.00	SINEC (99-00)
Rural	796,923.00	SINEC (99-00)
Urban	1,128,497.00	SINEC (99-00)
Student/teacher ratio:		
Total	23.25	SINEC (99-00)
Rural	23.12	SINEC (99-00)
Urban	23.34	SINEC (99-00)
No. of students per administrative worker:		
Total	741.00	SINEC (99-00)
Rural	1,853.00	SINEC (99-00)
Urban	521.00	SINEC (99-00)
Primary education spending by quintile		
20% poorest	35%	ECV 1999
Second quintile	26%	ECV 1999
Third quintile	20%	ECV 1999
Fourth quintile	13%	ECV 1999
20% richest	6%	ECV 1999
% of public education spending dedicated to investment	20%	Social spending module (2001)
VOCATIONAL TRAINING:		
No. of training institutions accredited	-	
No. of training programs accredited	-	
No. of students in vocational training programs	-	
% of training resources allocated on a competitive basis	-	
Institutional strengthening		
% of social investment programs pre-evaluated by the STFS	-	

Table 1
Minimum expenditure in basic social sectors
(Budget, in millions of current US dollars)

Ministry	2003	2004	2005
Education (1)	782	849	923
Health	347	377	410
Social Welfare	373	406	441
Total	1,502	1,632	1,774

(1) Does not include higher education.

Table 2
Priority Programs to be Protected
(Budget, in millions of current US dollars)

	2003	2004	2005
Health	42.2	46.1	50.3
Expanded immunization plan	10.4	11.4	12.4
Control and surveillance of contagious diseases	8.0	8.7	9.5
Maternal-child care	20.0	21.8	23.8
Micronutrients program	0.8	0.9	1.0
Generic drugs	2.5	2.7	3.0
Basic social insurance	0.5	0.5	0.6
Social Protection:	291.8	319.2	350.5
Human Development Benefit (<i>Bono de Desarrollo Humano</i>)	203.0	221.7	242.1
Childhood development programs	35.7	39.0	42.6
ORI	23.7		
<i>Nuestros Niños</i>	12.0	12.0	
FODI		27.0	42.6
Food and nutrition programs	43.1	47.1	51.4
PANN	4.3		
PAE	28.8		
PRADEC/NAM/DIS	8.5		
PAD	1.5		
SIAN Fund		47.1	51.4
Rural social insurance	10.0	10.9	11.9
SELBEN		0.5	2.5
Education:	27.0	29.5	32.2
<i>Redes Amigas</i> program	13.0	10.0	
Basic education improvement programs (2)	14.0	19.5	32.2
Social infrastructure:	5.0	10.0	10.9
FISE	5.0	10.0	10.9
Total	366.0	404.8	444

SOCIAL SECTOR REFORM PROGRAM (EC-0216)

Technical Assistance Activities

Title of consulting study	Planned activities	Approximate cost
(A) EC-0216 Program Monitoring Unit	Finance the contracting of a group of professionals to help the MEF unit responsible for the program with respect to monitoring and coordinating policy activities for the program and reporting regularly to the national authorities and to the Bank on compliance with the quarterly program.	US\$80,000
(B) EC-0216 Program monitoring and evaluation	Finance additional activities as needed for monitoring the indicators identified in the "program performance indicators", as well as for preparing an ex post evaluation consistent with Bank requirements.	US\$80,000
(C) Evaluation of the BDH ¹ process	Finance an evaluation of BDH procedures, including: (i) analyzing the degree of targeting of the BDH benefits; (ii) quantitative and qualitative analysis of at least the major bottlenecks in the subprogram, i.e. the banking and trust scheme, information systems, information flows, payments, transparency, response to complaints, news updating, problems in the supply of health and education services; and (iii) level of understanding among stakeholders in the BDH about their duties and rights and their perceptions of the program ² .	US\$100,000 ³
(D) Technical evaluation of social investment programs	Finance evaluation of a group of investment programs submitted by the ministries of education, health and social welfare for funding during 2004 and 2005.	US\$80,000
(E) Social marketing of program reforms	Finance activities relating to information, education and communication on the program among potential beneficiaries.	US\$150,000
(F) Technical assistance to amend the educational resource allocation scheme.	Finance technical assistance for the MEC and the MEF in allocating resources on the basis of a formula. This activity will be based on: (i) definition of coverage targets by territorial unit; (ii) proposal to make teachers operational as necessary; (iii) monitoring coverage targets for territorial units with shortfalls (grades 2 to 7); (iv) design and implementation of a school attendance monitoring and verification system for grades 2 to 7 in territorial units.	US\$200,000

¹ In addition to this evaluation, the World Bank will finance an impact evaluation of the BDH

² Beneficiary families, National Coordination Unit, Selben Program, Provincial Councils, etc.

³ The total cost of this activity is US\$ 150,000, but US\$50,000 is already available from technical cooperation approved by the Bank, which will be used for this purpose (ATN/SF-7954-EC).

Title of consulting study	Planned activities	Approximate cost
(G) Technical assistance for vocational training	Financial support for: (i) modernizing and reforming the SECAP and designing and operating a competitive fund for vocational training and professional development programs; and (ii) putting into operation the quality assurance system for vocational training institutions.	US\$110.000
(H) Technical assistance to support implementation of the FODI child support programs	Finance technical assistance to FODI for: (i) design and implementation of a competition for awarding FODI funds to public and private providers; (ii) design and implementation of the supplier supervision system; (iii) design and development of the system for evaluating the impact of activities financed by FODI.	US\$150.000
TOTAL		US\$950.000

POLICY LETTER

Official Letter No. 2318^{DM-03}

Quito, 3 June 2003

Mr. Enrique Iglesias
President
Inter-American Development Bank
Washington D.C.

Dear Mr. Iglesias,

This document describes the background, the context, the policies and the commitments that the Government of Ecuador has considered as key elements in requesting the Bank's support in implementing its Social Sector Reform Program.

I. The national government's economic program

1. The current administration announced its Program for Economic Restructuring and Human Development before taking office on 15 January 2003. The central objectives of that program are: to reduce poverty by promoting growth with stability and eradicating corruption. In this respect, the program seeks to resolve immediately the problems of liquidity and fiscal solvency; to support competitive production policies by introducing flexibility in the markets for goods and services; to increase the productivity of the factors of production; and to foster social inclusion and improve equity in the distribution of opportunities for all citizens.
2. The program establishes a series of targets to be met during period 2003-2007. Specifically, the government program seeks to reduce poverty from 51% to 38% by 2007; to reduce the illiteracy rate from 10% to 8%; to generate an average annual economic growth rate exceeding 5% over the years 2003-2007; and to bring the inflation rate quickly towards international levels. Consistent with the social program, which will be described in Section II, the economic program calls for financing real growth in social expenditure and introducing reforms to improve the effectiveness and quality of that spending, with a focus on strengthening the provision of basic services, optimizing the social protection system and, in general, achieving better targeting and impact for subsidies to the poorest and most vulnerable sectors.
3. The agreement between the national government and the International Monetary Fund, signed in February, constitutes the basis for the economic program. That agreement committed the government to pursue sound fiscal policies and to adopt

guidelines consistent with developing a sustainable economic framework for the country. The government's fiscal policies are geared towards the following main objectives:

- (i) resolving immediate liquidity pressures and regularizing arrears left by the previous administration;
 - (ii) tightening the fiscal stance to recover from the slippages of 2001 and 2002;
 - (iii) protecting the poor by stabilizing prices and real income levels, and increasing opportunities by strengthening social programs; and
 - (iv) improving the flexibility of fiscal policy and prioritizing expenditures, while promoting reforms in education, health and social protection systems.
- 4. On the economic front, the issues that have dominated the agenda for the first 100 days of this government have been the search for solutions to the liquidity problem, re-establishing fiscal discipline, consolidating the government finances, and managing the sovereign debt, all of which are preconditions for achieving the accepted inflation and growth targets. In addition, the agenda has been supplemented with efforts of lower profile but high expected impact, such as dialogue with players in government, civil society and international agencies to construct an agenda of comprehensive structural reforms that will link stability and economic recovery with the sustainability of dollarization over the medium-term. In this context, priority has been placed on the following areas of work: preparing the tax reform, reforming the civil service, initiating efforts to reform public enterprises (water, electricity, telecommunications), examining the efficiency of the national petroleum industry, modernizing the labor market, and negotiating the pillars of reform to the systems for delivering social services.
- 5. Finally, the government remains firm in its determination that the economic program should be an instrument for inspiring confidence and encouraging citizen participation in economic issues, primarily through the promotion of fiscal transparency and citizen control over expenditure and over the efficiency of the national and subnational public sector.
- 6. **Austerity.** Upon assuming office, the new government took immediate corrective measures: (a) an austerity program that has limited public spending by: (i) freezing salaries for public servants; (ii) suspending paid overtime; and (iii) a 10% salary cut for freely removable public employees who earn more than US\$1,000 a month; (b) a budget for 2003 that is consistent with the austerity and fiscal transparency program and with the legislation on stability and responsibility; (c) an increase in gasoline

prices, averaging 20%; and (d) implementation of an active policy of debt repurchase.

7. With the measures adopted, and with the expected support of international organizations, the government intends to close the financing gap by 2003. Total financial requirements (budgetary and cash) stand at about US\$2 billion, a gap that the government expects to overcome through a combination of: (a) fiscal surpluses achieved through expenditure cuts and additional revenues from oil and the sale of derivatives; (b) rollover of the domestic debt (including repurchase with funds from FEIREP); and (c) coordinating the economic, political and social sectors of government to secure reforms that will make it possible to obtain program financing from multilateral agencies, including the Inter-American Development Bank, the Andean Development Corporation, the World Bank, the International Monetary Fund, and member countries of the Paris Club.
8. **The outlook.** The outlook for 2003 is one of moderate growth and steadily declining inflation. Growth is forecast at 3 to 3.5%, led by the expansion of private oil exports through the Heavy Crude Oil Pipeline (OCP), which will come into operation in the second half of the year. On the basis of this growth, combined with limited absorption (thanks to the public austerity policy and consumption levels for 2003 that are expected to rise more slowly than in previous years) the inflation target for December 2003 has been set in the range of 6% to 8%.

II. Social Policy and a Basic Social Agenda for Combating Poverty

9. In the social sector, the government's policy guidelines are set out in the Basic Social Agenda *Juntos Podemos* [roughly "Together We Can Do It"], which is designed to combat poverty, and was developed by the Technical Secretariat of the *Frente Social*, with consultation and support of the sector ministries.
10. The agenda has two objectives: short-term, immediate moves to reduce vulnerability to extreme poverty; and over the medium term, reducing and preventing poverty.
11. The agenda contains four components for achieving these objectives:
 - a. Social Safety Net. This includes all transfers in cash and in kind. It is targeted at families living in poverty and in extreme poverty, and is conditional on individual or household efforts to protect human capital (primarily in terms of education and health).
 - b. Programs for vulnerable groups. This involves coordination and restructuring of the models for delivering assistance programs for the elderly and disabled, women in conditions of vulnerability, and children under five years of age.
 - c. Improving the models for delivery of universal health and education services, in order progressively to expand public access to health systems and to meet the

objectives of the Social Contract for Education (consistent with the Global Millennium Goals), and in particular to ensure 10 years of quality basic education.

- d. Application of innovative models of employment generation and microfinance to provide productive opportunities for people living in poverty and extreme poverty, and to help revive local economies and reactivate the efforts of urban and rural grassroots organizations.

12. The Basic Agenda for Combating Poverty has the following main thrusts:

- Increased social spending: a social policy with ambitious targets, such as that proposed by this government, will require greater funding for basic social programs and programs aimed at combating poverty.
- Institutional reform: the increase in social spending will be consistent with improvements in the quality of spending. In this respect, management models will be adopted that will achieve greater impact by coordinating initiatives in the sector, consolidating social sector objectives with the activities of society, in order to construct government policies, and institutionalizing strategic initiatives for the protection and development of human and social capital.
- Decentralization: the focus is on strengthening the capacities of locally based public institutions, through processes that involve participation by local players, and incorporating local circumstances into the planning and execution of social initiatives.
- Targeting: this is designed to ensure that funding benefits the neediest groups, exclusively if possible, by making use of the tools at hand: the poverty map for geographic targeting (developed with World Bank support) and the SELBEN, the Social Program Beneficiary Selection System, for individual targeting (developed with IDB support).
- Institutional strengthening of the *Frente Social*: to provide technical support to public institutions responsible for executing social policies, to lend sustainability and coordination to their management, and to facilitate the functions of leadership, coordination, communication and monitoring of social policy, the Council of Ministries of the *Frente Social* must be made operational; this will require the strengthening of the Technical Secretariat (STFS) as its non-executing support body. Similarly, it is important to articulate the work coordinated by STFS with efforts on the environmental, productive and economic fronts. In this respect, it will be important to institutionalize the social role of the government's economic team, under the leadership of the Ministry of Economy and Finance, the senior authority of which has since January been a member of the Group of Ministries of the *Frente Social*.

13. A new sense of direction was given to horizontal components and themes when the government subscribed to the Declaration of Global Millennium Goals in Monterrey. Pursuant to that commitment, and consistent with the country's own social objectives, a number of priority themes have been identified with their respective indicators of progress, to fulfill that declaration:

- Eradication of extreme poverty and hunger: the Social Assistance Network, programs for the most vulnerable, and the use of innovative models for employment creation and microfinance are aimed essentially at achieving this goal and will help in moving towards the desired levels of the progress indicators.
- Universal coverage in education: the target for budgetary increases in the sector, and the reallocation of funding to achieve greater efficiency and to improve the models for universal delivery of education services, are contributing to this goal and will result in better levels for the progress indicators.
- Gender equity and women's empowerment: this has been adopted as a horizontal principle for implementing initiatives under the social agenda.
- Reducing infant mortality: a strategy has been designed that is consistent with maternal-child health, through application of the Free Maternity Law and promotion of the universal insurance initiative as key reforms in the health sector, together with programs for prevention, care and nutrition, with children under five years of age as the priority group.
- Improving maternal health care: once again, the Free Maternity Law, which is now in effect, guarantees universal coverage of services for mothers and children, with a defined package of services; the proposed reform calls for major steps to achieve this target and to bring maximum relevance, quality and coverage to the services that are currently provided.
- Combating and preventing disease: the social reforms on the agenda also call for strengthening programs and implementing a strategy to provide universal health services, an initiative that is of direct relevance to the declared objective.

III. The Articulation of Social Policy and the Social Sector Reform Program (IDB)

a. Consolidating the social protection system for the poorest

14. One of this government's principal policies is to consolidate the system of social protection for the poorest, by reforming the existing cash transfer programs so as to increase the level of the benefit, to select beneficiaries using modern methods of targeting, and to enhance their impact both on family consumption and on the protection of people's human capital. As well, the government is reforming its programs for delivering in-kind benefits, in order to expand their coverage, ensure

that they reach the neediest groups, make them more effective, and eliminate existing duplication and overlap. The intent is to ensure that there is maximum coordination of government efforts on behalf of poor and indigent groups, that those efforts should be more effective, and that scarce resources should be used more efficiently. The social sector program for which IDB financing has been requested will support the efforts that the government is already making to create and develop the Human Development Benefit and to reorganize food and nutrition programs and child support programs.

15. **Human Development Benefit** (*Bono de Desarrollo Humano*, BDH). The government is aware of the problems with the *Bono Solidario* (the current cash transfer mechanism) both in terms of its targeting and its impact. It is estimated that 18% of the beneficiaries under the *Bono Solidario* program are not in fact poor (i.e. it includes people who are not part of the target group), while at the same time 21% of the target population for the program has been excluded. We also know that the level of the benefit is inadequate. A presidential decree has therefore been issued to create the Human Development Benefit (BDH) to replace the *Bono Solidario* and the *Beca Escolar* (school subsidy). The beneficiaries of the BDH will be selected gradually and individually (by household) through the Social Program Beneficiary Selection System, SELBEN. The BDH will be retargeted as part of the sector program with the Bank, over a period of one year beginning in June 2003. The action plan for converting the *Bono Solidario* and *Beca Escolar* into the BDH calls for the inclusion of at least 450,000 eligible families as beneficiaries by June of this year. By the end of the year, the BDH will have a coverage of between 1 and 1.1 million families.
16. Because the BDH constitutes the key program of the country's social protection system, the government has developed a methodology and a timetable for a survey to determine the baseline that will be used to evaluate the impact of the BDH. The firm responsible for carrying out that survey has already been selected.
17. **Food and Nutrition Programs.** In this area, the central reform has been to create the Integrated Food and Nutrition Program System, SIAN. The objective of this program is to improve the nutritional status of the most vulnerable population; to this end, a fund has been created which, with Bank support, will be readied for capitalization so as to reach the poorest population in a sustainable manner. The SIAN fund has been designed to unify and channel in a coordinated way the resources of the National Child Food and Nutrition Program (PANN), the Food for Community Development Program (PRADEC), and the School Meals Program (PAE). The principal objectives of this system relate to targeting and to optimizing the cost-benefit ratio.
18. In addition, programs are being better targeted on young children (up to five years), and on pregnant and nursing women, who are regarded as key vulnerable groups because of their particular nutritional needs.

19. **Child support programs.** With respect to child support programs, and in the same spirit of the reform to the food and nutrition programs, there has been a ministerial order issued to create the Childhood Development Fund, FODI, for channeling resources of the MBS devoted to this age range, allocating them in accordance with competitive procedures similar to those developed under the *Nuestros Niños* (“Our Children”) Program, and targeting them at the poorest population.
20. **Additional funds for social protection.** In order to consolidate a policy for addressing the social vulnerability to which the country is subject because of its high exposure to natural and social risks, a financial instrument is required to guarantee that sufficient funds are available to meet emergencies arising from economic, social or natural crises. To this end, the existing regulations for the FEIREP are to be made more specific so that it can be activated at times of crisis, while replenishing and conserving it at times when economic output, and oil revenues in particular, are growing.

b. Social expenditure

21. As mentioned earlier, the government is committed to reducing poverty and to strengthening basic social services. To do so, more resources are needed for the sector. Since it took office, the government has reallocated the budget for this year in favor of the ministries of the *Frente Social*. In coming years, the government will continue with the effort begun in 2003. Thus, both the present program proposed to the IDB and the program initiative proposed to the World Bank contain a component for the protection of social spending. To guarantee a minimum level of social spending, a budgetary floor will be established for the ministries of education (excluding higher education), health and social welfare, to be calculated on the basis of allocations for the year 2003 plus an annual increment of at least 3.5% in real terms for the years 2004 and 2005 (Table 1). As a supplement to the foregoing, minimum allocations will be guaranteed for a group of priority programs, which in total will increase by at least 4% annually in real terms in 2004 and 2005 (Table 2). In this way, priority programs will increase their share of total social spending, and their activities will be protected as an economic, social and political priority.
22. In order to guarantee resource transfers by the Ministry of Economy and Finance, mechanisms have been designed with the participation of the Budget Secretariat and the National Treasury, and with the permanent support of the Public Investment Secretariat and the Technical Secretariat of the *Frente Social*, which have committed themselves to finding technical ways of ensuring that transfers are made on time, and that they amount to at least 90% of the planned level.

c. Education

23. Consistent with the 1998 Constitution, which guarantees the right of all Ecuadorians to basic education and literacy, the Ministry of Education is pursuing two policies. The first is a national literacy campaign, the objectives of which are: literacy for

young people and adults; strengthening reading and writing skills in primary school; promoting reading and writing among children, youth and adults; and strengthening reading and writing skills among teachers. The second, called the "Social Contract for Education", has the objective of providing 10 years of quality education to all Ecuadorians, and adopting education quality standards that take due account of Ecuador's ethnic diversity. This also includes training in civic, moral and ethical values. In addition, the Ministry of Education is promoting a policy to improve efficiency in the administration of public education, and in the use of budgetary resources for the sector. Following is a description of some of the specific policies and measures planned in this context.

24. The structure of the Ministry of Education and Culture (MEC) is dysfunctional, overcentralized and bureaucratic. The government has a clear political will to move forward with a fundamental overhaul that will rationalize strategic aspects of the ministry.
25. The resource allocation system for public schools and high schools is inequitable. The government is interested therefore in reforming that system promptly, on the basis of positive discrimination factors such as the density of school-age population, rural location, inter-cultural considerations, vulnerability and gender. Allocations will be based on a formula that takes as its criterion the density of the school-age population (6 to 12 years), as a function of coverage goals, student vulnerability/poverty criteria and the type of establishment. This proposal is in line with the MEC's targets for expanding coverage over the period 2003-2005. By its scope, this initiative represents one of the most innovative structural reforms in the country's social sector in recent decades, and it is expected to become a pillar for enhancing efficiency in the sector, and improving the quality of expenditure.
26. At the same time, the government has recognized that reform could be facilitated by reducing arrears in the payment of teachers' salaries, and it has adopted a policy for addressing this problem, starting with the poorest provinces with the lowest education indicators. Currently, the MEC and the MEF are working to define a strategy to reduce arrears through procedural reforms that will increase efficiency and transparency.
27. Consistent with the above objectives, one of the principal problems that the MEC must address on an urgent basis is the lack of any reliable information system on human resources employed in the sector. The national government is now working on a reliable information system for the ministry's human resources, and on rationalizing the distribution of teaching positions.
28. In this respect, the MEC will implement a records update plan that will identify provinces for the initial pilot project, with a program of activities for conducting the update, identifying the officials responsible within the MEC, and the baseline data to be used.

29. Finally, one of the MEC's current needs is to have an integrated and efficient system of management information and communication to streamline its internal procedures. Administrative and technical information is currently chaotic and scattered, and it needs to be unified and centralized so that it can be used as a support for timely decisions and efficient management. The MEC is working to correct this situation by implementing a system and a strategy of information and communication to integrate the various existing components into a coherent system that will be useful for management purposes.

d. Vocational training

30. The Ministry of Labor is promoting changes both in the institutional mechanisms and in the criteria for allocating funding for vocational training and professional development. As well, it has decided to develop mechanisms for regulating vocational training institutions. These changes are a move in the direction of requiring institutions providing vocational training to compete for public funding, thereby generating greater incentives to improve the efficiency and relevance of public providers, and introduce quality assurance mechanisms that will preserve the criterion by which the function of evaluation and accreditation for vocational training institutions should be separated from the function of resource allocation.
31. Consistent with the foregoing, two initiatives are being pursued. On one hand, the SECAP is being reformed and modernized, allowing a transitional period for modernization, with gradual reduction of the payroll contributions from public enterprises, beginning with the 2004 budget, and the creation of a fund for vocational training and development programs, financed in part with resources from payroll contributions, which will be deducted from the funds earmarked for SECAP, without compromising SECAP's ability to compete for other funding. Similarly, steps are being taken to establish a quality assurance system for vocational training institutions, one that will have the capacity to accredit and assess those entities.

e. Institutional strengthening of the sector

32. As part of the sector's institutional strengthening, a draft resolution of the Council of Ministers of the *Frente Social* has been prepared, which would make the STFS responsible, in addition to its other tasks, for the technical evaluation of social investment programs before they are included in the budget by the MEF; and for monitoring the technical and budgetary execution of priority social programs.
33. That resolution will be developed, in detail, in a Ministerial Order of the MBS, as Coordinator of the *Frente Social*, with a view to consolidating the social protection network and the role of the Technical Secretariat of the *Frente Social*, defining and consolidating its institutional structures in the areas of administration, finance, evaluation and monitoring, fund-raising, supervision of expenditure and investment, targeting beneficiaries, specialized studies and communication through its facilities and technical assistance.

34. The government is aware that the implementation of the program's policy measures is a complex matter and for this reason it has planned for a series of technical assistance and communication activities in support of the social ministries and agencies involved in the operation. The role of the Ministry of Economy, through the Investment Secretariat, and that of the *Frente Social* itself, through its Technical Secretariat, are key to the success of the program. The Government of Ecuador hopes that program activities will prove a key complement to the progress that the government has already made, in its short time in office, with respect to strengthening the STFS and those portions of the MEF involved in social issues.

f. Complementarity with other multilateral agency programs

35. The IDB program is complementary to the World Bank's social program loan. The identification and evaluation missions for the two operations were conducted jointly, in order to achieve maximum coordination. Both operations are designed to support the government's efforts in the social sector. Their common objective, differentiated by the specific activities of the two operations (i.e. of the World Bank and the IDB) is to strengthen the *Frente Social* and its priority programs, and improve its operating efficiency, eliminate the duplication of objectives, generate synergy and coordinate initiatives, protect social investment, and channel resources towards the poorest and most vulnerable people and social groups. The first social program loan with the World Bank will be disbursed in June 2003, and it is expected that social program lending from that institution, taken together, will result in freely available funds totaling US\$150 million between 2003 and 2005.
36. Finally, the government wishes to stress that the Social Sector Reform Program proposed to the IDB is the result of technical consultations with the *Frente Social* and its Technical Secretariat, as well as technical and political consultations with the authorities of the Ministry of Economy, and the social ministries. In this process, the Bank has been important in helping arrange the widest possible consultations within the available time. The specific agreements reached are detailed in the policy matrix for the program: the government has ratified its commitment to it as a central instrument for implementing the country's needed social reforms.

Yours truly,

[signed]
Mauricio Pozo Crespo
Minister of Economy and Finance
Government of the Republic of Ecuador

Table 1
Minimum expenditure in basic social sectors
(Budget, in millions of current US dollars)

Ministry	2002	2003	2004	2005
Education (1)	734	782	849	923
Health	268	347	377	410
Social Welfare	303	373	406	441
Total	1,305	1,502	1,632	1,774

(1) Does not include higher education.

Table 2
Priority Programs to be Protected
(Budget, in millions of current US dollars)

	2003	2004	2005
Health	42.2	46.1	50.3
Expanded immunization plan	10.4	11.4	12.4
Control and surveillance of contagious diseases	8.0	8.7	9.5
Maternal-child care	20.0	21.8	23.8
Micronutrients program	0.8	0.9	1.0
Generic drugs	2.5	2.7	3.0
Basic social insurance	0.5	0.5	0.6
Social Protection:	291.8	319.2	350.5
Human Development Benefit (<i>Bono de Desarrollo Humano</i>)	203.0	221.7	242.1
SELBEN		0.5	2.5
Childhood development programs	35.7	39.0	42.6
ORI	23.7		
<i>Nuestros Niños</i>	12.0	12.0	
<i>FODI</i>		27.0	42.6
Food and nutrition programs	43.1	47.1	51.4
PANN	4.3		
PAE	28.8		
PRADEC/NAM/DIS	8.5		
PAD	1.5		
SIAN Fund		47.1	51.4
Rural social insurance	10.0	10.9	11.9
Education:	27.0	31.6	34.6
<i>Redes Amigas</i> program	13.0	10.0	
Basic education improvement programs *	14.0	19.5	32.2
<i>Minga Nacional por un Ecuador que Lee y Estudia</i> [Minga National Literacy and Education Program]		2.1	2.4
Social infrastructure:	5.0	10.0	10.9
FISE	5.0	10.0	10.9
Total	366.0	406.9	446.4