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Report No: PGD118

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A

PROPOSED LOAN

IN THE AMOUNT OF US$500 MILLION

WITH THE GLOBAL CONCESSIONAL FINANCING FACILITY SUPPORT

IN THE AMOUNT OF US$6 MILLION

TO THE

REPUBLIC OF ECUADOR

FOR THE

SECOND INCLUSIVE AND SUSTAINABLE GROWTH DEVELOPMENT POLICY LOAN

April 24, 2020

Macroeconomics, Trade And Investment Global Practice
Latin America And Caribbean Region

Public Disclosure Authorized

Republic of Ecuador

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of April 15, 2020)
The US Dollar is the currency in Ecuador

ABBREVIATIONS AND ACRONYMS

ARCH	Regulatory Agency for Hydrocarbon *(Agencia de Regulación y Control Hidrocarburifero)*	MTFF	Medium-Term Fiscal Framework
ARCONEL	Regulatory Agency for Electricity (*Agencia de Regulación y Control de Electricidad)*	NFPS	Non-Financial Public Sector
ASA	Advisory Services and Analytics	OPEC	Organization of Petroleum Exporting Countries
CAF	Development Bank of Latin America	OECD	Organisation for Economic Cooperation and Development
CONAFIPS	National Corporation of Popular and Solidary Finance (*Corporación Nacional de Finanzas Populares y Solidarias*)	PDO	Project Development Objective
CIT	Corporate Income Taxes	PEFA	Public Expenditure and Financial Accountability Assessment
CPF	Country Partnership Framework	PFR	Public Finance Review
DPF	Development Policy Financing	PFM	Public Financial Management
EFF	Extended Fund Facility	PIT	Personal Income Taxes
ESMAP	Energy Sector Management Assistance Project	PSIA	Poverty and Social Impact Assessment
FDI	Foreign Direct Investment	PPP	Public-Private Partnership
FLAR	Latin American Reserve Fund (*Fondo Latinoamericano de Reservas*)	RFI	Rapid Financing Instrument
		SCD	Systematic Country Diagnostic
GCFF	Global Concessional Financing Facility	SENPLADES	Former Planning Secretariat (*Secretaria Nacional de Planificación y Desarrollo)*
GDP	Gross Domestic Product		
IBRD	International Bank for Reconstruction and Development	SERCOP	Public Procurement Service *(Servicio Nacional de Contratación Pública)*
IDB	Inter-American Development Bank	SOE	State-Owned Enterprise
IFIs	International Financial Institutions	TA	Technical Assistance
IMF	International Monetary Fund	VAT	Value-Added Tax
ISD	Capital Ouflows Tax (*Impuesto de la Salida de Divisas)*	UN	United Nations
LDP	Letter of Development Policy	WBG	World Bank Group
		WHO	World Health Organization
MEF	Ministry of Economy and Finance	WTO	World Trade Organization
MPA	Multi-phase Approach		
MSMEs	Micro, Small, and Medium Enterprises		

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REPUBLIC OF ECUADOR

SECOND INCLUSIVE AND SUSTAINABLE GROWTH DPF

TABLE OF CONTENTS

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The team appreciates the excellent collaboration with the Government of Ecuador and acknowledges the coordination efforts of the Ministry of Economy and Finance, plus the valuable support of the Advisor to the Executive Director.

SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic	If programmatic, position in series
P171190	Yes	2nd in a series of 3

Proposed Development Objective(s)

This DPF series supports measures aimed at: i) responding to COVID-19 to protect the vulnerable; ii) removing barriers to the private sector development and supporting the economic recovery; iii) promoting public sector efficiency and fiscal sustainability post-crisis

Organizations

Borrower:	REPUBLIC OF ECUADOR
Implementing Agency:	MINISTRY OF ECONOMY AND FINANCE

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**506.00**

DETAILS

International Bank for Reconstruction and Development (IBRD)	500.00
Trust Funds	6.00
Concessional Financing Facility	6.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

Results

Indicator Name	Baseline	Target
Results Indicator #1: Number of beneficiaries who received emergency transfers	0 (2019)	1000000 (2021)
Results Indicator #2: Average time to access unemployment benefit	60 days (2019)	7 days (during the crisis)
Results Indicator #3: Resources mobilized by the solidarity fund	0 (2019)	US$ 700 million (2021)
Results Indicator #4: Number of migrants covered by the migration registry	0 (2017)	230000 (2021)
Results Indicator #5: Number of new commercial companies registered per year	8210 (2017)	10800 (2021)
Results Indicator #6: Number of referential minimum wages set	> 2300 (2017)	< 2000 (2021)
Results Indicator #7: (i) number of basic accounts opened via remote processes, and ii) Co-movement[1] between interest rate ceilings and nominal interest rates charged by banks for productive and corporate segments	i) 0 (2017) ii) 0 (2017)	i) 250000 (2021) ii) >0.2 (2021)
Results Indicator #8: Difference between approved and actual budget.	16.3% (2017)	8% (2021)
Results Indicator #9: Spending in goods and services and personnel as a share of GDP.	14.7% (2017)	13.3% (2021)
Results Indicator #10: Fuel subsidies as a share of GDP.	2.1% (2017)	0.8% (2021)

[1] Co-movements is proxied by the ratio between standard deviation of monthly interest rate ceiling and the standard deviation of the effective interest rate measured with monthly data over an 18-month period.

IBRD PROGRAM DOCUMENT FOR A PROPOSED LOAN TO THE REPUBLIC OF ECUADOR

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed operation is part of the World Bank response to the COVID-19 crisis in Ecuador.** The proposed operation is the second in a programmatic Development Policy Financing (DPF) series of three operations. The World Bank had been working with Ecuador in a DPF series to support the Government of Ecuador's structural reform program, aimed at: (i) increasing the efficiency of public spending and revenue mobilization; (ii) removing barriers to the development of the private sector; and (iii) ensuring that vulnerable segments of the population are protected from the impacts of the first two sets of reforms. However, following the COVID-19 crisis, the series has been restructured to support Ecuador's responses to the emergency, while preserving the bulk of the medium-term reform agenda contemplated initially, which is now even more critical to support Ecuador's economy in the post-crisis recovery. This proposed US$506 million operation provides critical financing to Ecuador in a context of deep crisis. It consists of a US$500 million loan and US$6 million in concessional contribution on a non-reimbursable (grant) basis under the Global Concessional Financing Facility (GCFF)[2]. The GCFF was set up to support middle-income countries hosting large numbers of refugees, such as in the case of Venezuelan migration to Ecuador.

2. **Ecuador has been hit by two major simultaneous shocks in the first half of 2020: The COVID-19 outbreak and the collapse of international oil prices.** While the COVID-19 crisis is still unfolding and its duration and depth are unknown, it is clear that Ecuador will be severely affected. As of April 24, over 22 thousand cases – including 576 deaths – were recorded in Ecuador. The government responded quickly at the first signs of crisis by implementing spending reallocations and revenue mobilization measures to free up resources for priority spending, at the same time that it introduced strong containment measures. It also rolled out programs to support vulnerable segments. However, Ecuador's reduced fiscal buffers, limited monetary policy tools, and restricted access to financing constrain the size and scope of the response measures. The sharp drop in international oil prices in the first months of 2020 has aggravated external and fiscal imbalances faced by Ecuador's dollarized economy. While initial reform efforts introduced in 2018 and 2019 improved Ecuador's fiscal conditions, the COVID-19 crisis and low oil prices add unforeseen pressures to the economy. Poverty rates, which had increased slightly in the past five years due to slow growth and tight fiscal position, are expected to soar due to the current crisis. Bank estimates that approximately 1.5 million people could fall back into poverty in 2020.[3] Adapting to this challenging context requires a combination of quick crisis response measures and a solid medium-term reform program to continue addressing macro-fiscal imbalances and shifting from an economic model that is state-led to one that is more balanced and productivity-driven. This process must be managed carefully to safeguard the social achievements of the last two decades and to protect the vulnerable to the maximum extent possible.

[2] The Global Concessional Financing Facility (GCFF) is a partnership sponsored by the World Bank, the UN, and the Islamic Development Bank Group to mobilize the international community to address the financing needs of middle-income countries hosting large numbers of refugees.

[3] Olivieri, S. (2020) The perfect storm: the welfare and distributional impact of the triplet crises in Ecuador, Mimeo, Quito, Ecuador.

3. **The DPF series – originally designed to comprise two operations – has been adjusted to respond to the new reality and now consists of three loans.** The first DPF, for US$500 million, was approved by the World Bank's Board of Executive Directors in June 2019, while the second DPF was expected by mid-2020. In light of the strong commitment to reforms, but slower than expected implementation due to new challenges posed by the COVID-19 crisis and a complex social and political context, the last operation in the series was split into two operations (DPF 2 and DPF 3). In addition, the series now includes a new pillar to support the COVID-19 response (Pillar 1). The priority areas identified during the design of the DPF series remain critical to navigate the crisis and to continue supporting Ecuador's transition towards a sustainable and inclusive growth model in the post-crisis period. These priority areas have been grouped into two pillars to remove barriers to private sector development (Pillar 2) and promote public sector efficiency and fiscal sustainability post-crisis (Pillar 3). The proposed DPF 2 supports measures already taken to mitigate the impacts of COVID-19 and efforts to advance the reform agenda taken prior to the onset of the COVID-19 crisis. DPF 3 will deepen the COVID-19 response efforts and reforms to support the economic recovery, allowing for a successful closing of the series.

4. **The operation is being prepared as part of an international financing package to support Ecuador during the COVID-19 emergency.** The series is part of a coordinated effort by the international community to support Ecuador's macroeconomic stabilization and inclusive growth program. In the context of COVID-19, this international effort has been adjusted to help the crisis response. The international package includes an International Monetary Fund (IMF) Rapid Financing Instrument (RFI) for US$644 million, which is expected to be approved before this DPF and bridge financing during the preparation of a new Extended Fund Facility (EFF) with Ecuador. In parallel, the Inter-American Development Bank (IDB) is preparing a support package of around US$643 million to support the crisis response. The Development Bank of Latin America (CAF) is preparing a package of around US$500 million to support the crisis response. Finally, the Latin American Fund of Reserves (FLAR) is expected to support the country with US$418 million.

5. **The DPF series plays a central role in the World Bank Group's enhanced engagement with the Government in the context of a new County Partnership Framework (CPF).** The WBG's FY19-FY23 CPF (report no. 135374-EC), discussed by the World Bank Board of Directors in June 11, 2019, constitutes the first full-fledged WBG Strategy for Ecuador since 2007. The DPF series underpins two of the three results areas covered by the CPF. Pillars 2 and 3 of the proposed DPF series support CPF objectives under results area i) Supporting Fundamentals for Inclusive Growth, while Pillar 1 supports CPF objectives under results area ii) Building Human Capital and Protecting the Poor.

6. **The Program supported by this DPF series is also aligned with the country's climate change mitigation and adaptation objectives.** Pillar 3 supports the Government's efforts to rationalize energy subsidies and improve sector efficiency, reducing the gap between final prices, production costs, and market values for fuels and electricity. It also ensures that poor and vulnerable populations are protected against the negative impacts of these price changes. The reforms supported are part of a broader effort to introduce renewable energy to diversify the country's energy matrix as well as to increase the resilience of the electricity system to natural and geological occurrences including earthquakes, volcanic eruptions, tropical storms, floods and landslides, as well as to extreme climate events, the frequency of which is

expected to intensify with climate change.

7. **The DPF series builds on strong policy dialogue and close collaboration with the Government, as well as on the findings of analytical work, including the 2018 Systematic County Diagnostic (SCD).** Since 2017, the World Bank has engaged with the Government in a wide range of analytical and advisory work in the areas of public finance, energy reform, competitiveness, financial sector, and social protection. Examples include: (i) the programmatic Public Finance Review (PFR), which covers taxes, public procurement, the wage bill, and public financial management (PFM); (ii) the Energy Subsidy Reform Assessment, funded by Energy Sector Management Assistance Program (ESMAP), which supports the design of communication, fiscal, social, and sectoral aspects of these reforms; (iii) the Trade, Investment, and Competitiveness report, which identifies key barriers to private investment; and (iv) the Financial Stability and Inclusion report. In addition, a flagship report on Jobs and a report on Venezuelan Migration to Ecuador and the distributional impacts of the triple crises (i.e. second plunge in oil prices, COVID-19, and limited access to international financing) are informing DPFs 2 and 3. These analytical underpinnings have helped identify measures to tackle the critical challenges of fostering sustainable and inclusive growth in Ecuador. They are the basis for the design of the measures supported in this DPF series.

8. **The proposed DPF was prepared within an increasingly complex political environment.** Following protracted civil protests and social unrest, the authorities were forced to retract a presidential decree mandating gasoline and diesel subsidy removal. This decree was part of an economic reform package announced in early October 2019, that also comprised an urgent set of economic reform laws, including key reforms to the Tax, Monetary, and Organic Budget Codes. In November 2019, legislators also voted to reject the package of economic laws. These events took place in a context of social unrest across the region. The Government remains strongly committed to the structural reform agenda supported by the DPF series, but these events called for a more gradual implementation of this agenda, including additional consultation and consensus-building with lawmakers and citizens. Facing strong political and economic constraints and large financing needs, the Government has opted to sequence the reform agenda so as to prioritize reforms to support individuals and firms during the crisis and restore macroeconomic stability.

9. **The risks associated with the proposed DPF 2 are high. While there is a strong commitment by the Government to its reform agenda, there are significant downside risks that could delay or complicate the implementation of structural reforms.** The macroeconomic scenarios discussed in this Program Document are aligned with those in the IMF RFI report. Macroeconomic risks are high as low and volatile oil prices, low global growth and/or a tightening of global financial conditions could make it harder for the Government to meet its financing needs. Domestic risks such as the need for prolonged COVID-19 containment measures, social unrest, or natural disasters could further aggravate the macroeconomic situation. Ecuador’s limited implementation capacity, strained by crisis response efforts, combined with its complex political context, could also lead to additional delays in the approval or implementation of reforms. Full adherence to the fiscal and monetary targets of the new IMF program will contribute to a stable macroeconomic framework. Technical assistance would help further mitigate these risks, as would World Bank continued support for the design of a communication strategy in support of key reforms.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

10. **After sustaining more than a decade of rapid growth on the back of high oil prices, Ecuador has seen a marked slowdown in GDP growth since oil prices plummeted in mid-2014**. The remarkable episode of stable growth experienced between 2001-2014 (where annual GDP growth averaged 4.5 percent) seemed to have marked a break with two decades of booms and busts. This growth was initially driven by stabilization reforms and the decision to adopt the US dollar as the national currency in the early 2000s but was then fueled by high oil prices. However, as oil prices plunged from US$106 per barrel in July 2014 to US$30 per barrel in January 2016, GDP stagnated in 2015 and then contracted 1.2 percent in 2016. Growth resumed in 2017, reaching 2.4 percent on the back of external financing, recovering oil prices and domestic credit. This momentum was quickly lost, with growth declining to 1.3 percent in 2018 and registering close to zero in 2019. This deceleration was a result of Ecuador's ongoing fiscal consolidation, coupled with dampened private consumption and disruptions of economic activity associated with violent protests triggered by a government attempt to eliminate the fuel subsidy in October 2019.

11. **A significant part of the economic boom can be explained by the rising role of the public sector. (Box 1).** Public expenditure increased from 21 percent of GDP in 2006 to 44 percent in 2014. Over this period, current spending expanded by 11.5 percentage points of GDP, driven by wages and salaries, social security contributions, and, most notably, other expenditures including items such as fuel imports (and associated subsidies), and service fees to private oil operators.[4] Government purchases of goods and services also expanded in the latter part of this period. Capital spending expanded by about 9.5 percentage points of GDP, as a sizable share of the oil windfall was directed to investment projects in infrastructure and energy, as well as social programs.[5] These policies fueled domestic demand, further accelerating growth. The public sector expansion was financed by oil revenues, dissaving, and external funding. During this period, the Government dismantled its sovereign oil fund[6] and incurred in a selective debt default despite benign external conditions. Other measures, including changes to oil contracts, further eroded Ecuador's investment climate and stymied private investment. Regulatory changes in the tax and labor codes created rigidities in the labor supply and eroded competitiveness.

12. **Public sector dynamics also explain the sharp slowdown since 2014.** Expansionary policies and regulatory changes during the boom period hampered the country's ability to respond to the negative external shock that hit in 2014. The selective default and the lack of macroeconomic buffers increased the country's risk ratings, limiting access to the external funding needed to smoothen the fiscal and external adjustments facing Ecuador's dollarized economy. With limited options, the Government resorted to large

[4] Interest payments decreased due to a selective default of international bonds worth US$3.2 billion. In December 2008, the Government stopped payments of Global 2012 and 2030 bonds even though they had the resources to do so. In 2009, it bought back US$2.9 billion worth of defaulted bonds at US$900 million, hence reducing interest payments by about US$300 per year.
[5] Many social programs are classified as investment spending in Ecuador.
[6] The fund was dismantled in 2008 and its resources absorbed by the annual budget.

cuts in investment spending and costly methods of financing, which had a strong negative effect on economic activity. With its competitiveness eroded by real exchange rate appreciation and labor market and price rigidities, Ecuador's stagnant and underinvested private sector was unable to offset the decline in public sector demand.

Box 1. The impacts of Ecuador's public sector-driven growth model on private sector activity
The oil boom of the early 2000s allowed the Government to embark on an ambitious agenda to improve roads, housing, schools, and hydroelectric generation. Ecuador's public investment was the highest among its structural peers, averaging 11 percent of GDP between 2007 and 2014. Many of these investments helped the country improve social outcomes and infrastructure—access to education and health services increased and key transport infrastructure was built. The public sector injection of resources from the oil boom into the economy increased economic activity and household income. **Notwithstanding its benefits, the growth model of the boom years was unsustainable and constrained private sector development.** Changes to the labor code to expand and improve benefits to workers also reduced flexibility to adjust to shocks. These changes significantly increased the minimum wage and costs associated with separation benefits for employees (which are the highest among peers). The Government also promoted an import substitution strategy whereby tariffs on imports were increased to protect domestic production. In addition, the Government introduced capital outflow taxes and tariff surcharges to limit balance of payments imbalances, especially in times of stress such as the global financial crisis and the oil price drop. Labor productivity also grew at a slower rate than wages, eroding Ecuador's competitiveness. The country's real exchange rate, a measure of competitiveness, appreciated more than that of other countries that benefited from the commodity boom and appreciated further after oil prices dropped.

13. **Amid recent improvements in the business climate, rising private investment has partially cushioned the effect of public investment cuts over the last three years.** Although capital expenditure dropped from 15 to around 7.8 percent of GDP between 2014 and 2019, the overall gross capital formation remained at around 25 percent of the GDP. This is because policy reforms helped improve the investment climate starting in 2017. The Government repealed the import surcharges introduced in 2015. It signed a free trade agreement with the European Union at the end of 2016 and the European Free Trade Association in 2018 and is presently negotiating trade and investment agreements with the United States, the Pacific Alliance (Chile, Peru, Colombia, and Mexico), Canada and Japan, among others. In the oil sector, the country's oil-producing state-owned enterprise (SOE), PetroAmazonas, signed oil service contracts that replaced fixed payments for variable fees based on international oil prices, and the Government introduced a law to reinstate production sharing agreements. In August 2018, the Government passed a Law on Productive Development, Investment Attraction, Job Creation, and Fiscal Stability, which introduced reforms to improve fiscal sustainability and promote private investment. Recent efforts to reduce distortive taxes and encourage entrepreneurship are expected to lead to higher private investment in the medium term.

Table 1. Key Macroeconomic Indicators[7]

	2014	2015	2016	2017	2018	2019e	2020f	2021f	2022f	2023f	2024f
Real sector, annual percentage change, unless otherwise indicated											
Nominal GDP (US$ billion)	101.7	99.3	99.9	104.3	107.6	107.4	97.1	102.6	105.0	107.5	111.0
GDP growth	3.8	0.1	-1.2	2.4	1.3	0.1	-6.7	4.1	1.3	1.4	1.8
Private Consumption (Contribution)	1.7	-0.1	-1.5	2.3	1.3	0.9	-4.0	2.5	0.9	1.0	1.2
Government Consumption (Contribution)	1.0	0.3	0.0	0.5	0.5	-0.4	-0.5	-0.3	-0.1	0.2	0.3
Gross fixed capital formation (Contribution)	0.6	-1.7	-2.2	1.2	0.5	-0.8	-2.7	1.1	0.1	0.0	0.1
Changes in inventories (Contribution)	0.3	-0.8	-0.6	1.4	-0.1	-0.7	0.0	0.0	0.0	0.0	0.0
Net exports (Contribution)	0.2	2.3	3.1	-3.0	-0.9	1.0	0.5	0.7	0.5	0.1	0.1
GDP deflator	3.0	-2.5	1.9	1.9	1.8	-0.2	-3.1	1.4	1.0	0.9	1.5
Consumer price index (p.a.)	3.6	4.0	1.7	0.4	-0.2	0.3	0.0	1.2	1.0	0.9	1.2
Fiscal accounts, percent of GDP											
Public revenues	38.4	33.6	30.3	32.0	35.3	33.4	29.8	30.9	31.4	31.9	32.2
Public expenditure	43.6	39.5	37.7	36.5	38.5	36.6	37.4	35.7	34.5	34.3	33.8
o.w. Capital expenditure	15.1	11.8	11.0	9.3	9.6	7.8	7.8	7.1	6.1	5.3	4.5
NFPS balance	-5.2	-6.0	-7.3	-4.5	-3.2	-3.2	-7.5	-4.8	-3.2	-2.4	-1.6
NFPS debt	26.7	33.4	42.3	44.6	46.1	49.6	64.6	66.9	69.1	69.8	69.2
Balance of payments, percent of GDP, unless otherwise indicated											
Current account balance	-0.7	-2.2	1.1	-0.1	-1.2	-0.1	-5.1	-3.9	-2.9	-2.6	-2.2
Exports	26.1	19.2	17.4	18.8	20.6	21.2	16.5	17.0	17.9	18.4	18.7
o.w. oil export	12.8	6.4	5.1	5.9	7.3	7.2	4.2	4.4	4.6	4.8	4.8
Import	26.2	20.8	15.9	18.5	20.8	20.2	17.5	17.7	18.3	18.6	18.7
Foreign direct investment	0.8	1.3	0.8	0.6	1.4	0.9	0.6	0.8	0.9	0.9	1.0
International reserves (US$ billion)	3.9	2.5	4.3	2.5	2.7	3.4	0.8	-5.2	-4.1	-6.4	-6.9
Months of imports	1.6	1.3	2.6	1.3	1.2	1.6	0.5	-2.9	-2.2	-3.2	-3.4
Percentage of GDP	3.9	2.5	4.3	2.4	2.5	3.2	0.8	-5.1	-3.9	-5.9	-6.2

Source: Central Bank of Ecuador, Ministry of Economics and Finance, and staff's estimates. f = forecast

14. **Despite initial efforts to curb public spending, the fiscal deficit widened during 2014-2017, and the public debt soared during this period**. Since 2014, capital spending of the non-financial public sector (NFPS) has declined by 6 percentage points of GDP to approximately 9 percent in 2017, approaching the level of regional peers like Colombia and Peru. However, the rigid nature of current expenditure (for example, wage payments to public servants) limited the Government's ability to fully adjust fiscal spending to the new reality. The Government tried to prevent a sharper expenditure consolidation by tapping into diverse sources of financing such as standard international bond issuances and budget support from bilateral and multilateral creditors, and non-standard financing instruments such as advanced oil sales, Central Bank financing, and arrears. Despite these and other temporary revenue-raising measures, the fiscal deficit remained above 4.5 percent of GDP between 2014-2017[8] and NFPS debt increased from 27 percent of GDP in 2014 to 45 percent in 2017.[9]

15. **In May 2018, the Government announced a strategy to pursue a more orderly and gradual fiscal adjustment but has faced challenges in its implementation.** The Ministry of Economy and Finance (MEF) established the goal of gradually reducing the overall fiscal deficit over a four-year period and of reducing debt to the 40 percent debt ceiling over the same period as part of the Law on Productive Development, Investment Attraction, Job Creation, and Fiscal Stability.[10] The adjustment focused on reducing current expenditure to levels that are consistent with non-oil revenues. The initial roll-out of the consolidation

[7] Baseline projections are aligned to the one presented in the IMF RFI report.
[8] From less than 1 percent of GDP on average in 2010-2013.
[9] NFPS debt estimated by the WBG staff as official debt reports refer to the aggregate public debt. The NFPS debt is composed of the external debt and the domestic debt held by the private sector, the Central Bank and other public financial institutions. The external debt includes the official external debt, advanced oil sales, and a financial operation with Schlumberger. The domestic debt includes the treasury certificates (CETES), letters of credit related to fuel imports, the arrears of PetroAmazonas and the Hydrocarbons Secretary with the private oil companies, and other payables.
[10] This law also allows the Government to temporarily lift the debt ceiling to implement the ongoing fiscal consolidation process.

plan suffered some setbacks stemming from rigidities in current expenditures, higher interest payments, and weaknesses in the budgetary process. More recently, efforts to eliminate fuel subsidies and advance legal reforms also faced strong opposition. As a result, most of the adjustment to date has relied on capital spending cuts.

Table 2. Key Fiscal Indicators[11]

% of GDP	2014	2015	2016	2017	2018	2019e	2020f	2021f	2022f	2023f	2024f
Overall balance (NFPS)	-5.2	-6.0	-7.3	-4.5	-3.2	-3.2	-7.5	-4.8	-3.2	-2.4	-1.6
Primary balance	-4.2	-4.6	-5.8	-2.3	-0.7	-0.5	-4.5	-1.5	0.2	1.3	2.4
Revenue	38.4	33.6	30.3	32.0	35.3	33.4	29.8	30.9	31.4	31.9	32.2
Oil revenues	10.7	6.5	5.4	5.6	7.6	7.2	4.1	4.4	4.6	5.1	5.3
Tax revenues	18.9	20.8	18.8	18.7	19.5	18.9	18.6	19.2	19.3	19.3	19.4
Taxes on goods and services	7.1	7.2	6.2	6.6	6.8	6.7	6.1	6.8	6.9	6.9	6.9
Taxes on international trade	1.3	2.0	1.6	1.4	1.5	1.3	1.2	1.2	1.3	1.3	1.3
Income tax	4.1	4.8	3.6	3.6	4.5	4.0	4.4	4.2	4.2	4.1	4.2
Social security	4.6	5.1	4.7	5.2	5.2	5.5	5.5	5.5	5.5	5.5	5.5
Other taxes	1.7	1.6	2.6	1.9	1.6	1.5	1.5	1.5	1.5	1.5	1.5
Operative balance of SOEs	4.1	1.1	0.6	2.0	2.6	2.4	2.3	2.6	2.7	2.8	2.8
Other	4.7	5.1	5.5	5.7	5.6	4.8	4.8	4.8	4.8	4.8	4.8
Expenditure	43.6	39.5	37.7	36.5	38.5	36.6	37.4	35.7	34.5	34.3	33.8
Expense	28.5	27.7	26.6	27.2	28.9	28.8	29.6	28.6	28.4	29.0	29.3
Compensation of employees	9.3	10.0	10.0	9.9	9.6	9.5	10.3	9.9	9.9	9.9	9.9
Purchases of goods and services	5.2	5.1	4.7	4.8	4.4	4.3	4.6	3.9	3.7	3.7	3.7
Interest	1.0	1.4	1.6	2.1	2.5	2.7	3.1	3.3	3.4	3.7	4.0
Domestic	0.2	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4
Foreign	0.8	1.2	1.3	1.8	2.2	2.4	2.8	3.0	3.0	3.3	3.5
Social security	3.6	4.3	4.7	4.8	5.0	5.4	5.8	5.8	5.8	5.8	5.8
Other expense	9.3	6.9	5.7	5.5	7.4	6.9	5.8	5.6	5.6	5.8	5.9
Capital expenditure	15.1	11.8	11.0	9.3	9.6	7.8	7.8	7.1	6.1	5.3	4.5
NFPS financing	5.2	6.0	7.3	4.5	3.2	3.2	7.5	4.8	3.2	2.4	1.6
External, net	4.3	3.1	5.2	4.9	2.7	3.6	8.8	6.0	2.8	2.7	1.2
Domestic, net	0.9	2.9	2.1	-0.5	0.4	-0.4	-1.3	-1.2	0.3	-0.3	0.4
NFPS debt	26.7	33.4	42.3	44.6	46.1	49.6	64.6	66.9	69.1	69.8	69.2
External debt	18.7	22.3	28.1	32.0	34.3	37.6	49.6	53.0	54.6	56.1	55.5
Domestic debt	8.0	11.1	14.1	12.6	11.8	12.0	14.9	13.9	14.4	13.7	13.7

Source: Central Bank of Ecuador, MEF, and staff's estimates. f = forecast

16. **While the NFPS deficit has declined quickly in the past three years, the adjustment in the central government deficit has been gradual and leaves little room to respond to shocks.** The NFPS deficit fell from a peak of 7.3 percent of GDP in 2016 to an estimate of about 3.2 percent in 2019 on the back of improving oil prices and capital expenditures cuts (Table 2). A technical review of Ecuador's fiscal statistics, supported by IMF technical assistance, revealed that the fiscal deficit was higher than originally reported in EFF and DPF 1, but the size of the fiscal consolidation was in line with expectations (Box 2). Oil revenues increased from a low of 5.4 percent in 2016 to 7.2 percent in 2019 due to the recovery of oil prices and an uptick of oil production in 2019. However, the central government deficit has declined modestly, from 5.6 percent in 2016 to an estimated 4 percent in 2019, as higher oil prices benefited mostly public firms outside the central government and increased the cost of subsidies. In fact, higher oil exports allowed state oil enterprises to reach sizable surpluses and reduce their arrears with private agents. Despite the adjustment efforts, the public debt continued increasing, approaching 50 percent of GDP in 2019. This tight fiscal situation limits the scope for responses to exogenous shocks, such as the COVID-19 crisis.

Box 2. Revisions in the fiscal statistics

After a thorough investigation by the authorities with support from the IMF, it became clear that official fiscal data used as a base for the design of DPF 1 and the IMF EFF suffered from serious statistical deficiencies. These deficiencies – detected by a mission of the IMF's Statistics Department – related largely to the recording of the revenues and expenditures of local governments, expenditures

[11] Fiscal projections are consistent with the adjustment measures proposed by the IMF Program.

of state-owned enterprises, and transactions in the financial assets of social security entities. The problems appear to have been present for years, going as far back as 2012. The authorities have now corrected the above-the-line fiscal data for 2018 and the above- and below-the-line data for 2019. The work is ongoing to correct historical data for earlier years. These statistical problems, largely at the source data in the entities outside the central government, implied that the fiscal deficit at the onset of the EFF program and of the DPF series was inaccurately measured (higher than previously estimated), which basically implied that nominal fiscal targets were beyond reach given the amount of fiscal consolidation that was built into the IMF program. However, the magnitude of Ecuador's fiscal consolidation efforts largely aligned with what was expected by measures implemented under the IMF program.

Ecuador is expected to continue strengthening institutional arrangements and technical capacity underpinning the compilation of its public finance statistics. This includes stronger collaboration among the agencies involved in the compilation of fiscal statistics, enforcement of reporting standards, systematic reconciliation of above- and below-the-line data, and compilation of fiscal accounts not only for the central government and the consolidated NFPS but also for the other sub-sectors of the NFPS (decentralized autonomous governments, state-owned enterprises, and social security funds). The reform to the Public Finance Code supported by this operation is expected to support these efforts by strengthening the criteria for information exchange and reporting among the different segments of the NFPS. The reform also strengthens principles and provisions for fiscal transparency requiring, for example, fiscal risk analysis to be submitted as part of the budget documentation and reporting on debt targets.

Table 3. Fiscal Financing Requirements and Sources

% of GDP	2014	2015	2016	2017	2018	2019f	2020f	2021f	2022f	2023f	2024f
Gross financing needs (NFPS)	9.4	11.3	11.9	9.4	8.8	9.6	11.8	8.1	7.8	7.4	6.3
Fiscal deficit	5.2	6.0	7.3	4.5	3.2	3.2	7.5	4.8	3.2	2.4	1.6
External debt amortizations	1.7	2.1	1.8	2.8	3.0	3.7	3.8	2.4	4.3	3.9	4.3
Assets purchases	1.8	1.9	1.5	1.2	1.6	0.8	0.1	0.1	0.1	0.1	0.1
Domestic debt amortization	0.7	1.3	1.2	1.0	1.1	1.9	0.4	0.8	0.3	1.0	0.3
Financing sources	9.4	11.3	11.9	9.4	8.8	9.6	11.8	8.1	7.8	7.4	6.3
External debt disbursements	6.3	4.9	7.3	8.5	6.6	7.6	12.0	8.5	7.2	6.7	5.6
Disbursements of other external liabilities	1.5	2.4	2.2	0.4	0.6	0.4	0.0	0.0	0.0	0.0	0.0
Domestic debt disbursements	2.0	0.9	1.2	3.3	0.4	1.3	2.0	0.8	1.2	0.7	0.6
Treasury certificates, net	0.2	0.7	3.1	-2.6	-0.4	0.3	0.3	-0.3	-0.1	0.0	0.0
Accumulation of other liabilities, net	0.5	2.6	-0.1	-0.6	0.5	0.1	-0.2	0.0	0.0	0.0	0.0
Depletion of public deposits, net	-0.1	1.0	-1.4	-0.5	-0.9	0.0	-0.1	-0.3	0.0	0.0	0.0
Discrepancy and others	-0.9	-1.2	-0.4	0.9	2.0	-0.1	-2.1	-0.6	-0.6	0.0	0.0

Source: Central Bank of Ecuador, MEF, and staff's estimates. f = forecast

17. **Financing prospects improved with the signing of an agreement with the IMF in 2019 but have deteriorated significantly due to the impacts of COVID-19.** The NFPS financing needs for 2019 (approximately 9.5 percent of GDP) were mainly met through multilateral financing mobilized by the EFF with the IMF and international bond issuances, including a liability management operation buying back most of the bonds due in 2020. External financing not only enabled Ecuador to finance its fiscal debt but also reduced non-conventional liabilities such as advanced oil sales and helped increase international reserves. However, access to the internal capital market continues to be limited given markets' perception of insufficient efforts to stabilize fiscal accounts in a context of volatile oil prices. Although the EFF helped reduce Ecuador's sovereign spreads to around 600 basis points in mid-2019, spreads increased to 1,400

basis point in mid-November, after violent protests against a decree aiming at ending the fuel subsidy and the rejection by the National Assembly of a bill proposing a comprehensive set of reforms in October. Spreads declined again to about 800 basis points in early December, after the approval of a revised tax reform proposal by the National Assembly and the conclusion of the second and third reviews of the EFF. However, they have increased continuously since February following the spread of COVID-19 around the world and in Ecuador, reaching 5,500 basis points by the end of April. Reduced access to financing in the context of the COVID-19 crisis led to liquidity shortages and motivated a downgrade of Ecuador's debt between December 2019 to April 2020 by Moody's from B3 to Caa3, Fitch from B- to RD, and S&P from B- to SD. This followed the "consent solicitation" made by the Ecuadorian government to defer external bond interest payments while it pursues a comprehensive restructuring. The successful conclusion of the consensual round of debt renegotiation on April 17, 2020 is expected to relieve market perceptions.

18. **The current account deficit and insufficient external financing have constrained the net inflow of dollars, with implications for domestic demand.** As a fully dollarized economy with limited international reserves, Ecuador needs a net dollar inflow to expand the money supply. However, the current account balance moved from a surplus of 1.1 percent of GDP (US$1.3 billion) in 2016 to a small deficit (US$0.1 billion) in 2019 owing to a phasing-out of import surcharges and increasing capital goods imports (Table 4). With low foreign direct investment, money supply depends on external financing to the public sector that is also financing the accumulation of public deposits at the Central Bank to strengthen international reserves. In effect, between 2018 and 2019, gross international reserves increased from US$2.6 billion to US$3.4 billion. Against this backdrop, the growth rate of the money supply dropped from 16 in 2016 to 8 percent in 2019.

Table 4. Balance of Payments Financing Requirements and Sources

% of GDP	2014	2015	2016	2017	2018	2019f	2020f	2021f	2022f	2023f	2024f
Gross financing needs	7.1	7.5	5.2	11.4	7.3	6.2	14.6	15.1	5.1	8.6	5.3
Current account	0.7	2.2	-1.1	0.1	1.2	0.1	5.1	3.9	2.9	2.6	2.2
Public loans amortizations	1.7	1.4	1.8	2.8	2.7	2.2	3.2	2.4	2.3	2.9	2.5
Other capital outflows	4.7	3.8	4.5	8.5	3.4	3.9	6.4	8.9	-0.1	3.1	0.6
Financing sources	7.1	7.5	5.2	11.4	7.3	6.2	14.6	15.1	5.1	8.6	5.3
Foreign direct investment	0.8	1.3	0.8	0.6	1.4	0.9	0.6	0.8	0.9	0.9	1.0
Portfolio investment	1.5	1.5	2.2	6.2	2.4	2.1	8.1	7.3	4.4	4.8	3.0
Capital grants	0.1	0.0	-0.5	0.1	-0.2	0.1	0.1	0.1	0.1	0.1	0.1
Public loans disbursements	4.3	3.3	4.6	2.3	3.8	3.8	3.2	1.1	0.8	0.7	0.7
Changes in reserves	0.4	1.5	-1.8	2.2	-0.2	-0.7	2.7	5.9	-1.0	2.1	0.5

Source: Central Bank of Ecuador, MEF and Finance, and staff's estimates. f = forecast

19. **The economy experienced a credit upsurge over the past two years, but liquidity declined.** After declining by 2 percent in 2015, credit provided by commercial banks grew 15 percent in 2017 as high external financing allowed the public sector to clear arrears with the private sector and restore liquidity. Although loans decelerated in recent years, they continued growing at more than 11 percent in 2019 as financial institutions swapped liquidity for loans. The expansion in loans increased their returns to equity from 7 percent in 2016 to about 13 percent in 2019, while non-performing loans remained low for regional standards. However, private bank liquidity decreased from a peak of 32 percent of short-term liabilities in 2016 to a historically low of 25 percent in 2019, as credit expansion was not accompanied by dollar inflows into the system. Banks have limited space to further expand domestic credit unless they borrow overseas.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

20. **Ecuador's economic outlook is shaped by the severe impacts of the spread of COVID-19 and the oil price collapse.** Following the spread of COVID-19 in China and around the world, oil prices dropped sharply from almost US$70/bbl in early January 2020 to less than US$30/bbl in early April 2020. This affected Ecuador's financing capacity as oil accounts for 39 percent of exports and 21 percent of fiscal revenues. These developments—combined with increasing risk aversion by international investors—caused Ecuador's emerging market bond index (EMBI) spreads to soar and led to the downgrade of the country's sovereign debt by major rating agencies, further limiting access to external financing. Furthermore, the spread of COVID-19 is significantly disrupting economic activity.

21. **The Government has responded quickly to the twin shock**. It introduced fiscal adjustment measures to create space for priority spending and quickly introduced containment measures against the spread of the virus. The Government announced new social transfers, enhanced credit measures, and deferment of taxes and contributions to attenuate the impacts of the crisis on vulnerable individuals and SMEs. However, Ecuador's tight fiscal position, dollarized economy, and constrained access to external financing limit the scope and size of the policy response (Box 3).

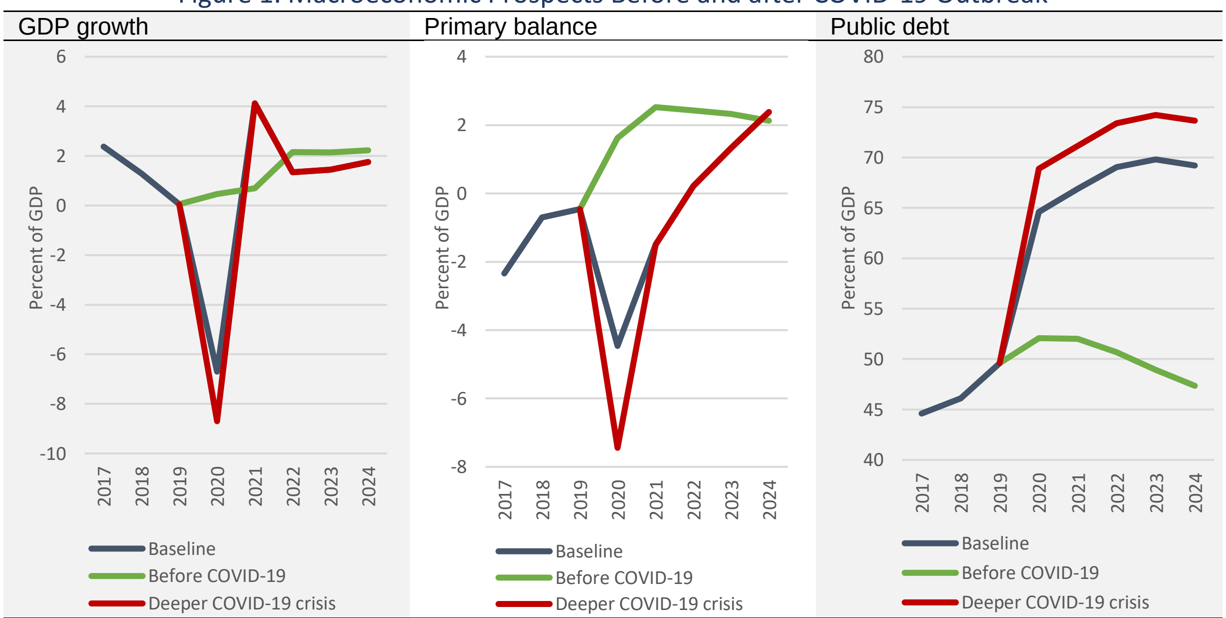
Box 3. COVID-19 impacts and responses
Ecuador has been particularly affected by the COVID-19 pandemic. While the COVID-19 crisis is still unfolding, its impacts on the world economy to date are already expected to surpass those of the 2008 global financial crisis. Ecuador's economy has been affected by the pandemic through different channels. Initially, lower growth in China and disagreements among OPEC members reduced oil prices by two thirds in 2019, reducing fiscal revenues. Lower growth in China and around the world also affects tourism and the price of non-oil exports such as shrimp, cocoa, and tuna further reducing export value. Ecuador's weaker economic position and tighter external financing conditions limit the country's market access. **While necessary to save lives, COVID-19 containment measures are expected to have severe economic and social impacts.** The Government reacted quickly to the arrival of COVID-19 in announcing a range of measures to contain the spread of the virus and ensure the availability of resources for the health response and targeted support to vulnerable households, workers, and firms. On March 11, President Lenin Moreno declared a State of Emergency and introduced measures such as limited mobility of citizens, curfew, closure of all airports and borders for passenger transportation, closure of schools, restaurants and bars, and prohibition of cultural and religious events and gatherings. These measures affected almost all sectors of the economy, either through scarcity of labor, lack of demand, or disruptions in production chains. SMEs and informal workers in urban areas have suffered the most. In a baseline scenario, where the spread of the virus is controlled by mid-2020, GDP growth is expected to contract by 6.7 percent in 2020, compared to the 0.5 percent growth forecast prior to the pandemic. In a scenario of prolonged containment[12], GDP growth could contract by up to 8 percent in 2020. While the economy is expected to recover in 2021, growth will remain lower than before the crisis during the

[12] This scenario is designed by the World Bank team and is not part of the RFI, it is used only as part of the box and is not considered in the DSA.

period 2022-2024. The contraction will destroy jobs and reduce income for a large number of households, particularly those in the informal sector. In the baseline scenario, the poverty rate is expected to increase by 7 percentage points reaching 32 percent of the population. This implies that 1.5 million individuals could fall into poverty.

The COVID-19 crisis and necessary responses will affect macro-stability, resulting in sharp increases of the fiscal deficit and public debt. Despite fiscal consolidation efforts in recent years, Ecuador entered the COVID-19 crisis with an increasing public debt trend, limited fiscal space and financing resources. The crisis will add significant spending pressures. According to IMF calculations, health spending related to the crisis could amount to approximately US$350 million in the baseline case and more than US$500 million under a more severe crisis scenario. Emergency programs to mitigate the social impacts of the crisis could surpass US$300 million if the crisis persists. The crisis will also undermine revenue mobilization capacity. Despite the 2019 tax reform and revenue mobilization measures announced at the beginning of March 2020, the economic contraction will likely result in an expected decline of US$1.7 billion in tax revenues during 2020. In a baseline case, these effects will contribute to an increase in the NFPS deficit to 7.5 percent of GDP and in the public debt to approximately 65 percent of the GDP in 2020. This is significantly higher than the 1.1 percent of GDP deficit and 52 percent of GDP debt expected in the absence of the crisis, respectively. In a prolonged crisis scenario, the deficit could reach 10.6 percent of GDP and the public debt could escalate to 69 percent in 2020.

Figure 1. Macroeconomic Prospects Before and after COVID-19 Outbreak



Source: Central Bank of Ecuador, MEF and staff estimates

Despite its limited space for crisis response, Ecuador has announced a range of measures to mitigate the impacts of the crisis on vulnerable households, workers, and firms. The announced measures are being implemented gradually as resources become available. The proposed DPF supports the first round of measures, which were promptly implemented. Measures include efforts to mobilize resource and create fiscal space for priority spending, actions to mitigate the economic and social impacts of the crisis, (detail list of measures below). The Humanitarian Assistance Law proposal, presented to the National Assemble on April 16, 2020, includes measures such as the creation of a solidarity fund to finance additional transfers and easier access to unemployment benefits.

COVID-19 Response Measures Announced by the Government

Containment and Health Measures (all implemented)

- Declared the State of Emergency
- Mandatory curfew at 14:00 nationwide.
- Closure of borders and all airports for passengers.
- Suspension of inter-provincial bus transport**.**
- Closure of all schools at all levels until further notice.
- Prohibition on gatherings.
- Restriction of movement (exceptions apply for trips to get food, medicines, hospital/clinic visits and to provide elderly assistance).
- Closure of restaurants, bars, cafes (open for delivery only).
- The obligation of the disinfection of all public transport vehicles every 3 hours.
- Zero import tariff on medical equipment and supplies.

Measures to create fiscal space and mobilize resource to priority spending

- Increase the income withholding tax for large companies by 0.75 percent (implemented – estimated 0.13 percent of GDP).
- Creation of a solidarity fund (pending approval of the National Assembly – estimated 0.9 percent of GDP).
- Cut in capital expenditure (implemented - estimated 0.5 percent of GDP).
- Reallocation of current spending (under implementation – estimated up to 1 percent of GDP).
- Cut in the salary of high public officials, including a 50 percent cut in the salary of the president.
- Agreed deferment of payment on international bonds (under implementation – up to 0.8 percent of GDP).

Economic support measures

- Defer payment of taxes for April, May, and June by 6 months (implemented).
- Postpone social security contributions for April, May, and June for voluntary and unrelated affiliates for 90 days.
- Debt moratorium - rescheduling of capital repayments (implemented).
- Regulatory forbearance -temporary suspension of loan classification and temporary suspension of the listing in the credit bureau (implemented).
- Voluntary restructuring of debt exposures for private banks and cooperatives, but mandatory for public banks (implemented).
- Defer utility bill payments - no disconnection of electricity service for non-payment in April and May 2020 for commercial (low voltage) and deferment of March and April bills, with repayment on a pro-rata basis, in 12 months from June 2020 with no interest.

Protection of individuals and jobs

- Emergency cash transfer scheme (2 monthly payments of US$60) (implemented for 400,000 households, starting implementation for 550,000, expecting further expansion).
- Regularization of telework and of temporary modifications or suspension of work shifts (implemented).
- Extension of immigration amnesty for 60 days and regularization process of migrants and ratified the validity of Venezuelan passports expired up to 5 years (implemented).
- No disconnection of electricity service for non-payment in April and May 2020 for residential (implemented).
- No eviction of tenants for non-payment during the crisis.
- Faster access to unemployment benefit
- Extended duration of health care coverage for unemployed individuals.

22. **Economic activity is expected to contract sharply in 2020, recover in 2021, and follow a gradual recovery trend as macroeconomic reforms set the ground for growth to reignite in the medium term.** While there are still uncertainties about the length and impact of the COVID-19 outbreak, under a baseline scenario, economic growth is expected to drop to -6.7 percent in 2020. While the initial growth effect of the outbreak will come through lower exports and reduced resources to finance public sector demand, COVID-19 will have a widespread impact on the economy as both aggregate supply and demand will be impaired by measures to contain the spread of the virus. Assuming the health crisis fades during the second half of 2020, positive growth is expected to resume at 4.1 percent in 2021 and then return to a moderate but increasing growth trend during 2022-2024 as reforms spark enough private investment and non-oil exports to cushion the effects of the fiscal consolidation.

23. **Inflation is expected to remain moderate.** A slowdown in domestic demand and money supply contributed to a decline in average inflation, from 4 percent in 2015 to 0.3 percent in 2019. This downward trend is expected to continue in 2020 following the sharp deceleration in economic activity but will reverse thereafter. One-off effects associated with policy changes could also affect headline inflation. Sustained external capital inflows, mainly external financing to the public sector, and small current account surpluses are projected to enable an expansion of the money supply.

24. **The current account deficit is expected to peak in 2020 and gradually decrease afterwards; improved external financing to the public sector and a modest growth in foreign direct investment (FDI) are expected to increase international reserves.** Declining oil and non-oil exports and growing interest payments abroad could deepen the current account deficit from 0.1 percent of GDP in 2019 to 5.1 percent in 2020. The weakened domestic demand, growing non-oil exports (especially mining) and an uptick in oil exports related to the production of new fields should help gradually reduce the deficit to 2.2 percent of GDP in 2024. External financing and modest improvements in FDI should help gradually increase international reserves to reach 3 months of imports by 2024. External financing will allow the Government to accumulate deposits and clear some nonconventional liabilities, including short-term liabilities with the Central Bank.

25. **Fiscal consolidation will pause in 2020 to accommodate the severe impacts of the health and commodity crisis, but it will resume at a gradual pace in the 2021-2024 period.** In a conservative baseline scenario (aligned with the IMF RFI macro framework) which: (i) assumes limited consolidation efforts, (ii) excludes the impact reforms that have not been implemented to date, and (iii) does not take into account

potential impacts of debt renegotiation, the NFPS deficit is expected to increase to 7.5 percent of GDP in 2020. The increase in the fiscal deficit is expected to be attenuated by the austerity measures implemented by the Government, such as the additional withholding of taxes for large companies in selected sectors. These measures create space for priority spending and help accommodate the large impacts on the revenue side. The deficit is expected to return to a gradual declining path in 2021, reaching 1.6 percent of GDP in 2024 (Table 3).

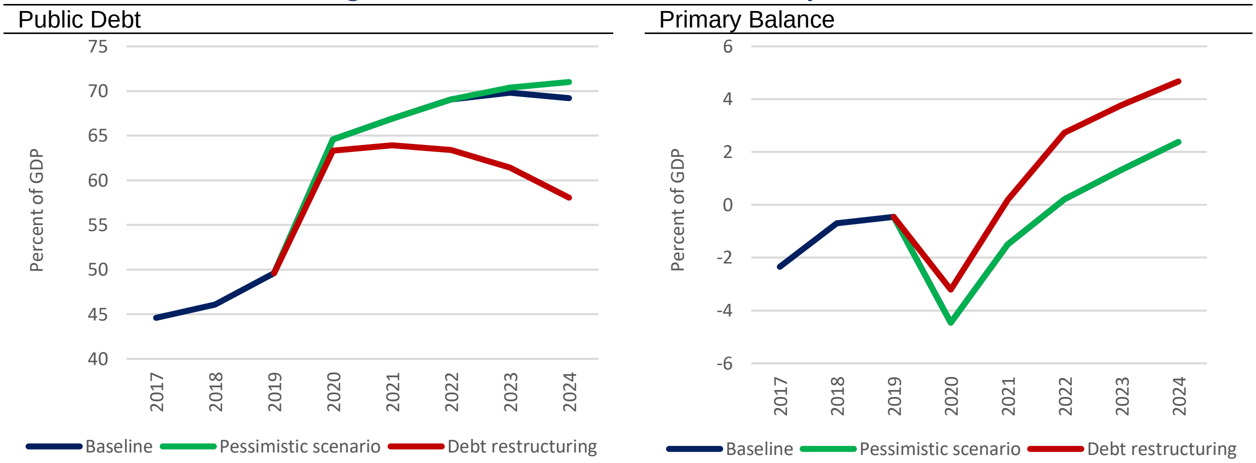
26. **NFPS debt is expected to increase sharply over the next two years due to the impacts of the COVID-19 crisis but should start declining after 2023**. Under this conservative baseline scenario, the large NFPS deficit in 2020 is expected to push the public debt to 64.6 percent of GDP by the year end. Primary surpluses and a gradual recovery in economic growth are expected to stabilize around 70 percent of GDP in 2022-2023 and enable a small decline to 69 percent of GDP in 2024 and 68 percent of GDP in 2025. External debt is also projected to increase continuously during the forecasting period to reach 56 percent, following an intentional shift in the debt profile. Increased external debt can help mitigate the economic impacts of the adjustment process by boosting money supply and helping the Government clear its arrears and other liabilities.

27. **The proposed DPF is part of an international support package that will help Ecuador cover the large financing needs that emerged from the COVID-19 crisis and the low oil price shocks and reduce the financing costs presented in the baseline scenario.** The NFPS financing needs are expected to reach 11.1 percent of GDP in 2020. In this context, Ecuador has reached out to the international community to secure financing needs. This DPF is part of World Bank's assistance package that includes a US$20 million emergency loan to support the health sector processed under the recently approved global emergency Multi-phase Approach (MPA) umbrella, and US$50 million from the restructuring of the resilience and emergency response to help support social transfers. The overall international package includes an IMF Rapid Financing Instrument (RFI) for US$644 million, which is expected to be approved before this DPF. The RFI will bridge financing while the IMF engages on a new Extended Fund Facility (EFF) with Ecuador. In parallel, the IDB is preparing a support package of around US$643 million to support the crisis response, including US$280 million in budget support. The CAF is preparing a package of around U$500 million to support the crisis response, including US$400 million in budget support. These financing efforts are expected to be complemented by bilateral lending. Finally, FLAR is preparing a US$418 million loan. The agreement reached with bondholders on April 17, 2020 to suspend the payment of interests for four months could further help alleviate financing pressures this year. Finally, the creation of a solidarity fund, which is currently being discussed by the National Assembly, could bring up to US$900 million in additional resources.

28. **Given the existing uncertainty about the post-COVID-19 prospects, the public debt path is analyzed under three scenarios: (i) the previously-discussed conservative baseline (displayed in Tables 1-3); (ii) an active fiscal consolidation, International Financial Institutions (IFI) financing, and debt refinancing scenario; and (iii) a pessimistic scenario, where financing costs increase sharply throughout the forecasting period. The three scenarios are aligned to those considered in the IMF RFI**. Given the likely materialization of IFI financing and at least some fiscal consolidation reforms, it is important to consider alternative scenarios to the conservative baseline proposed (Figure 2). Under scenario (ii), which

considers a 5 ppts of GDP adjustment in non-oil primary balance including fuel subsidies between 2019 and 2024 and assumes a relief from the debt reprofiling, the public debt peaks at 63.3 percent of GDP in 2020 and converges to 58 percent in 2024, as the primary surplus and GDP growth compensate for higher interest payments. Gross financing needs converge to 4 percent of GDP by 2024. Nevertheless, under scenario (iii), which considers a more modest fiscal adjustment compared to baseline due larger interest payments, the public debt could increase gradually to reach 71 percent of GDP. This pessimistic scenario does not consider any additional consolidation effort to compensate for higher interest payments.

Figure 2. Alternative Fiscal Sustainability Scenarios



Source: Central Bank of Ecuador, MEF and staff estimates

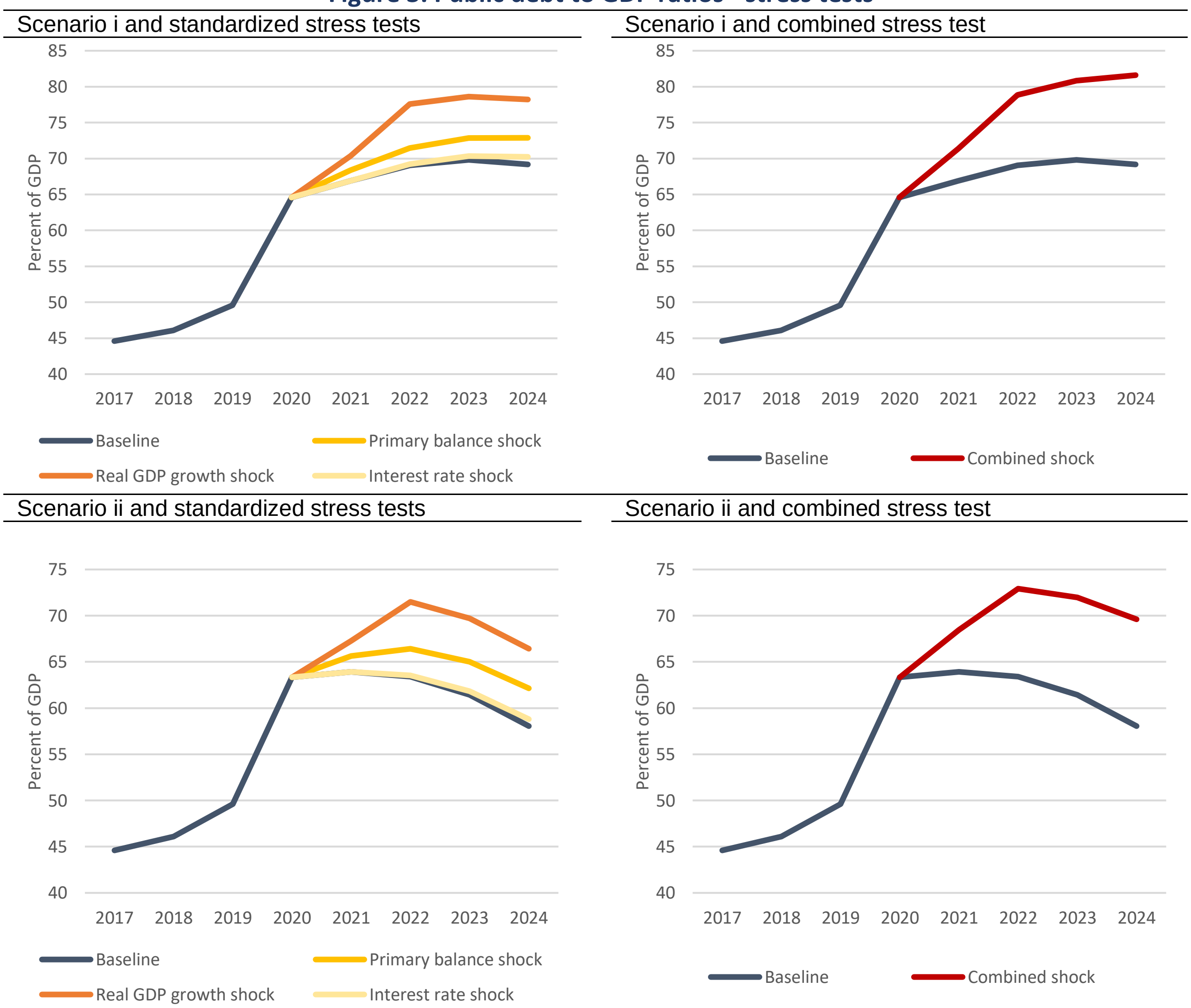
29. **The path of public debt is subject to several risks, such as higher interest rates, a weaker than expected fiscal consolidation path, and lower economic growth, independently of the scenario analyzed.** A debt sustainability analysis is carried out for scenarios (i) and (ii), which are perceived as more plausible. Under scenario (i) (conservative baseline), a permanent increase of the interest rate by 200 basis points from 2020 onward is expected to increase the public debt by 1 percentage point of GDP in 2024 compared to the baseline. A reduction in the primary balance by 1.2 percentage points of GDP in 2020 and 2021 (half of the 10-year historical standard deviation) is expected to increase public debt to 73 percent of GDP in 2024, 3.8 percentage points above the baseline.[13] The public debt-to-GDP ratio is most sensitive to low GDP growth. A reduction of 2.8 percentage points in growth in 2020 and 2021[14] (the 10-year historical standard deviation) would lead to a sharp increase in public debt. In this scenario, public debt would jump from 49.6 percent of GDP in 2019 to 78 percent in 2024. If all these stresses are combined, public debt could increase continuously to reach 82 percent by 2024, 12 percentage points

[13] This shock is combined with an increase of the interest rate by 25 basis points per one percent of GDP worsening of fiscal balance.

[14] The scenario is combined with a deterioration of fiscal revenues, higher interest rates (25 basis points per one percent of GDP worsening of fiscal balance) and lower inflation rate (25 basis points per one percentage point decrease in GDP growth).

above the baseline scenario. Under scenario (ii) (active consolidation and restructuring), the public debt reaches a declining path under all test applied. a permanent increase of the interest rate by 200 basis points from 2020 onward is expected to bring the public debt to approximately 59 percent of GDP in 2024. A reduction in the primary balance is expected to bring public debt to 62 percent of GDP in 2024, while a reduction in growth is expected to bring public debt to 66 percent of GDP in 2024.[15] If all these stresses are combined, public debt could almost reach 70 percent by 2024, but remains in a sustainable path.

Figure 3. Public debt to GDP ratios - stress tests



Source: Central Bank of Ecuador, MEF and staff estimates
Note: The exchange rate shock was excluded because of Ecuador's full dollarization.

[15] This shock is combined with an increase of the interest rate by 25 basis points per one percent of GDP worsening of fiscal balance.

30. **Ecuador's public debt-to-GDP ratio is expected to grow continuously for all stress tests under the conservative scenario (scenario i) but remains below the threshold for emerging markets in most standardized stress tests under the active consolidation and renegotiation scenario (scenario ii; the high country-risk highlights the importance of debt reduction efforts post-crisis).** Under scenario i, the debt path crosses the 70 percent of GDP threshold for emerging markets under all stress test and increases continuously when hit by a combination of shocks. Under scenario ii the public debt is expected to end the forecasting period well below the threshold in all standardized tests considered (

31. Figure 3). Nevertheless, Ecuador is still perceived as a high-risk country by financial markets. Past defaults, the absence of solid macroeconomic buffers (fiscal and international reserves), and the delay in some structural reforms adversely affected risk perception. Efforts to gradually reduce public debt towards the legally mandated debt ceiling of 40 percent of GDP through a credible fiscal adjustment plan is critical to reduce Ecuador's high levels of country risk, as well as to protect its dollarization regime and to make it more resilient to external shocks.

32. **Ecuador's macroeconomic framework, anchored in the IMF program and macroeconomic framework of the IMF RFI, is considered adequate for the proposed operation, although downside risks are high and need to be carefully monitored.** The Government is committed to reducing the fiscal imbalance, maintain international reserves to secure macroeconomic stability, set the ground for economic recovery, and foster private investment. The Government is also likely to receive financing support from IFIs, which helps contain the increase in interest payments over the forecasting period. Finally, Ecuador has embarked on a consensual renegotiation with creditors, that is likely to reduce pressures associated with servicing the public debt. These positive developments can bring the public debt from an increasing trend under the conservative baseline scenario to a declining and sustainable path. However, limited macroeconomic buffers make Ecuador vulnerable to downside risks, including prolonged impacts of the COVID-19 pandemic, low or volatile oil prices, and appreciation of the US dollar. On the domestic front, risks stem from the unknow depth and duration of the COVID-19 containment measures and from the fiscal pressures associated it. Natural disasters and a complex political context that could impede or delay the implementation of reforms add to these risks.

2.3. IMF RELATIONS

33. **While a new Extended Fund Facility (EFF) is in preparation, the IMF has mobilized additional financing to support Ecuador during the COVID-19 crisis through a Rapid Finance Instrument (RFI).** On December 11, 2019, the IMF Board of Executive Directors approved the second and third reviews of the current EFF. The reviews included modifications in quantitative targets (non-oil primary balance including fuel subsidies, social assistance spending, and net international reserves) and structural benchmarks (regarding the time and scope of legal reforms) to reflect the new reality faced by Ecuador. The three-year EFF for US$4.2 billion, approved in March 2019, the proposed programmatic DPF series and parallel operations by the IDB, CAF, and FLAR, all form part of a financial effort of about US$10 billion over the 2019-2021 period. The IMF and World Bank have coordinated closely on the design of the EFF and the DPF series to ensure the consistency and complementarity of the policy measures that each of them supports. Complementary technical assistance has been offered to the MEF on a number of issues, such as wage bill

management, subsidy reform, public financial management, debt management, and financial stability. Large revisions on fiscal statistics (Box 3) and the dramatic impacts of the COVID-19 crisis have led the IMF to start preparations for a new EFF, which would maintain the structural benchmarks of the original program but adjust the macro framework and quantitative targets to fit Ecuador's new economic context. While the new EFF is under preparation, the IMF is ensuring continued financing to Ecuador during the COVID-19 crisis through an RFI for US$644 million, which is expected to be discussed by the IMF Board on May 1, 2020.

3. GOVERNMENT PROGRAM

34. **The Government's strategy for the country's development is enshrined in two plans, but the COVID-19 emergency has made the crisis response the top priority.** The National Development Plan – *Toda una Vida 2017- 2021* focuses on the country's development goals for the medium- and longer-term, aimed at reducing poverty and increasing shared prosperity. The Government's *Plan de Prosperidad 2018-2021* acknowledges that Ecuador's economy requires strong adjustment through the responsible, transparent and disciplined use of public resources to promote sustainable and inclusive growth, while reducing poverty. This plan is focused on short-term measures to enable economic growth and comprises four priorities to help stabilize and reactivate the economy in the short term. While the government remains committed to the two plans, the COVID-19 emergency brought new priorities to the agenda such as the health sector response and emergency support to vulnerable segments of the population.

- ***Priority 1: Stabilizing the Economy.*** The Government's plan highlights the need for strong and orderly fiscal adjustment, as well as the fact that the economic growth needed to address poverty and offer opportunities for the next generations cannot rely solely upon the public sector but must provide the conditions to attract the private sector, including foreign, investment;

- ***Priority 2: Protecting the Vulnerable and Leveling Opportunities.*** The plan is based on the premise that the needed fiscal adjustment cannot affect the most vulnerable population. It guarantees that resources for social protection will be increased to reduce the levels of poverty and extreme poverty by increasing the coverage of social protection programs;

- ***Priority 3: Reigniting Growth and Employment.*** The plan includes a proposal to provide productive credit and regulatory reforms to foster entrepreneurship and reactivate production to create quality jobs without generating fiscal pressures, and

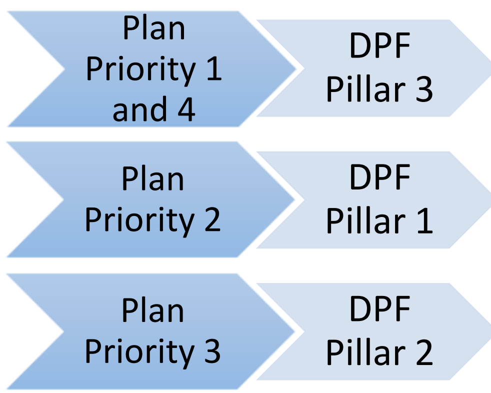
- ***Priority 4: Promoting Transparency and Fighting Corruption.*** The plan also prioritizes establishing the legal framework to combat corruption, including the preparation and submission to the National Assembly of legislation that provides incentives to report corruption and protecting whistleblowers. This area also considers more transparency and accountability in the allocation of government resources throughout the annual budget cycle.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

35. **The proposed DPF is the second in a series of three operations supporting measures aimed at: (i) responding to the COVID-19 pandemic to protect the vulnerable, (ii) removing barriers to private sector development and supporting the economic recovery, and (iii) promoting public sector efficiency and fiscal sustainability post-crisis**. Resisting the health crisis and recovering from it are emerging priorities that add to the Government's primary concerns of achieving macroeconomic stability and transitioning towards a sustainable and inclusive economic model. The DPF series complements and reinforces these efforts by supporting measures put in place by the Government in response to the COVID-19 crisis. In addition, it lays the ground for Ecuador's economic recovery post-COVID-19 by tackling distortions and leveling the playing field for private sector-led growth as well as by creating space for priority spending through increased spending efficiency and revenue mobilization. These are all important measures to sustain growth post-crisis under less favorable external conditions. During this process the Government is strengthening the country's social safety net and promoting financial inclusion.

Figure 3: Mapping *Plan Prosperidad* Priorities- DPF Pillars



36. **The DPF series is fully aligned with the Government's development plans.** The pillars and actions supported by the DPF series reinforce the priorities in the Government's *Plan de Prosperidad 2018-2021*. For example, Pillar 3 of DPF 2 supports the Government's Priority 1 (Stabilizing the Economy) and an orderly fiscal adjustment by promoting efficient spending and revenue mobilization. Pillar 3 also addresses Priority 4 of the Government's plan (Promoting Transparency and Fighting Corruption) by backing reforms to improve the transparency and accountability of the budget process. By supporting reforms to remove barriers to private sector development, while also facilitating entrepreneurship and improving financial intermediation, Pillar 2 is closely linked to the Government's Priority 3 (Ensuring More Opportunities and Fewer Burdens for Citizens). Finally, Pillar 1 supports the implementation of the Government's Priority 2 (Protecting the Most Vulnerable), by designing and implementing well-targeted social programs to protect the vulnerable groups against economic shocks, such as those arising from the COVID-19 crisis.

37. **The implementation of the WBG' assistance program for Ecuador in recent years offers lessons that have been considered in the preparation of this DPF.** Prior to the first operations in the DPF series, the World Bank had not financed a policy-based operation in Ecuador in more than a decade. Following a suspension of World Bank-financed activities in Ecuador in 2007, the Bank followed a gradual re-engagement process starting in FY14. This has generated some important lessons reflected in the design of the DPF series, particularly of this second operation in the series, as follows:

- **Advisory Services and Analytics (ASA) provide an important platform to inform policy dialogue and identify options for reform**. A rich body of analytical work has been instrumental in forging a deeper understanding of the country's issues, increasing evidence-based decision making, and facilitating collaborative interactions between the Bank and the government and within the government, thus facilitating the overall design of the operations.
- **Close implementation support is critical for achieving results given limited institutional capacity.** Effective and timely implementation of projects has been challenging due to weak institutional capacity for preparing and implementing projects and reforms. For this reason, this operation is accompanied by a number of technical assistance activities that bridge knowledge gaps and inform the design of reforms in line with sound international practices. Technical assistance has been stepped up to help the government respond to challenges posed by the COVID-19 crisis.
- **Implementation must be gradual to allow time and attention for communication, consultation, and consensus-building around the reform agenda.** The government's efforts to implement important economic reforms have faced considerable resistance. In October 2019, President Moreno announced the elimination of gasoline and diesel subsidies as part of a broader package of economic reforms. The announcement was followed by nearly two weeks of widespread protests and social unrest. Two weeks later, President Moreno agreed to reverse the removal of diesel and gasoline subsidies. In that same month, the government submitted an urgent economic package to the National Assembly (which needed to be voted within 30 days). The package included the tax law, the organic budget code, and the Central Bank code. However, the National Assembly voted to reject the package, arguing that there was not enough time to evaluate such comprehensive reform. Both episodes highlighted the need to engage in intensive consultation and consensus-building (beyond what was already done in this early reform efforts) to achieve progress. The design of this second DPF reflects the Government's decision to proceed gradually and intensify consultations around the reform agenda.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

38. **The proposed operation combines crisis-response measures with structural reforms that will help strengthen Ecuador's economic position to navigate the COVID-19 crisis and its aftermath.** The three proposed pillars are interlinked and mutually reinforcing. Measures under Pillar 1 support the COVID-19 crisis response, helping maintain the livelihood of vulnerable segments of the population through cash transfers. They also help maintain formal jobs in the private sector, creating fiscal space for crisis response. Pillar 2, which aims at removing barriers to private sector development through

improvements in productivity, increases the prospects of firm and employment survival during the crisis, while laying the ground for the post-crisis recovery. Finally, efforts to promote a more efficient allocation of government resources under Pillar 3 are expected to reduce the Government's footprint in a sustainable manner through efficiency gains that will further free up resources for priority spending in the short run and will ensure fiscal sustainability after the crisis.

39. **The original DPF series has been adjusted to reflect the impacts of the COVID-19 crisis, and the need for a more gradual pace of implementation of reforms. As a result, the series is now composed of three operations.** The DPF has been adjusted to support Ecuador through these challenges and to include a COVID-19 crisis response pillar (Pillar1). The priority areas identified during the design of the DPF series remain critical and are supported under Pillar 2 and 3. The proposed DPF 2 supports COVID-19 response measures already implemented and solid steps to advance the structural reform agenda while DPF 3 deepens the crisis response and structural reform efforts to support Ecuador's recovery. Given the strong political and economic constraints, the Government has had to prioritize within a broad reform agenda. Reforms to manage the crisis, preserve macroeconomic stability, and safeguard the dollarization regime are being tackled first. This leaves limited political room to pursue reforms to the Public-Private Partnership (PPP) Law and Labor Code, originally contemplated as part of the DPF series. Annex 5 presents and explains the changes introduced in the series, which are also discussed in the following section.

Pillar 1: Responding to COVID-19 to protect the vulnerable

40. **Pillar 1 helps protect vulnerable segments of the population against the impacts of the COVID-19 crisis through well-targeted social programs, more flexible labor regulation, additional fiscal space to priority spending, and solidarity towards migrants.** The impacts of the COVID-19 crisis are expected to be particularly severe on poor and vulnerable households. Income and job loss during the crisis could lift the poverty rate by almost 7 percentage points, pushing 1.5 million people back into poverty. In addition, the conditions of those who are already poor have worsened. The vulnerable include a large Venezuelan migrant population that has entered Ecuador in recent years. The Government is committed to implementing reforms that can ensure that existing fiscal space is allocated to effectively protecting poor and the vulnerable households, mitigating the impacts of the crisis on these groups.

41. **Pillar 1 also supports the Government's goal of maintaining jobs and protecting workers.** Ecuador's rigid labor market regulations have contributed to an increase in the share of informal workers since 2014. Such rigidities include high firing costs, limited work modalities, and rigid working hours, which leave little room for firms to adjust to economic shocks. When formal workers lose their jobs, they face a long waiting time and cumbersome process to access unemployment benefits which are available for a relatively short period of time.[16] Adding flexibility and expanding social protection is also critical to help ensure the survival of productive firms and formal jobs, while protecting workers who end up unemployed.

[16] Unemployment insurance only covers workers who are fired from their jobs. Workers can only apply after being unemployed by at least 60 days and approval can take up to 45 days. Payments are only made for five months, with a reduction of five percentage points each month, so they reach 50 percent of the original wage by the end of the period.

Designing a well-targeted COVID-19 response program

Prior Action #1 DPF 2: In the context of the COVID-19 crisis, the Borrower has created an emergency cash transfer scheme for vulnerable households that are not covered by social assistance programs. **Indicative Trigger #1 DPF 3:** The Borrower has expanded the emergency transfers to reach the poor and vulnerable, including those covered by social assistance programs.

42. **Rationale.** The Ecuadorian government responded quickly to the onset of the COVID-19 pandemic with stringent containment measures. These are critical to saving lives, yet they are causing widespread economic hardship, especially among the poor and vulnerable. These groups habitually work informally, do not have assets, and rely on daily income to cover their basic needs.[17] Almost 4 out of 10 informal workers could fall into poverty.[18] Estimates also suggest that the crisis could reverse all the poverty reduction gains achieved during the commodity boom years. An emergency support program is needed to help meet the basic needs of poor or newly poor households as they comply with containment measures.

43. **Substance.** The Government has drawn up a comprehensive emergency cash program to cover up to 1 million poor and vulnerable households[19]. Progress in the expansion of the social registry supported by DPF 1 and the recent implementation of the 2018 poverty targeting index will help the government identify the poor and vulnerable and design a targeted social response to the crisis. The program will be implemented by the Ministry of Economic and Social Inclusion (MIES) in stages as financing resources become available. Prior Action #1 supports the design of the program's first stage, which will deliver two monthly installments of US$60 to 400,000 vulnerable households that do not currently participate in social assistance programs. This DPF supports the design and creation of the emergency transfer scheme and complements the recently restructured Risk Mitigation and Emergency Recovery Project (P157324), which will help finance the scheme's implementation. Trigger #1 supports the expansion of the program to include additional beneficiaries among the poor and vulnerable households, including those currently covered by the social protection system. The hope is to reach up to 1 million households.

44. **Expected results and Indicators** These results will be tracked by the overall number of beneficiaries who receive emergency cash transfers, which is expected to increase from a baseline of zero in 2019 to more than 1 million by 2021.

Reforming labor markets to the COVID-19 crisis context

Prior Action #2 DPF 2: The Borrower has increased flexibility in work arrangements in the context of the COVID-19 crisis by regulating telework and allowing for emergency adjustments or suspension of

[17] Olivieri, S. (2020), The perfect storm: the welfare and distribution impacts of the triplet crises in Ecuador, Mimeo, Quito, Ecuador.
[18] Olivieri, S. (2020), The perfect storm: the welfare and distribution impacts of the triplet crises in Ecuador, Mimeo, Quito, Ecuador.
[19] Approximately 4 million individuals, close to 80 percent of projected number of poor individuals in 2020.

work shifts.

Indicative Trigger #2 DPF 3: The Borrower has facilitated access to unemployment benefits.

45. **Rationale.** Ecuador's rigid labor regulations make formal working arrangement incompatible with the COVID-19 containment measures. Ecuador's labor regulations include rigidities such as high minimum wages, very high mobility costs, and inflexible working hours or contracts. This setting not only discourages firms from creating formal positions but makes it impossible for the private and public sectors to maintain formal working arrangements while complying with the requirements imposed by the COVID-19 containment measures. In addition, workers who lose their jobs have a hard time accessing unemployment benefits. Eligibility is based on having no less than 24 monthly contributions to social security before becoming unemployed. Individuals must wait at least 60 days to apply and the approval can take up to 45 days. Only employees who are fired from their jobs are eligible and independent workers are not eligible. The incentives and the structure of this insurance could be improved by easing eligibility requirements and the application process.

46. **Substance of the Prior Action.** Prior Action #2 supports crisis response measures to increase flexibility in work arrangements in the context of the COVID-19 crisis. These measures include the regulation of telework arrangements and allow for emergency adjustments to, or suspension of work shifts, while maintaining the employment relationship. Indicative Trigger #2 complements the protection of formal workers by facilitating access to unemployment benefits.

47. **Expected results and Indicators:** Prior Action #2 and Indicative Trigger #2 comprise part of a labor reform strategy to protect formal jobs and workers in response to the COVID-19 crisis. The impact of the strategy will be measured by a reduction in the average time to access unemployment benefit from 60 days (2019) to 7 days (during the crisis).

Creating fiscal space for crisis response

Prior Action #3 DPF 2: The Borrower has created fiscal space for crisis response by: (i) increasing the withholding of income taxes for large corporations in resilient segments while deferring payments from firms in the most affected segments; and (ii) reducing the costs associated with purchased medical equipment by eliminating import tariffs and restrictions applied to these goods in response to the COVID-19 emergency.

Indicative Trigger #3 DPF 3: The Borrower has created a Solidarity Fund to provide financial support to vulnerable households and firms.

48. **Rationale.** Spending pressures associated with the COVID-19 crisis call for additional financing resources. Despite the Government's efforts to cut low-priority spending, pressures associated with the COVID-19 crisis response could lead to an increase in expenditures of almost one percent of GDP. Given that Ecuador has limited access to external financing, mobilizing additional revenues is critical to financing proper response measures.

49. **Substance of the prior action.** Prior Action #3 supports the Government's efforts to prevent a sharp drop in revenues in 2020 in the context of the COVID-19 crisis. It increased the withholding of income taxes for large corporations in resilient sectors such as telecommunications, finance, and extractives, while deferring tax payments from vulnerable segments such as micro, small, and medium Enterprises (MSMEs) and tourism. The Government has also taken steps to reduce the costs of medical equipment and supplies by eliminating the usual tariffs and restrictions on these imported products. Indicative Trigger #3 consists in creating a solidarity fund to benefit individuals and MSMEs affected by the COVID-19 crisis. The fund is to be financed through a temporary progressive income tax on firms and formal employees and managed by representatives of civil society to ensure accountability in the use of resources.

50. **Expected Results and Indicators.** This Prior Action and Indicative Trigger are expected to mobilize additional revenues to finance the crisis response. This result will be captured by the resources mobilized under the solidarity fund, which are expected to increase from a baseline of 0 in 2019 to US$700 million (by 2021).

Protecting migrants and improving their access to services

Prior Action #4 DPF 2: The Borrower has: (i) created a Migratory Registry based on the information of the Migratory Census to ensure the effective provision of public services to Venezuelan migrants and refugees; and (ii) extended by 60 days the amnesty to irregular Venezuelan migrants, thus allowing them to remain in the country, and ratified the validity of Venezuelan passports expired for less than 5 years, in the context of the COVID-19 crisis.

Indicative Trigger #4 DPF 3: The Borrower has prepared a new migrant integration strategy informed by the implementation of the Migratory Registry.

51. **Rationale.** Since 2015, more than 2 million Venezuelans passed through Ecuador in a "humanitarian corridor" and almost 400,000 settled in the country.[20] Ecuador has one of the most welcoming regulatory frameworks to protect migrants and refugees in the region, which includes free access to health and education guaranteed by the constitutional mandate for everyone living in the country, whether they are Ecuadorian citizens, migrants or refugees. Migrants benefit from child development programs and in-kind transfers associated with school enrollment. The country also became an example of good practices in international protection, by facilitating access for the refugee status determination procedure and strengthening the refugee registration platform. Ecuador has responded to the increase in the demand for education, health, and social protection services through the implementation of tailored measures, but a recent diagnostic shows that Venezuelan migrants still face challenges in accessing these services. Despite free access, more than half of school-age migrants remain outside the education system mainly due to lack of information about the registration process, while in the health system, migrants struggle to get appointments.[21] More than half of Venezuelans in Ecuador

[20] http://reporting.unhcr.org/node/2543
[21] World Bank (2020) Between countries: challenges and opportunities of Venezuelan migration in Ecuador

have irregular status.[22] In response to this situation, the government has instituted a temporary amnesty for irregular migrants and created a no-fee humanitarian visa requiring minimal documentation to help integrate Venezuelan migrants into the Ecuadorian society. Unfortunately, results have not met expectations because many migrants lack even minimal documentation or the resources and time required to obtain such documentation from the Venezuela Embassy.

52. **Migrants are particularly vulnerable to the impacts for the COVID-19.** These individuals tend to work informally, have limit assets, and cannot rely on a social network for support. Their livelihood could be severely affected by the economic repercussions of containment efforts. As discussed, this population already faces challenges accessing services, including health services. Fear of persecution or deportation could further discourage sick migrants to seek help. For this reason, the Ecuadorian government took additional steps to protect this vulnerable group in the context of the COVID-19 emergency.

53. **Substance of the Prior Action.** Prior Action #4 supports the creation of a Migratory Registry that can help inform the design of more effective programs to support migrant populations. The information gathered will help the government and the development community to define a roadmap to better target social assistance aid, promote the local integration of migrants, and help family reunification. This information will be collected through a Migratory Census and will feed a Migratory Registry that will be accessed by the different ministries and agencies providing services to migrant populations. The registry will help redesign the program according to the status and location of these individuals. These efforts to better support and integrate migrant populations and to meet the associated financing needs are the basis for Ecuador's access to concessionary resources under the GCFF (see Box 4). In response to the COVID-19 crisis, the Government has extended the amnesty to irregular Venezuelan migrants by 60 days allowing their permanence in the country and ratified the validity of Venezuelan passports that have expired within 5 years. Finally, the Government established a procedure to regularize foreigners, parents of Ecuadorian children or adolescents who did not register their entry through official immigration control points. Indicative Trigger #4 for DPF 3 continues this work by supporting the preparation of a new migrant strategy informed by the registry. These important actions were not considered in the original DPF series.

Box 4. The Global Concessional Financing Facility
The Global Concessional Financing Facility (GCFF) is a partnership sponsored by the World Bank, the United Nations (UN), and the Islamic Development Bank Group to mobilize the international community to address the financing needs of middle-income countries hosting large numbers of refugees. By combining donor contributions with multilateral bank loans, the GCFF enables eligible middle-income countries that are facing refugee crises to borrow at below regular multilateral development bank rates for providing a global public good. The GCFF represents a coordinated response by the international community to the Syrian refugee crisis, bridging the gap between humanitarian and development assistance and enhancing the coordination between the UN, donors, multilateral development banks, and benefitting (host) countries. The GCFF is currently supported by Canada, Denmark, the European Commission, Germany, Japan, Netherlands, Norway, Sweden, the United Kingdom, and the United States.

[22] Ibid

54. **Expected results and Indicators:** Prior Action #4 and Indicative Trigger #4 aim to increase the impact of programs and services for migrant populations, helping protect and integrate these individuals in the medium-term. However, the full implementation and materialization of the impacts of these reforms are likely to go beyond the implementation period of this DPF. A proposed intermediary output indicator is in the numbers of migrants covered by the registry (from 0 in 2017 to 230,000 in 2021).

Pillar 2: Removing barriers to private sector development and supporting the economic recovery

55. **Actions under Pillar 2 focus on removing barriers to the private sector development, helping firms survive during the COVID-19 crisis and supporting the post crisis recovery.** By doing so**,** these reforms will contribute to higher productivity and competitiveness. The appreciation of the real exchange rate, in the presence of rigid labor laws in a dollarized economy registered in the past decade, has contributed to a loss of competitiveness of the tradable sectors of the economy. In addition, some of the policies that accompanied the expansion of the state's footprint in the economy were harmful to private sector development. Several barriers, including regulatory uncertainty, high costs to open and close businesses, rigid labor market regulation, and distortions in financial markets have negative effects on the performance and resilience of private firms. Previous administrations enacted a series of legal changes that stymied private investment (domestic and foreign). In addition, the time and costs involved in registering a new business in Ecuador are high compared to regional peers. Minimum wages have grown above productivity, undermining competitiveness. The complex wage-setting process is distortive and leaves little room for firms to adjust to economic fluctuations. Limited access to finance is also considered an important obstacle by businesses. Regulatory barriers limit financial sector performance. For example, interest rate ceilings exclude borrowers priced out of formal credit markets under current caps. Public banks play an important role in financing the economy but face challenges related to the structure of funding, transparency and accountability, and mandate. In many segments, public banks compete with private ones. Tackling these barriers could foster a more dynamic and resilient private sector, which is better equipped to weather economic shocks such as the COVID-19 crisis and which is to be able to reestablish productive relations in the post-crisis period.

Creating conditions for a more dynamic private sector

Prior Action #5 DPF 2: The Borrower has included provisions in the Entrepreneurship and Innovation Law to facilitate firm entry and growth of small young firms, including: (i) the creation of a simplified regime for registering a corporation; and (ii) the creation of entrepreneurship-enhancing programs in the education system.

Indicative Trigger #5 DPF 3: The Borrower has approved regulations to strengthen competition and the enforcement powers of the Competition Authority.

56. **Rationale.** Entrepreneurial decisions are shaped by managerial capabilities as well as costs associated with entry, exit and firm operations. Managerial capabilities, influenced by cognitive abilities,

soft skills and entrepreneurial attitudes, are among the main determinants of firm productivity growth.[23] Entrepreneurs are also more willing to enter new markets, experiment and innovate, and invest in new growth opportunities if they face low entry and exit costs. Ecuador's non-conducive regulatory environment has led to a sluggish private sector during the last decade. It takes 48.5 days for an entrepreneur in Ecuador to start a business, almost twice the regional average and five times the average for OECD high-income countries. The cost to start a business as a percentage of per capita income reached 33 percent in 2019, higher than the average for Latin America and the Caribbean of 31 percent. Despite recent Government efforts, the labor market remains very rigid. Barriers to entry, exit, and growth disproportionately affect young and small firms, which represent the bulk of Ecuador's private sector. In 2015, more than 97 percent of firms were micro and small firms and nearly 40 percent were less than five years old. Existing research shows that while young firms are on average relatively smaller in terms of sales than incumbents, they generate relatively more jobs on average.[24]

57. **Substance of Prior Action.** Prior Action #5 considers articles from the Law for Entrepreneurship and Innovation that favor the entry and growth of young firms, defined as those having less than five years of operation, fewer than 49 workers and less than US$1 million in annual sales. Reform provisions to the Companies Law introduce the possibility of registering companies within a simplified regime. This will reduce the fixed cost to register a business by: (i) allowing contributions in cash to the minimum social capital to be paid up to two years after firm registration, and (ii) eliminating the need to hire a lawyer and a notary. In addition, the law creates a physical and online single window for entrepreneurs to reduce the asymmetry of information on the procedures required to create and operate a business; introduces a more flexible contractual labor modality for young firms; permits and regulates crowdfunding platforms; and promotes soft and hard entrepreneurship skills through the education system. These measures will help support new economic activity post-COVID-19. Indicative Trigger #5 complements these efforts and introduces regulations to strengthen competition in the economy and the enforcement powers of the Competition Authority, further reducing barriers to firm entry and growth in the post-crisis period. These measures expand the scope of the original action contemplated by the DPF series.

58. The DPF series also contemplated a reform to PPP Law to align it with international best practices. However, under the current political and economic environment, the Government would be unlikely to mobilize enough support in the National Assembly to approve such a reform. For this reason, DPFs 2 and 3 support other meaningful efforts to foster private sector resilience, development, and competitiveness.

59. **Expected Results and Indicators.** The measures are expected to lower barriers to entry, encourage formal registration of firms, and foster firm's growth potential, including by lowering their registration costs and enhancing managerial capabilities. The proposed indicator to track these effects during the DPF implementation period is the number of new commercial companies registered, which is expected to increase by 31 percent, from 8,210 per year in 2017 to 10,800 in 2021.

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[23] Several studies have found that entrepreneurs' cognitive abilities, as measured by psychometric tests, can be useful in predicting the success of businesses (Grover Goswami et al., 2019. High-Growth Firms: Facts, Fiction, and Policy Options for Emerging Economies. Washington, DC: World Bank).
[24] INEC 2017, Panorama Laboral y Empresarial del Ecuador.

Reforming labor markets to reduce distortions

Prior Action #6 DPF 2: The Borrower has adopted measures to reduce the number of sectoral and occupational minimum wages that are fixed and improve the timeline for setting minimum wages.

Indicative Trigger #6 DPF 3: The Borrower has approved regulations improving the minimum wage setting process by committing to adjust wages following an objective pre-defined formula, if no agreement is achieved by 3-part negotiations (between workers, employers, and Government).

60. **Rationale.** Wage setting for the private sector is determined by the Basic Unified Minimum Wage that includes a national minimum wage and minimum wages by sector and occupations. The unified minimum wage is defined through a bargaining process between workers, employers and Government representatives at the end of each calendar year. If no agreement is reached, minimum wages are set by the Ministry of Labor. Once the national minimum wage is defined, representatives of workers, private-sector employers, and the Government meet again in Sectorial Wage Councils to decide minimum wages increases by sector and by occupations within sectors. 21 sectorial councils are responsible for estimating minimum wages for more than 2,300 occupations. Sectoral minimum wages differ across councils for similar occupations creating distortions in the labor market. As a result, the minimum wage structure in the economy does not reflect differences in productivity within and across sectors/firms. Moreover, firms do not have enough time to adjust to changes in sectorial minimum wages. The announcement of the new structure of minimum wages is usually done by late December or early January to be immediately implemented. This inefficient minimum wage-setting mechanism directly affects formal jobs creation, private sector competitiveness and it is particularly costly for small firms.

61. **Substance of the Prior Action.** Prior Action #6 removes some inefficiencies in the process of setting minimum wages by sector. It supports the issuance of Ministerial Agreement MDT-2020-023 to reduce the number of sectors' minimum wages by a minimum of 5 percent each year from 2021 to 2022, merging similar occupations across sectors and setting the timeline for further simplification of sectoral minimum wages towards a universal minimum per sector. The Ministerial Agreement also requires that all minimum wages to be announced by the end of November of each calendar year give firms enough time to make necessary adjustments before implementing the changes in January.

62. Indicative Trigger #6 builds upon this Prior Action and consists of implementing a rigorous and transparent methodology to determine the minimum wage. The main objective of having a methodology/ formula is to reflect common policy objectives of workers, employers, and government (such as reducing income inequality or guaranteeing fair remuneration to workers, as per their contribution to productivity gains). The resulting wages serve as a technically derived "starting position" in regular negotiations, rather than as a predetermined and uncontestable outcome and/or could be used as the main criteria to determine minimum wages if workers and employers fail to reach an agreement in a bargaining process.

63. The measures proposed for DPFs 2 and 3 differ from those originally proposed in the DPF series. Originally the series contemplated a reform to the Labor Code to increase flexibility and increase formality among vulnerable segments of the population. Under the current political environment, it is uncertain if

and when the Government will be able to mobilize enough support in the National Assembly to approve such a sensitive reform. Instead, the proposed approach is to promote labor reforms that can be addressed through executive decrees and secondary regulations.

64. **Expected results and Indicators:** The expected medium-term outcome of these reforms is to increase formal employment in general. However, the full implementation and materialization of the impacts of these reforms are likely to go beyond the implementation period of this DPF. A proposed intermediary output indicator is the reduction of the number of referential minimum wages set from more than 2,300 wages set in 2017 to less than 2,000 by 2021.

Reducing regulatory distortions and expanding the reach of the financial sector

Prior Action #7 DPF 2: The Borrower has helped expand the reach of the financial system by: (i) reducing barriers to digital financial services for underserved populations, including by allowing for remote uptake of basic accounts via mobile phones; and (ii) reducing the cost of getting financing from abroad by expanding the criteria for exemption of the outward foreign exchange tax (Impuesto a la Salida de Divisas- ISD) associated with financial transactions.

Indicative Trigger #7 DPF 3: The Borrower has reduced financial distortions by: (i) reforming the governance and sources of funding of public banks; (ii) partially liberalizing interest rate ceilings; and (iii) reforming the Financial and Monetary Code to allow banks to have subsidiaries that foster capital market development.

65. **Rationale.** The bank-dominated financial sector in Ecuador is subject to restrictive regulations that inhibit its capacity to support private sector-led growth and efficiently deliver financial services. It is shallow, with private credit to GDP standing at 29 percent compared to 49 percent on average in Latin America and the Caribbean. Ecuador also lags the regional average on financial inclusion.[25] The use of banks by Ecuadorian firms to finance investments is lower than the average for the region and for similar income country groups, while access to long-term finance is low even for large companies. Women, youth, and rural residents are particularly likely to be financially excluded, partly as a result of limited financial infrastructure outside urban areas and poor product design. Low financial education also plays a role. Limited financial deepening and inclusion are partially related to the crowding out of the private sector by the public sector and the pervasive presence of interest rate caps across all credit segments limits private banks' involvement and risk taking. Financial sector authorities have undertaken several measures to improve the efficiency of financial intermediation and financial inclusion in recent years, some of them supported through DPF 1. Yet several weaknesses remain that need to be addressed.

66. The financial sector is critical to helping mitigate the economic impact of the devastating consequences of the COVID-19 pandemic by providing the most extensive and capillary network to channel financial flows to the real economy and facilitate cash transfers to the most vulnerable segments of the society. In order to support firms and individuals who face difficulties in paying their existing loans during the COVID-19 crisis, the authorities announced temporary and time-bound refinancing,

[25] Global Findex, 2017

restructuring or renovation of all loans from private banks, public banks and financial cooperatives for up to 90 days during which financial institutions will continue to classify the loans as current and will not report the payment deferral as late payment to the credit reporting systems. These measures could help avoid a wave of defaults in the short term and can offer immediate relief to the real sector and additional time to financial institutions and borrowers. It should, however, be cautiously implemented. It should be time-bound and closely monitored to avoid any moral hazard, financial disclosure veracity problems and other unintended consequences. The supervisory authorities should closely monitor the implementation of these measures.

67. **Substance of the Prior Action.** Prior Action #7 supports changes in the regulations governing basic accounts to allow for remote account opening - including via mobile phone and third-party retail agents - with simplified, risk-based measures in place to address anti-money laundering (AML) concerns.[26] Basic accounts are a critical entry point into the formal financial sector and are designed to meet the basic payment and savings needs of underserved consumers.[27] Traditionally, opening an account with a financial institution in Ecuador has required physical travel to a branch of a bank or financial cooperative and face-to-face interaction with financial institution staff. However, many Ecuadoreans do not live near a branch, are unfamiliar or discouraged by bureaucratic account opening processes, and may be intimidated by formal financial institutions staff. Prior Action #7 also supports broader criteria for exemption from the outward foreign exchange tax (ISD) associated with financial sector transactions. A tax of 5 percent applies to all outward foreign exchange flows with some exemptions. This tax discourages not only capital outflows, but also inflows as there is an additional risk or cost on the return of such investment. Outflows in connection with bank and nonbank financing exceeding six months are now exempt for housing, microcredit, equity investment, and productive investment. Similarly, capital transactions such as dividend payments and transfers abroad related to capital and money market securities, including those linked to investment in financial institutions, are exempted from the payment of the tax. Increased capital outflow mobility can facilitate the recycling of international savings in the domestic financial system and help keep international capital markets open while maintaining liquidity in the financial system during the COVID-19 crisis. As a matter of fact, several large banks in Ecuador have contingent lines of credit with international lenders.

68. Indicative Trigger #7 aims to improve the corporate governance framework of public banks, strengthen the independence of the boards of directors, improve their risk management and revise their mandate to complement private banks. This can also contribute to mobilizing more transparent sources of funding of public banks. Indicative Trigger #7 also supports initial steps for interest rate deregulation by revising the criteria for determining the ceilings in different segments. A revised interest rate management framework is expected to lead to ceilings that are more responsive to structural and cyclical developments in credit markets, paving the way for a gradual convergence of interest rates towards market clearing rates

[26] While in-person account opening requirements typically stem from AML concerns and the need to undertake customer due diligence (CDD) processes to validate the identity of the financial consumer, such requirements should be proportionate to the level of risk implied by low-value, basic transactional products. A number of countries have adopted simplified CDD that allows access to products with limited functionality. These reforms helped expand access to bank accounts and facilitated the delivery of emergency cash benefits in remote areas of the country.

[27] Basic accounts in Ecuador are deposit accounts, subject to certain functionality limitations (e.g., maximum balance, number of monthly transactions) and limits on fees (e.g., for cash withdrawal and interbank transfers), as established by regulation.

across credit segments. While further interest rate liberalization will help better allocate resources, the timing and sequencing of reforms need to be carefully calibrated in order to create consensus among different actors while strengthening necessary preconditions to reduce risks of macroeconomic and financial instability. Finally, Indicative Trigger #7 expands the activities that banks can carry out through subsidiaries, including securities brokerage firms and FinTech firms, contributing to capital market development. These measures are fully aligned with those originally contemplated by the DPF series.

69. **Expected Results and Indicators.** The broadening of exemptions from the outward foreign exchange tax on financial transactions abroad is expected to lead to increased liquidity in the financial system while the use of remote services will expand its reach. Together with better governance practices, this can contribute to mobilizing countercyclical financing, thus mitigating the impact of the fiscal adjustment. The set of actions in Indicative Trigger #7 will expand the possibilities of the financial sector to serve new segments of the population while diversifying sources of funding for the productive corporate sector. These results will be monitored by: (i) number of basic accounts opened via remote processes from 0 in 2017 to 250,000 in 2021, and (ii) co-movement[28] between interest rate ceilings and nominal interest rates charged by banks for productive and corporate segments, from 0 in 2017 to > 0.2 by 2021.

Pillar 3: Promoting public sector efficiency and fiscal sustainability post-crisis

70. **Actions under Pillar 3 promote improvements to the allocation of government resources, helping create fiscal space during the crisis and supporting an orderly fiscal consolidation in the post crisis period.** Weak budgetary processes and current spending rigidities have prevented a more strategic and equitable approach to fiscal adjustment, forcing the Government to rely on large capital spending cuts to address fiscal imbalances in the past. Relatively low non-oil revenues have added to fiscal pressures that have been further intensified by the COVID-19 crisis. Reforms supported under Pillar 3 seek to address these challenges. They help strengthen the MEF's responsibility and oversight during budget preparation and execution, improve information exchange and monitoring, align budgetary processes and public investment planning with the fiscal sustainability objectives, and create a sound framework to manage fiscal risks to help cope with exogenous shocks. Reforms also help improve procurement and human resource management processes, allowing for sustainable savings on goods and services and personnel spending without adversely affecting service provision. Additionally, these reforms support changes in the pricing of energy products, reducing Ecuador's large and poorly targeted subsidies and creating incentives for increasing productivity. Finally, reforms under Pillar 3 support a more efficient revenue mobilization, including during the COVID-19 crisis, by rationalizing tax expenditures and improving tax policy.

Strengthening budgetary processes and aligning them with fiscal sustainability objectives

[28] Co-movements are proxied by the ratio between standard deviation of monthly interest rate ceiling and the standard deviation of the effective interest rate measured with monthly data over an 18-month period.

Prior Action #8 DPF 2: The Borrower has: (i) submitted to the National Assembly, for approval thereof, amendments to the Organic Code of Planning and Public Finance to: (a) introduce a four-year medium-term fiscal framework and a fiscal risk management framework; (b) reduce from 15 percent to 5 percent the margin for changes to the central government budget without prior approval from the National Assembly;[29] and (c) integrate the forward-looking cost implications from public investment decisions into annual budgets; and (ii) established a Committee of Public Finance (*Comité de Finanzas Públicas*) to oversee fiscal risk assessment and mitigation.

Indicative Trigger #8 DPF 3: The Borrower approved key regulations to implement amendments to the Organic Code of Planning and Public Finance to introduce a medium-term fiscal framework and a fiscal risk management framework, revised downwards to 5 percent from the current margin of 15 percent for changes in the budget without consulting the National Assembly, and created an integrated national and subnational public investment system.

71. **Rationale.** Ecuador lacks budget preparation procedures and milestones that ensure consistency between macro-fiscal programming and the annual budget— or access to accurate information to properly monitor its implementation. For the last decade, budget preparation has followed a bottom-up approach with no aggregate, sectoral, or institutional ceilings communicated to align the budget with fiscal targets and the macroeconomic management objectives. Ecuador has weak technical and formal coordination arrangements to ensure consistency between macro-fiscal programming and the formulation and approval of the annual budget before submission to the National Assembly, and the access to accurate information to properly monitor its implementation. On the investment side, prioritization among projects remains a challenge. The investment planning process is disconnected from overall budget preparation and execution, as it is outside the control of the Ministry of Finance and includes no formal coordination process.[30] Multi-year planning and the incorporation of investment spending projections is also weak. Investment projects rarely consider the forward-looking operation and maintenance expenses associated with the new assets. Finally, the budget code departs from international good practice standards: in particular, the code allows the executive to make modifications of up to 15 percent in excess of the Assembly-approved annual budget undermining accountability and fiscal discipline. Between 2015 and 2017, ex-post deviations between approved and executed budgets have hovered around 17 percent. Finally, the government lacks a framework to accurately assess and mitigate fiscal risks, which has further exposed the fiscal accounts to exogenous shocks.

72. **Substance of the Prior Action.** DPF 1, 2, and 3 all contain measures to gradually strengthen the budget preparation process. Prior Action #8 of DPF 2 supports the presentation to the National Assembly of a well-consulted reform to the Organic Code of Planning and Public Finance that includes the introduction of a multi-year fiscal framework as the anchor of the annual budget, reduced from 15 percent to 5 percent, the ceiling for non-approved budget modifications, and introduced a fiscal risk statement to the Budget documentation. It also introduces a set of fiscal rules to anchor the medium-term fiscal framework. However, the fiscal impacts of the COVID-19 crisis will likely delay their implementation. The

[29] There are exceptions that allow for emergency situations, including those such as the COVID-19 crisis.
[30] The Organic Code of Planning and Public Finance allocates the responsibility of investment planning to the Technical Planning Secretariat (*Secretaria Tecnica Planifica Ecuador* by its name in Spanish, formerly known as SENPLADES).

revised Code also strengthens the link between public investment planning and budget preparation and execution, by integrating the forward-looking cost implications from public investment decisions into annual budgets. In October 2019, the Government presented to the National Assembly an urgent economic package that included these reforms to the Organic Code of Planning and Public Finance, but this package was ultimately rejected by the National Assembly. The new reform proposal, presented to the National Assembly on April 16, 2020, is the result of extensive consultations with the Assembly and other key stakeholders, which mitigates the risk of rejection when the package is resubmitted. The revisions include a fiscal risk management dimension.

73. In addition, the Government has established a Public Finance Committee, the role of which is to oversee the implementation of the legal reform, develop a PFM reform strategy and monitor fiscal risks.[31] Indicative Trigger #8 for DPF 3 acknowledges the expected enactment of the amendments to the Organic Code of Planning and Public Finance including the key features of the proposal submitted to the National Assembly in line with the reforms originally proposed by the DPF series and supports initial steps for its implementation.

74. **Expected Results and Indicators.** The reforms to the budget preparation and execution processes and institutions are expected to increase the budget's reliability and its consistency with fiscal policy goals. The difference between the approved and the executed budgets is expected to decline from a baseline of 16.3 percent in 2017 (before the reforms started) to 8 percent in 2021. Preliminary estimates suggest that deviation between approval and execution was slightly above 1 percent of initial budget in 2019 reflecting early-stage improvements in execution and controls. However, this deviation is likely to be larger in 2020 due to the unforeseen repercussions of the COVID-19 crisis.

Increasing the efficiency of spending on goods and services and personnel, while preserving service delivery

Prior Action #9 DPF 2: The Borrower has eliminated redundancies in staff by adopting and implementing an inter-ministerial agreement to cut duplicative posts in deconcentrated offices.

Indicative Trigger #9 DPF 3: The Borrower has approved a decree to further improve the efficiency of public sector human resource management through institutional reorganization to reduce duplications and reform the salary scale. The Borrower has enacted reforms to the Public Procurement Law to further increase transparency and competition in public procurement.

75. **Rationale.** Fiscal adjustment efforts to date have relied mostly on capital spending cuts, while there are potential efficiency gains to be had in the wage bill and in goods and services spending. The Ecuador PFR suggests that there are opportunities to contain the public wage bill, without affecting service delivery. The government payroll increased by 30 percent over the period 2014 to 2019, driven by a rapid increase in the number of government employees (from 400,000 in 2014 to around 550,000 at the start of 2019), mostly on health and education, with workers entering the public sector under special regimes

[31] Ministerial Agreement No, 17 of January 31, 2020.

for recruitment. As of April 2019, the number of employees at deconcentrated offices (zonal and district offices) accounted for 45 percent of the total number of public sector employees. Analysis suggests that these offices are not efficiently set up and there are duplications both in managerial positions and support functions (for example, finance, human resources, procurement, administration, legal, IT). Salary levels are higher than in other comparable countries and in the private sector, specially at the lower grades. Inefficient human resource management has exacerbated the problem. Initial efforts to contain the growth of the wage bill focused on wage freezes and salary cuts for high-ranking officials, with some positive results in terms of a lower wage bill in 2018. Still, deeper and more sustainable reforms in human resource management are required to improve service delivery results while controlling the wage bill. Such reforms are supported by DPFs 2 and 3.

76. The analysis developed for the Ecuador PFR suggests that there are opportunities to allocate resources more efficiently by promoting savings in the purchase of goods and services (Figure 3). Procurement data for 2013-2017 showed that about 50 percent of the value was awarded using non-competitive procurement methods. These methods resulted in higher prices when compared to competitive methods, such as framework agreements and catalogs. Detailed analysis of the data also unveiled a pattern of "over specification" of items, which contributed to higher prices while surpassing the expected functionality and needs for these items. The PFR also found that specifications were based on available budget rather than on functional needs. DPF 1 supported regulations to tighten procedures and requirements for noncompetitive procurement methods that lead to higher prices. These regulations shifted a portion of the awarded value to competitive methods and maximized the use of framework agreements and catalogues, shortening procurement lead times while delivering more value for money. These efforts are deepened in DPF 2 in the context of the crisis and in DPF 3 more broadly.

Figure 4: Opportunities for saving in public procurement

	Variable with impact on prices	Savings	Suggested policy or strategy
Directly impacted by procurement policies or strategies	Quantity	7.3%	One main contract to supply 80% of the annual demand of goods of high volume and low complexity.
	Procurement method	2.5%	(1) To expand the use of e-catalogues for goods of high volume and low complexity; (2) to deploy reverse auctions more selectively, for goods of low complexity and competitive markets; (3) to curb noncompetitive procurement, especially for "menor cuantía" and "regimen especial" procedures.
	Time to award a contract	1.3%	To implement electronic processes that are more dynamic and efficient to support award processing.
	Seasonality	1%	To improve procurement planning and more predictable budget releases so as to avoid large concentrations of procurement in the last months of the year, and smooth distribution along the year.
	Bidding success ratio	0.5%	To modernize procedures and information availability for contract management, with the goal of curbing cost and schedule overrruns. To train officials in charge of contract management.
	Time allowed to prepare and submit bids	0.3%	To allow more reasonable time for bidders to prepare responsive bids.
	Publication of bidding opportunity	0.3%	(1) To publish an electronic request for bids for simple procedures; and (2) to notify electronically all registered bidders of any bidding opportunity on their area of business.

	Variable with impact on price	Savings	Suggested policy or strategy
Indirectly impacted by Procurement policies or strategies	Number of bidders	2.4%	(1) To approach bidders with a view to understand the barriers to sell to the government; (2) to curb required documentation to submit bids for low complexity items; (3) to process payments quicker; (4) to develop market strategies based on the supply positioning matrix.
	Market concentration	1.8%	To develop customized procurement strategies for the markets that showed highest levels of concentration, based on market competitiveness and end-user needs.
	Supplier specialization	0.7%	To use competitive methods for categories where there are manufacturers.
	Supplier size	0.5%	The strategies suggested to quantities and procurement methods would already impact this variable. Moreover, a survey to understand the barriers and difficulties to prepare a responsive bid would help design effective strategies.
	Buyer concentration	0.2%	To develop a capacity building program to agencies with highest levels of concentration.
	Supplier origin	0.2%	To foster participation of foreign suppliers in markets with low competition, high levels of concentration or where innovation is an important element.
	Supplier province	0.2%	To develop an outreach program to local suppliers, through electronic newsletters and training workshops on how to identify bidding opportunities and to prepare responsive bids.

Source: Ecuador PFR Phase I - 2018

77. **Substance of the Prior Action.** This prior action supports initial efforts to eliminate duplication and redundancies in the deconcentrated system for the provision of services. In October 2019, the Planning Secretariat, the MEF, and the Ministry of Labor published the Interinstitutional Agreement (*Acuerdo Interinstitucional* SENPLADES-MEF-MDT-001-2019) which aims to rationalize the number of deconcentrated offices as well as the number of managerial staff and people performing supporting functions not directly linked with service delivery. The reform introduces a review of the institutional set up in order to improve efficiency of the administration of sub-national offices, without impacting staff involved in front-line service delivery. The reform mostly impacted the Health and Education Ministries' deconcentrated offices as these two ministries have the largest number of deconcentrated offices and workers. The bulk of the agreement was implemented before the arrival of the COVID-19 crisis and so far there is no evidence of an adverse impact on the Government's ability to respond. However, final implementation steps might be delayed by the crisis. When fully implemented, the agreement could affect between 3,000 and 5,000 employees, generating fiscal savings estimated at between US$40 million and US$70 million per year, or between 0.4 percent and 0.8 percent of the wage bill.

78. Indicative Trigger #9 deepens the fiscal consolidation efforts by supporting the additional steps laid out in the 2020 decree to improve functional efficiency, human resource management and spending efficiency in the government, including central ministries and other public sector institutions. Building on the findings from the PFR, it supports reforms to the procurement code that: (i) tighten the conditions for use of "*regimen especial*", which the PFR analysis found to result in higher prices; (ii) enable Public Procurement Service (SERCOP) to monitor and fight monopolies and oligopolies in public procurement at the buyer level; (iii) add a pre-bidding stage to help improve planning; and (iv) remove awards based on criteria such as raffles and direct selections.

79. The proposed measures on HR management differ from those originally proposed by the DPF series. The original trigger, which linked payment with performance, was identified as unconstitutional –

the Constitution does not allow different remuneration for individuals doing the same job. In this context, authorities shifted their efforts towards the optimization of functions and structure. The measures on procurement are similar to those originally proposed in the DPF series.

80. **Expected Results and Indicators.** The implementation of reforms on public procurement and human resources is expected to generate more efficient, transparent, and accountable systems, resulting in fiscal savings from expenditures in personnel and the purchase of goods and services. This would free up resources to respond to the COVID-19 crisis and would allow for fiscal consolidation in the post-crisis period. In this context, total spending on goods and services and personnel is expected to decline from 14.7 percent of GDP in 2017 to 13.3 in 2021. This result reflects a decline of 0.6 percent of GDP of the wage bill (from 9.9 percent of GDP in 2017), plus an effort to reduce spending in goods and services by 0.8 percent of GDP (from 4.8 percent of GDP in 2017). In 2019, the public wage bill reached 9.5 percent as a result of initial efforts, while goods and services declined to 4.3 percent. These gains will be offset in 2020 because of additional spending associated with the COVID-19 crisis response, especially that which relates to personnel and to goods and services in the health sector. But the temporary pressures are expected to fade in 2021 as the situation stabilizes.

Reforming energy pricing policies to rationalize subsidies and reduce fiscal costs associated with the energy sector

Prior Action #10 DPF 2: The Borrower has: (i) appointed a commission within the Regulatory Agency for Hydrocarbon (ARCH) to set fuel prices and increase transparency in price setting by making final prices and reference prices publicly available; and (ii) launched the competitive auction for renewable energy opening the market to the private sector while reducing the fiscal impacts of electricity by adopting a least cost expansion plan for generation and by allowing the pass-through of all costs to end user prices.

Indicative Trigger #10 DPF 3: The Borrower has: (i) implemented a compensation mechanism to mitigate the impact of fuel subsidy price reforms; and (ii) issued a decree introducing a gradual removal of gasoline subsidies and further empowered ARCH to improve its pricing methodology, notably through a price smoothing formula.

81. **Rationale.** Energy price subsidies absorb a large amount of fiscal resources that mostly benefit those who are relatively well off. For example, price subsidies for liquid fuels were estimated at around 2.1 percent of GDP in 2017, paid for through government outlays and financial losses borne by the national oil company. The subsidy cost from financial losses and foregone revenues by the electricity distribution utilities adds another 0.5 percent of GDP. The top 60 percent of the income distribution received between 80 and 92 percent of the gasoline and diesel subsidies.[32] Subsidize prices are set in an *ad hoc* manner by the president. Reforms supported by DPF 1 eliminated subsidies for selected fuels and transferred the price-setting responsibilities to the fuel regulatory agency ARCH following a pre-determined cost-based formula. These efforts contributed to around 0.3 percent of GDP in fiscal savings. DPF 1 also supported

[32] Subsidy calculations are based on opportunity costs which are import-parity costs for gasoline, diesel and LPG and export-parity for heavy fuel oil. For further information about how these figures were estimated see Annex IV.

efforts to better target the social tariffs for electricity (*Tarifa de Dignidad*) but delays in the implementation of this action prevented the government from tapping into the 0.1 percent of GDP savings associated with this measure in 2019.

82. DPFs 2 and 3 continue supporting efforts to reduce fiscal impacts associated with the energy sector. In October 2019, the Government attempted to fully eliminate gasoline and diesel subsidies, but the measure was reversed after two weeks of intense protests. The political and social challenges faced by the government highlights the need for carrying out consultations and building consensus with relevant actors in society and the design of compensatory measures to protect vulnerable groups. Record low international oil prices associated with the COVID-19 crisis provide a good opportunity to reform fuel subsidies. The government remains committed to pursuing the subsidy reforms and is carefully redesigning its implementation through a consultative process that will be reflected under the next DPF in the series. As the Government makes progress in the dialogue for a gradual phase-out of the low-octane gasoline subsidy, it is critical that a well-targeted compensation mechanism is designed and implemented. Credible protection mechanisms can also help build consensus and mobilize support to a traditionally difficult reform. Meanwhile, the government took steps to strengthen the capacity and transparency of ARCH and to promote an efficient expansion of electricity generation, reducing the fiscal impacts of the sector.

83. **Substance of the Prior Action.** Prior Action #10 helps strengthen the price-setting capacity of ARCH by supporting the creation of a price-setting commission and the publication of reference prices and final prices, as well as reference prices in the neighboring countries. This makes information about subsidy amounts readily available to the larger public and complements the decision to provide the reference price in the invoices implemented in August 2018, which reached less than one third of consumers and none of the individuals who currently no consume fuels but can potentially be affected by subsidy reforms. This transparency measure will support the communication strategy associated with the subsidy reform.

84. Prior Action #10 also recognizes efforts to expand electricity generation through the first competitive auctions for renewable energy production implemented according to best practice, moving from feed-in tariffs – which represent essentially a subsidy for renewables – to competitively awarded auctions. For the first time in Ecuador, reference tariffs calculations for the auction include all costs, including CAPEX, which will be passed-through end-user tariffs (although the expected increase in prices is expected to be only marginal). The first renewable energy auction of the (200MW) photovoltaic plants in El Aromo and the (110MW) Villonaco II and III wind farms, each requiring an investment of US$400 million, was launched in August 2019. The quantity auctioned has been derived through the least-cost expansion plan underpinning the updated *Plano Maestro de Electricidad* which was finalized in August 2019 and published in January 2020. These changes will support the government in reducing fiscal costs associated with the energy sector. The launch of the renewable auction also contributes indirectly to the removal of fossil fuel subsidies by introducing renewable energy that will displace thermal fuels for power generation and provide a resilient alternative to hydroelectric plants during droughts. This will contribute toward a shift to less carbon-intensive fuels as well as provide greater reliability of service in the case of

extreme weather events, which are expected to increase due to climate change.[33]

85. Indicative Trigger #10 supports additional steps for the gradual removal of gasoline subsidies following a consultative process. It supports the design and implementation of compensation mechanisms associated with the phase-out of gasoline subsidies and the actual phase out strategy, empowering ARCH to improve its pricing methodology. This reform could result in fiscal savings of up to 0.4 percent of GDP, supporting fiscal stabilization after the COVID-19 crisis.

86. **Expected Results and Indicators.** This Prior Action and Indicative trigger support, directly and indirectly, reductions on energy subsidies. Results will be measured by a reduction in the total spending on gasoline subsidies from 2.1 percent of GDP in 2017 to less than 0.8 percent in 2021. By helping align energy prices with market values, these reforms will also curb excess consumption and wasteful production. The actions also support the use of cleaner renewable energy sources.[34] Both channels contribute to lower carbon emissions and support the Government's climate change mitigation objectives under the intended nationally determined contributions to the Paris Agreement goals.

Improving domestic resource mobilization

87. **Part of the Government's fiscal consolidation efforts need to stem from a more efficient mobilization of non-oil revenues, which become even more pressing when international oil prices are low and volatile.** While tax administration reforms helped increase revenue collection in the past decade, tax revenues (18.7 percent of GDP in 2017, including social contributions) are low compared to regional peers (22.8 percent on average). Revenue performance is affected by narrow bases and, in some cases, relatively low rates. Tax expenditures reached 4.5 percent of GDP in 2017, above the regional average (3.5 percent). The Government has intensified the use of this instrument since 2017 in efforts to promote private investment, but its design has not considered fiscal policy objectives and could further undermine revenue collection in the future. Ecuador's tax system also includes less traditional sources such as import tariffs, tax on capital outflows (ISD), plus a mandatory redistribution of profits to workers, which are very distortive.

88. **In December 2019, the National Assembly approved an important tax reform, but that had a narrower scope than the reform originally contemplated in the DPF series.** The tax reform that was originally planned comprised a broader range of measures, including changes in the VAT rates and base, which would help increase revenue collections by more than one percent of GDP. Anticipating a likely rejection by the National Assembly of changes in the VAT, the Government presented a somewhat more modest reform that aimed at increasing revenue collections by 0.5 percent of GDP. The reform Tax Code

[33] Based on the World Bank Climate Knowledge Portal, climate projections for Ecuador indicate that mean annual temperature will rise by 1.9°C in 2050 and total annual hot days of temperature above 35°C will rise by 21.1 days in 2050 (RCP 8.5, High Emission).
[34] El Aromo project alone is expected to result in savings of US$9 million of fuel oil otherwise used to generate electricity, reducing emission by around 128,000 tons of CO_2 per year. The electrical production of Villonaco II and III could imply a reduction of up to 219,000 tons of CO_2 per year.

helps mobilize additional revenues more efficiently. The tax reform also aimed at simplifying the tax system, making it more growth-friendly, and improving revenue mobilization while reducing distortions and preferential treatments. The reform included most of the simplification features of the original proposal. Since the approval of the Law, two legal claims of unconstitutionality have been submitted to the Constitutional Court, but as of now the claims have not been accepted by the Court. If the demands prosper, the specific provisions of the Law being challenged could be declared unconstitutional and the implementation of key aspects of the Law could be delayed by one year and its revenue impacts reduced to around 0.3 percent of GDP. While the tax reform is an important step towards fiscal sustainability, it will not be considered as a prior action for this operation due to the potential risks associated with the legal demands.

89. **The tax reform is expected to expand the tax base and reduce distortions, thus attenuating the revenue losses generated by the crisis and improve revenue collection in the medium term.** Progress towards this goal can be tracked by an expected 0.5 percent of GDP increase in tax revenues in the medium run.[35] Revenues are expected to increase only mildly from 13.5 percent of GDP in 2017 to 13.7 percent of GDP in 2021, due to impacts of the COVID-19 crisis on revenues. However, they should recover further to 13.9 percent of GDP in 2022. Revenue collection is expected to drop to 13.1 percent of GDP in 2020 because of the strong economic contraction.

Table 5: DPF Prior Actions and Analytical Underpinnings

Prior Actions	**Analytical Underpinnings**
Pillar 1: Responding to COVID-19 to protect the vulnerable	
Prior Action #1	Distributional impacts of the triplet crises (2020)
Prior Action #2	Trade, Investment, and Competitiveness ASA (2019), Ecuador Jobs Diagnostic (2020)
Prior Action #3	Distributional impacts of the triplet crises (2020)
Prior Action #4	Ecuador Venezuelan Migration Report (2020)
Pillar 2: Removing barriers to private sector development and supporting the economic recovery	
Prior Action #5	Ecuador SCD (2018), Ecuador CPSD (2019)
Prior Action #6	Ecuador SCD (2018), Ecuador Jobs Diagnostic (2020)

[35] Excluding social security contributions.

Prior Action #7	Financial Stability and Inclusion ASA (2019), ongoing technical assistance.
Pillar 3: Promoting public sector efficiency and fiscal sustainability during the recovery	
Prior Action #8	Ecuador Public Finance Review- Phase I (2018) and Phase II (2019), ongoing technical assistance.
Prior Action #9	Ecuador Public Finance Review- Phase I (2018) and Phase II (2019), ongoing technical assistance.
Prior Action #10	ESMAP- Sustainable and Equitable Energy Subsidy Reforms in Ecuador (2018-2020), Ecuador SCD (2018)

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

90. **The WBG CPF FY19-FY23 for Ecuador aims at rebalancing the economy, reigniting sustainable growth and protecting the vulnerable.** The CPF was prepared in parallel to the first operation in the DPF series and jointly discussed by the World Bank Executive Board of Directors in June 2019. It focuses on achieving the WBG's twin goals—ending extreme poverty and boosting shared prosperity—through three interdependent areas where expected results are aligned with the Government's priorities outlined in *Plan de Prosperidad* and the key challenges identified by the 2018 Ecuador SCD. These are: (i) Supporting Fundamentals for Inclusive Growth, (ii) Building Human Capital and Protecting the Poor, and (iii) Enhancing Institutional and Environmental Sustainability. Pillars 2 and 3 of the proposed DPF series support CPF objectives under the results area (i), while Pillar 1 supports CPF objectives under the results area (ii).

91. **The proposed operation and the DPF series more broadly are closely linked to other World Bank-financed operations, including the Social Safety Net IPF and the Risk Mitigation and Emergency Recovery Project.** As previously discussed, the DPF series benefited from many ASAs and TAs that allowed for the identification and design of critical reforms. The DPF series also complements other World Bank lending operations. Pillar 2 support reforms to the Monetary and Financial Code that are needed for the implementation of the Promoting Access to Finance for Productive Purposes for MSMEs Project (P172899). Pillar 1 supports regulatory reforms needed for the implementation of the Social Safety Net Project (P167416) the objective of which is to improve the equity, integration, and sustainability of selected safety net programs. It also supported the creation of the emergency cash transfer program, which will be implemented with resources from the Risk Mitigation and Emergency Recovery Project (P157324). One of the main sub-components of that project is to support the effective and timely updating of the Social Registry beyond the bottom two quintiles of the per capita consumption distribution. Pillar 3 relates closely to Component 3 of the recently restructured Risk Mitigation and Emergency Recovery Project (P157324). The restructured project includes the mitigation of macroeconomic risks as part of the Project's Development Objective (PDO) and expands its Component 3 to support MEF's technical capacity to implement macro and structural reforms that increase resilience against macroeconomic shocks.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

92. **The Government has carried out consultations on the main measures supported by this DPF and has intensified the consultation on measures to be supported by the next operation in the series**. Public deliberation and participation have been a useful and legally mandated mechanism to work on overcoming polarization, helping mobilize support for the reforms and mitigating adjustment costs. All legal reform proposals are made publicly available online and have two open consultation phases of a minimum of 30 days in the National Assembly. The first round takes as its base the initial reform proposal. It includes key actors affected by the initiative but is opened to the public at large. A second-round takes place if there is a presidential veto of a law approved by the National Assembly, and there are further revisions to the law.[36] This process was followed for approval of many of the Prior Actions supported by this DPF, including those that are part of the Tax Law and the Innovation and Entrepreneurship Law. Following the developments last October and November, the government is also carrying out additional consultation and consensus-building rounds on reforms to the Organic Budget Code, Monetary and Financial Code, and Gasoline subsidies, which are suggested as indicative triggers for DPF 3.

93. **The World Bank is supporting the Government's renewed efforts in its consultation and communication strategies as well as the design of compensation mechanisms related to energy subsidy and related sectoral reforms.** The Bank, through an Energy Sector Management Assistance Program (ESMAP)-financed activity, is supporting consultations with focus groups and an opinion poll survey of 1,000 interviews that represent different productive and household segments potentially affected by the reform across the country; particularly indigenous, rural and current users of low-octane gasoline populations. The output of these consultations will inform the preparation of the communication strategy being developed by the Presidency's Communication Secretary with support from the Bank. The Bank is also providing technical assistance on the design of compensation mechanisms associated with both the reforms and the impact of COVID-19.

94. **Collaboration with other Development Partners.** This DPF forms part of a package of coordinated financial assistance from international partners, including the IMF, IDB, and CAF. The staff of the four institutions have met regularly to coordinate efforts and align messages. Strong complementarities exist in selected areas of support. These derive from coordinated technical assistance activities. For example, prior actions to improve human resource management build on the work under the Ecuador PFR and coordinate technical assistance with the IMF and IDB. The IMF assistance focuses on cutting personnel and containing wage growth, while the IDB supports the reorganization of personnel in MEF. On PFM, the DPF prior action related to strengthening budget processes creates conditions for the implementation of a sound fiscal framework supported by the IMF. On fuel subsidy reforms, the World Bank is providing technical assistance on the design of compensation mechanisms. At the same time, the IMF considers the expected fiscal savings associated with this reform as part of the fiscal adjustment supported by the program by 2021. The World Bank has also coordinated closely with international partners such as the World Health Organization, United Nations, IMF, IDB, and CAF in order to help Ecuador respond to the

[36] A veto may happen when the President expresses concern or disagreement with aspects of a law after the first approval by the National Assembly. In this event, the law returns to the National Assembly and these aspects are revised.

COVID-19 crisis. Annex 6 presents the different IFIs' support to the Government's structural reform agenda and crisis response.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

95. **The Prior Actions supported by this operation are expected to have positive or neutral effects on poverty in the short term—particularly to help offset the impact of the COVID 19 crisis—, while exerting overall positive effects over the medium and longer terms**. The poverty and social impact assessment (PSIA) follows Bank guidelines and provides an analysis of the potential distributional effects of the government's program. It covers poverty and shared prosperity implications, as well as other welfare-related outcomes such as household income and expenditures, employment, and prices. The policies supported by this operation such as the measures for compensating the impacts of the COVID-19 crisis are expected to protect vulnerable populations. In addition, the prior actions aimed at removing barriers for private sector development are expected to continue the medium-term reform agenda during the recovery period. These actions are designed to facilitate private sector investment, increase financial inclusion, and reduce access to financing from abroad in Ecuador. Finally, the measures for increasing efficiency in the mobilization and allocation of public resources are expected to strengthen the fiscal position of the government. The expected effects are based on quantitative analysis, a review of academic literature and additional information gathered during the preparation of the operation.

96. **Policies under Pillar 1 are aimed at protecting and including vulnerable populations, as well as reducing firm closures and job losses resulting from the COVID-19 crisis in the short run**. Estimates show that the welfare situation of beneficiary households would be improved because of the conditional cash transfer provided by the program. The poverty incidence and gap would be reduced by 12 and 5 percentage points respectively among beneficiary households. In addition, the telework and the workday flexibility would have a positive or neutral impact on workers who can work from home. This would cushion the possible reduction in their labor income and would prevent them from falling into poverty. Moreover, the reduction in import taxes for medical equipment is key to providing proper health services to all individuals in need because of the COVID-19 pandemic, independently of their welfare status. Also, the deferment of tax payments for firms significantly impacted by this crisis would prevent them from reducing their workforce. Notably, migrants were not overlooked by the government in this crisis. The creation of the Migratory Registry is critical for policy design that will allow the easing of migrants' integration process in a sustainable manner. The amnesty extension to irregular Venezuelan migrants by 60 days which allows their permanence in the country and the ratification of the validity of Venezuelan passports that expired within the last 5 years would help migrants cope with the COVID-19 crisis in the short run.

97. **The policies in Pillar 2 are aimed at removing barriers for private sector development and supporting the recovery process.** These are expected to facilitate private-sector investment and formal

employment, to increase financial inclusion, and to reduce costs of financing from abroad for Ecuadorian Banks, all with a neutral to positive effect on the distribution in the short run. Policy actions related to the promotion of firm entry, survival, and growth are expected to positively impact poverty reduction by expanding demand for labor. Other positive indirect effects might take years to materialize. Simplifying the number of minimum wages would increase formal employment in the medium and long term. This would imply having access to better quality jobs (i.e. higher incomes and access to social security *inter alia*) which most importantly could boost the household's welfare. Policies aimed at fostering FDI and local entrepreneurial activities could have positive impacts in the medium to long run, working mainly through improvements to labor markets (formalization) and income generation opportunities (entrepreneurship), although the magnitude may not be substantial. In addition, policies to reduce the costs of financing from abroad might have neutral to positive impacts by providing access to additional financing to firms.

98. **The Prior Actions under Pillar 3 are expected to have neutral or mildly negative distributional effects in the short term**. These policies are expected to strengthen the fiscal position of the Government, enhance its budget preparation processes and would either have no impact or positive impacts on the bottom of the distribution. For instance, the improvement in budget planning and execution can help ensure that resources are allocated more effectively toward the government's pro-poor goals, including better access to public goods and services for alleviating poor's deprivations by improving governmental procurement processes. In addition, the small reduction in personnel would have a mildly negative impact on well-being in the short term. However, this negative effect is expected to be mitigated in the medium and long term by the indirect effects in economic growth from prior actions in Pillar 2 that aim to remove barriers to private sector development. Finally, the responsibility of setting final fuel product prices and making them available online would not have any impacts on poverty or inequality.

99. **As the Government implements the urgent measures to deal with COVID-19 and the reform agenda during the recovery period on DPF 2, positive social impacts are expected to materialize in the medium and long run**. Labor income is the main component of total household income (i.e., about 80 percent in the last decade) and it was the main contributor to poverty reduction. Before international oil prices fell, almost 11 percentage points in poverty reduction could be attributed to improvements in labor income. That said, around 70 percent of total household labor income comes only from the household head. Thus, simplifying the number of minimum wages would increase formal employment in the medium and long run. This would imply having access to better quality jobs (i.e. higher incomes, social security, etc.), which, most importantly, could boost a household's welfare. On the other hand, similar results are expected in the medium to long run as vulnerable group experience improved financial inclusion as a consequence of reduced barriers to remote uptake and usage of digital financial services.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

100. **The proposed DPF presents a low risk of adverse environmental impacts if suggested mitigation strategies are not put in place.** Prior Actions 1, 2, 3, 4, 5,6, 7, 8, and 9, are not likely to have impacts on the country's environment or its natural resource base. Prior Action 10 is likely to have positive

environmental impacts as described below:

- **Prior Action #10:** The competitive auctions for renewable energy generation are expected to result in reduced greenhouse gas emissions and, locally, in reduced air pollution. To mitigate potential negative impacts on biodiversity resulting from the construction and operation of new renewable energy projects, it is important that environmental impact assessments be properly carried out. In the case of wind generation facilities, it is important that these assessments take into account potential impacts on avifauna.

101. **Ecuador's legal and regulatory environmental management framework, underpinned by an environmentally progressive constitution, is relatively solid and complete, but its application is imperfect.** This framework includes a variety of instruments that regulate environmental issues and non-renewable natural resources. The 2017 Organic Environmental Code decentralizes environmental management and includes provisions such as the polluter pays principle and the principle of in *dubio pro natura*. It is complemented by laws and regulations controlling water, soil, and air quality, and by environmental provisions in sectoral laws, such as for hydrocarbons and mining. However, the implementation of such framework is suboptimal. Hampered by the lack of an environmental policy that recognizes current institutional weaknesses and orients the country toward specific goals based on clear priorities, the legal and regulatory environmental management framework also suffers from shortcomings in human, material, and technical resources for enforcement. Finally, enforcement of this framework could be more effective if entrusted to an autonomous enforcement agency with attendant technical resources and carried out, in line with best practices.[37]

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

102. **Ecuador's public financial management (PFM) system, the use of budget resources, and its foreign exchange environment, as controlled by the Central Bank of Ecuador (BCE) represent sources of risk**. The main drivers of this risk are the need for greater controls over the foreign exchange environment, budget execution, and cash payments and the need for strengthened external scrutiny of public expenditures. Based on these factors, the World Bank has identified some mitigating measures to contain such risks. The Government of Ecuador (GOE) has demonstrated strong commitment to a PFM reform program. In April 2019, the Ministry of Finance (MEF according to its acronym in Spanish) approved an action plan for strengthening the country's PFM framework. Furthermore, some measures included in the reform plan are being implemented with support from the World Bank-financed DPF series and the International Monetary Fund (among others) with mixed levels of advance.

103. **Overview of Public Financial Management (PFM) in Ecuador.** With the enactment in October 2010 of the Organic Code of Planning and Public Finances (*Codigo Organico de Planeacion de las Finanzas Publicas*- COPLAFYP) the country intended to modernize the complete cycle of public finances. This

[37] World Bank (2019): Analysis of the Environmental Management System of the Republic of Ecuador. Unpublished Background Paper.

covered inter alia implementation of a single treasury account, modernized government accounting, streamlined budget preparation and approval, improved fiscal transparency, and internal control. The most recent Public Expenditure and Financial Accountability (PEFA) assessment (April 2019) concluded that PFM in Ecuador is partially aligned with international best practices. Its main strengths are related to the existence of a strong regulatory framework, and the fact that the government's operations and transactions are systematically registered in an integrated financial management system used at the central government level (known as e-Sigef). The main challenges according to PEFA are the need to: (i) strengthen transparency of public finances; (ii) improve asset and liability management; (iii) maintain aggregate fiscal discipline; (iv) foster fiscal strategy, plus the budget management and control framework; and (v) improve internal control and external oversight of the public sector.

104. **PFM Reform program.** The Government's comprehensive action plan for PFM reform[38], which is currently under implementation, includes reforms supported under the First Inclusive and Sustainable Growth DPF (P169822), aimed at strengthening the budget preparation process by: (i) establishing budget processes and milestones, including the preparation and sharing of fiscally consistent ceilings for all public institutions covered by the budget; and (ii) strengthening MEF's role on budget forecasting and programming. The proposed DPF continues to support reforms to address the challenges of managing and sustaining a fiscal adjustment over the medium term while delivering on the government's strategic priorities. The reforms strengthen the ability of MEF to align the resource envelope and generate spending savings through the adoption of a medium-term fiscal framework as part of the budgeting process. The reforms also allow the MEF to limit potential deviation from planned expenditures by requiring prior approval from the Legislative Assembly should expenditures deviate by more than 5 percent from the budget, compared to the pre-reform case of 15 percent[39]. In addition, the IMF EFF arrangement further reinforces fiscal sustainability and the institutional foundations of Ecuador's dollarization by supporting the Government's efforts to strengthen fiscal policy framework and introduce more rigorous fiscal controls.

Detailed assessment of the main PFM components:

105. **Budget predictability, reporting, and control.** The general government budget is made publicly available on the MEF external website. Policies and priorities are explicit and broadly reflected in the budget. The legal framework, including the Constitution and the Organic Code of Planning and Public Finance, establish the links between the National Development Plan 2017-2021 and the budget. The Organic Code of Planning and Public Finance requires budget projections for the next four years, prepared on a rolling annual basis. The 2020 budget proforma included 2020-2023 forecasts fiscal aggregates based on economic classification. The last PEFA noted deficiencies in the reliability of the macro-fiscal forecasts, but these are now being addressed. Fiscal reports are published monthly and are available for public access on the MEF's internet site. Moreover, budget implementation reports are presented to the legislature every six months. However, such reports only cover the central government and not the entire

[38] The plan is in the MOF's internet site and is accessible at the following link: https://www.finanzas.gob.ec/plan-de-accion-para-el-fortalecimiento-de-las-finanzas-publicas/

[39] Currently, MEF has a discretionary limit to approve 15% of budget excess without Legislature approval, originating an excessive number of in-year adjustments (up to 4,000 per year) and reflecting a poor level of control.

public sector, limiting the possibility of the consolidated monitoring and management of the fiscal risk. In addition, there is limited oversight from the legislature during the budget cycle. The PFM reform plan aims to reinforce mechanisms for a comprehensive assessment and reporting of fiscal risks, plus improvements to fiscal transparency.

106. **Treasury**. The resources of the central government are managed through a Single Treasury Account (STA) that has an adequate level of control thanks to the e-Sigef system. However, there remain some weaknesses mainly due to limitations for preparing adequate cash projections and the establishment of ceilings. In order to avoid liquidity constrains, MEF has established additional layers of control overpayments related to fixed assets and transfers. There is room to improve control over cash payments by exercising centralized control of cash payments and improving cash forecast mechanisms. The PFM reform plan also cover these issues.

107. **Government Accounting and Financial Reporting.** Public accounting records in Ecuador are prepared on an accrual basis. Ecuador is pursuing convergence to International Public Sector Accounting Standards (IPSAS) and has put a comprehensive plan in place to that end. The government's goal is to produce financial statements in accordance with IPSAS by the end of 2020. Although this is an ambitious objective, MEF is accompanying the intended reform by upgrading the e-Sigef. The implementation of the new software would require complementary activities to reach the intended objectives.

108. **External scrutiny of public expenditures.** The country's normative framework establishes the obligation to present the Government's financial statements to the country's Supreme Audit Institution (*Contraloria General del Estado* or *CGE*). Nevertheless, there is no specific date requirement for such a presentation, and the CGE has no obligation to issue an opinion on the financial statements.

109. **Foreign exchange management.** Ecuador's official currency is the US dollar. A summary of the IMF Safeguards Assessment carried out in 2017 found that the Central Bank of Ecuador's (CBE) legal framework does not provide sound safeguards for independent management of the Central Bank's resources, including reserve assets. The overall internal control environment presents weaknesses due to the lack of independent and capable oversight and control mechanisms, including the fact that the financial reporting framework departs from International Financial Reporting Standards (IFRS)[40]. As a mitigating factor, the resources will be channeled through the Borrower's STA system, which has an adequate level of control due to the level of automation of the e-Sigef system.

110. **Disbursement arrangements.** Once the financing is approved and declared effective, based on the Borrower's request, the World Bank will disburse the financing proceeds into the bank accounts held by the BCE denominated in U.S. dollars that form part of the country's official foreign exchange reserves. The funds will be then immediately transferred into the STA managed by the Ministry of Finance and into a specific account internally designated as "CX". Such account will be tagged in the e-Sigef system using a specific code that allows for the identification of each specific loan and financier. Overall, the STA has an adequate level of control as it can manage virtually segregated accounts where the Government can track the use of funds through the e-Sigef system. The Borrower, within 30 days after the withdrawal of the

[40] IFRS are issued by the International Federation of Accountants (IFAC)

financing from the financing account, shall report to the Bank: (a) the exact sum received into the bank accounts ; (b) the record that an equivalent amount of the financing has been accounted for in the Borrower's budget management systems; and (c) the details of the accounts to which the equivalent of the financing proceeds will be credited.

111. **Auditing arrangements.** The World Bank reserves the right to request an audit of the bank account to be conducted by independent auditors acceptable to the Bank, in accordance with consistently applied auditing standards acceptable to the Bank. If such audit is required, the Borrower should furnish to the Bank as soon as available, but in any case not later than four months after the date of the Bank's request for such audit, a certified copy of the report of such audit, of such scope and in such detail as the Bank shall reasonably request, and make such report publicly available in a timely fashion and in a manner acceptable to the Bank; and furnish to the Bank such other information concerning the loan account and their audit as the Bank shall reasonably request.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

112. **The MEF will be the main coordinating agency for monitoring and evaluation among other participating ministries.** The Prior Actions detailed in this operation are the prime responsibility of the following ministries and agencies: the MEF, the Ministry of Energy, the Ministry of Production, Investment, and Commerce, the Secretary of Planning (Planifica Ecuador, former SENPLADES), the Hydrocarbon Regulatory Agency (ARCH), and the Electricity Regulatory Agency (ARCONEL), and the Office of the Presidency of Cabinet of Ministers (*Secretaria General de la Presidencia)*. The MEF will coordinate with other ministries on the monitoring of the results indicators, which are based on publicly available information. The World Bank will monitor the implementation of the DPF through regular supervision missions and during the preparation of the DPF 3.

113. **The program outcomes will be monitored through the measurement of the progress toward the achievement of results indicators included in the policy and results matrix (Annex 1).** This measurement seeks to assess progress toward the implementation of the policy and institutional measures supported by the proposed DPF series and will be evaluated following the disbursement of the DPF. The MEF will have the responsibility of presenting the information related to the reform implementation and progress made toward results on time upon request and in a format satisfactory to the World Bank.

114. **Grievance Redress**. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For

information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org. "

6. SUMMARY OF RISKS AND MITIGATION

115. **The overall risk rating of this operation is assessed as High**. The major risks to the operation's ability to achieve its development objectives include political and governance risks, macroeconomic risks and institutional capacity for implementation and sustainability risks. In addition, fiduciary and stakeholder risks are considered substantial. These risks have been exacerbated in the context of the COVID-19 crisis and the collapse in oil prices. If macroeconomic risks were to materialize, they would adversely affect the Government's ability to implement and sustain the reform efforts and crisis related measures– especially if they trigger social discontent – and hence make less successful the outcome of the development agenda supported by this DPF series. Political dynamics could also affect the Government's ability to mobilize parliamentary support to approve some of the reforms included in the program. The DPF program is designed to include flexibility so that DPF 3 can adjusted should some of these risks materialize. Specific risks, along with mitigation measures, are discussed below.

116. **Political and governance risks are assessed as High, despite the strong commitment of the Government to its reform agenda and arise from the increasingly complex political context.** With parliamentary and presidential elections planned for February 2021, pre-election politics are likely to intensify throughout the year. The difficulty in building consensus around the reform program was evidenced by the social unrest triggered by the presentation of critical reforms to the National Assembly. The President's party does not hold a majority in the Assembly and some of the envisaged reforms require parliamentary approval. While it is likely that parliamentarians and/or a new government will continue to emphasize macroeconomic prudence and structural reforms, they might disagree on how to do it. One mitigating mechanism is the broad commitment by most political groups to the IMF/World Bank/IDB/CAF-supported reform program and the associated macroeconomic framework. The Government has also intensified consultations and is developing communication strategies to explain reforms to the broader public. The COVID-19 crisis also provides an opportunity for dialogue among the different political forces. The World Bank is supporting some of these consultations and communication strategies through the ESMAP Trust Fund as well as through the restructured Risk Mitigation and Emergency Recovery Project (P157324).

117. **Macroeconomic risks are assessed as High and stem from weak external and internal conditions, which have been further strained by the COVID-19 health crisis and plummeting oil prices.** Externally, record drops in oil prices and tightening global financial conditions could further complicate access to finance for Ecuador. The country's economy is highly vulnerable to oil price volatility, with implications for the fiscal and real sectors. Finally, the Ecuadorian economy might be adversely affected by further socio-economic deterioration in Venezuela, as it might have to absorb part of any renewed outflow of Venezuelan migrants to neighboring countries. Internally, containment measures might need to be prolonged, the response of the economy to reforms might take longer than envisaged, or negative

internal shocks such as social unrest might derail the economic recovery. The Government reform agenda, financial support, close supervision and technical engagement provided through the IMF, World Bank, IDB and CAF-supported programs will help mitigate these risks.

118. **Institutional capacity for implementation and sustainability risks are assessed as High.** While there is strong commitment from the Government to the proposed program, implementation capacity is low in several areas. Implementation capacity has been further stretched by the crisis response. To mitigate these risks, the authorities have mobilized technical assistance, including from the World Bank Group, in almost all the reform areas supported by this operation. Some of the supported measures are aimed at strengthening governance and accountability in institutions (Prior Actions #1, #2, #3). In a politically complex environment where institutional capacity is weak, reforms could potentially be reversed in the medium term. Mitigation measures include: (i) the DPF program together with the IDB's budget support are supporting the Government's objective of developing Ecuador's energy potential through supply-side (SOE reform, and upstream/downstream competition) and demand-side (better targeting of subsidies) measures, as well as through the institutional modernization of ARCH and ARCONEL , and (ii) the World Bank's overall policy dialogue is supported by, and closely coordinated with, the IMF and the IDB as to avoid duplication and enhance synergies.

119. **The fiduciary risks are assessed as Substantial because Ecuador's PFM systems and Central Bank's management require significant modernization**. These risks arise from weakened internal controls over the foreign exchange environment, the need for greater control over budget execution and cash payments, and the need for strengthened external scrutiny of public expenditures. Based on these attributes, the World Bank has identified some mitigating measures to contain fiduciary risks, should they arise during implementation, such as an audit of government transactions to ensure that funds are credited into the single treasury account. Some risks are addressed frontally through the design of the operation, which supports improvements in Ecuador's PFM systems. Also, the IMF program includes important elements of the modernization of Central Bank governance and systems.

120. **Stakeholder risks are assessed as Substantial**. Early results from focus group's consultations on fuel tariff-related reforms suggest that there is significant misunderstanding among stakeholders about who the winners and losers of these reforms are as well as a doubts about the Government's ability to mitigate the impact on the poorest households. These factors fueled violent protests when the Government decided to anticipate the removal of gasoline and diesel subsidies in October 2019. Protracted slowdown in economic growth or a recession resulting from the COVID-19 crisis could add to negative perceptions about the reform agenda. To mitigate social risks coming from fuel subsidy reforms, a parallel Social Safety Net Project (P167416) is supporting the Government's efforts to strengthening of social protection mechanisms, including emergency-related programs. The World Bank is also supporting authorities' additional consultations and a communications strategy for these reforms under an ESMAP Trust Fund. Similar support will be mobilized for other reforms through the technical assistance associated with the restructured Risk Mitigation and Emergency Recovery Project (P157324).

Table 6: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	High
2. Macroeconomic	High
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	High
6. Fiduciary	Substantial
7. Environment and Social	Low
8. Stakeholders	Substantial
9. Other	
Overall	High

ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions and Triggers			Results		
Prior Actions under DPF 1	Prior Actions under DPF 2	Triggers for DPF 3	Indicator	Baseline	Target
Pillar 1: Responding to COVID-19 to protect the vulnerable.					
Prior Action #8. The Borrower has: (i) expanded the objectives of the Social Registry, and (ii) approved the creation of a unit within MEF dedicated to the design of compensation mechanisms to mitigate the impact of subsidy reforms; as evidenced by Executive Decree No. 465, dated August 1, 2018 published in the Official Gazette (*Suplemento*) No. 306 on August 6, 2018 and and *Oficio* No. SENPLADES-SIP-2019-0306-OF from the Borrower's National Secretariat of Planning, dated April 26, 2019.	Prior Action #1. In the context of the COVID-19 crisis, the Borrower has created an emergency cash transfer scheme for vulnerable households that are not covered by social assistance programs, as evidenced by the Borrower's Executive Decree 1022, March 27, 2020, published in the Official Gazette (*Suplemento*) No. 173 on March 31, 2020.	(Indicative) Trigger #1. The Borrower has expanded the emergency transfers to reach the poor and vulnerable, including those covered by social assistance programs.	Results Indicator #1: Number of beneficiaries who received emergency transfers.	0 (2019)	1 mil. (2021)
	Prior Action #2. The Borrower has increased flexibility in work arrangements in the context of the COVID-19 crisis by regulating telework and allowing for emergency adjustments or suspension of work shifts, as evidenced by the Ministerial Agreements MDT 2020-076 dated March 12, 2020 and MDT 2020-077 dated March 15, 2020	(Indicative) Trigger #2. The Borrower has facilitated access to unemployment benefits.	Results Indicator #2: Average time to access unemploymen t benefit	60 days (2019)	7 days (during crisis)

	Prior Action #3. The Borrower has created fiscal space for crisis response by (i) increasing the withholding of income taxes for large corporations in resilient segments while deferring payments from firms in the most affected segments; as evidenced by the Borrower's Executive Decree 1022, March 27, 2020, published in the Official Gazette (*Suplemento*) No. 173 on March 31, 2020 and Resolution of the *Servicio de Rentas Internas* No. NAC-DGERCGC20-00000025, dated April 1, 2020; and (ii) reducing the costs associated with purchased medical equipment by eliminating import tariffs and restrictions applied to these goods in response to the COVID-19 emergency; as evidenced by the Resolution of the *Comite del Comercio Exterior* No. 004-2020, dated March 22, 2020.	(Indicative) Trigger #3. The Borrower has created a Solidarity Fund to provide financial support to vulnerable households and firms.	Results Indicator #3: Resources mobilized by the solidarity fund	0 (2019)	US$700 mil. (2021)
Prior Action #8. The Borrower has: (i) expanded the objectives of the Social Registry, and (ii) approved the creation of a unit within MEF dedicated to the design of compensation mechanisms to mitigate the impact of subsidy reforms; as evidenced by Executive Decree No. 465, dated August 1, 2018 published in the Official Gazette (*Suplemento*) No. 306 on August 6, 2018 and and *Oficio* No. SENPLADES-SIP-2019-0306-OF from the Borrower's National Secretariat of Planning, dated April 26, 2019.	Prior Action #4. The Borrower has: (i) created a Migratory Registry based on the information of the Migratory Census to ensure the effective provision of public services to Venezuelan migrants and refugees; as evidenced by the Borrower's Executive Decree No 826, dated July 25, 2019 and published in the Official Gazette on July 26, 2019, and the Memorandum of Understanding entered into the Borrower's Ministry of External Affairs and ACNUR on October 22, 2019; and (ii) extended by 60 days the amnesty to irregular Venezuelan migrants, thus allowing them to remain in the country, and ratified the validity of Venezuelan passports expired for less than 5 years, in the context of the COVID-19 crisis; as evidenced by the	(Indicative) Trigger #4: The Borrower has prepared a new migrant integration strategy informed by the implementation of the Migratory Registry.	Results Indicator #4: Number of migrants covered by the migration registry	0 (2017)	230000 (2021)

	Borrower's Executive Decree (*Decreto Ejecutivo*) No. 1020, dated March 23, 2020, published in the Official Gazette number 168 on March 24 2020.				
Pillar 2: Removing barriers for private sector development and supporting the economic recovery					
Prior Action #5. The Borrower has adopted measures to facilitate firm entry, by: (i) including provisions in the Productive Law to strengthen the Limited Liability Modality for firms, and (ii) eliminating the obligation for importers to prove compliance with national technical requirements prior to arrival, replacing it with posteriori risk-based control; as evidenced, respectively, by Article 46 of the Productive Law and Resolution of the *Comité de Comercio Exterior* No. 024-2018 dated November 27, 2018 and published in the Official Gazette No. 379 on November 30, 2018.	Prior Action #5. The Borrower has included provisions in the Entrepreneurship and Innovation Law to facilitate firm entry and growth of small young firms, including: (i) the creation of a simplified regime for registering a corporation; and (ii) the creation of entrepreneurship-enhancing programs in the education system; as evidenced, respectively by the Borrower's Entrepreneurship and Innovation Law.	(Indicative) Trigger #5: The borrower has approved regulations to strengthen competition and the enforcement powers of the Competition Authority.	Results Indicator #5: The number of new commercial companies registered.	8210 (2017)	10800 (2021)
Prior Action #9. The Borrower has enacted a new law and regulatory framework aiming at preventing and eradicating violence against women to, *inter alia,* improve their economic opportunities; as evidenced by the Borrower's Law (*Ley para Prevenir y Erradicar la Violencia contra las Mujeres*) dated January 23, 2018 , published in the Official Gazette No. 175 on February 5, 2008 and; Executive Decree No. 397, dated May 15, 2018 and published in the Official Gazette (*Suplemento*) No. 254 on June 04, 2018.	Prior Action #6. The Borrower has adopted measures to reduce the number of sectoral and occupational minimum wages that are fixed and improve the timeline for setting minimum wages; as evidenced by the Ministerial Agreement (*Acuerdo Ministerial*) from the Ministry of Labor MDT 2020-023, dated February 14, 2020.	(Indicative) Trigger #6: The Borrower has approved regulations improving the minimum wage setting process by committing to adjust wages following an objective pre-defined formula, if no agreement is achieved by 3-part negotiations (between workers, employers, and Government).	Results Indicator #6: Number of referential minimum wages set	> 2300 (2017)	<2000 (2021)
Prior Action #7. The Borrower has reduced distortions on the banking sector by issuing	Prior Action #7. The Borrower has helped expand the reach of the financial system by: (i)	(Indicative) Trigger #7: The Borrower has reduced	Results Indicator #7: i)	0 (2017)	250000 (2021)

regulations to: (i) eliminate new Central Bank investments in public financial institutions, and (ii) increase bank liquidity by considering allocations to the Liquidity Fund as part of the amount required by the Domestic Liquidity Requirement; as evidenced by Resolution 500-2019-M published in the Official Gazette on March 1, 2019 and Certification of the Secretary of the *Junta de Politica y Regulacion Monetaria y Financiera* dated March 1, 2019 and Resolution No. 513-2019-M dated May 10, 2019.	reducing barriers to digital financial services for underserved populations, including by allowing for remote uptake of basic accounts via mobile phones; as evidenced by the Borrower's Resolutions of the *Junta de Política y Regulación Monetaria y Financiera* No. 503-2019-F, dated March 1, 2019 and published in the Official Gazette on April 3, 2019 and No. 518-2019-F, dated June 14, 2019, and published in the Official Gazette on August 1, 2019; and (ii) reducing the cost of getting financing from abroad by expanding the criteria for exemption of the outward foreign exchange tax (*Impuesto a la Salida de Divisas*- ISD) associated with financial transactions; as evidenced by article 41 of the Borrower's Tax Reform Law	financial distortions by: (i) reforming the governance and sources of funding of public banks, (ii) partially liberalizing interest rate ceilings, and (iii) reforming the Financial and Monetary Code to allow banks to have subsidiaries that foster capital market development.	number of basic accounts opened via remote processes, and ii) co-movement[41] between interest rate ceilings and nominal interest rates charged by banks for productive and corporate segments	0 (2017)	>0.2 (2021)
Pillar 3: Promoting public sector efficiency and fiscal sustainability post-crisis					
Prior Action #1. The Borrower has adopted measures to strengthen its budget preparation process by: (i) establishing budget processes and milestones, including the preparation and sharing of fiscally consistent ceilings for all public institutions covered by the budget, (ii) strengthening MEF's role on budget forecasting and programming, and (iii) endorsing the Principles of the Coalition of Finance Ministers for Climate Action; as evidenced by the Ministerial Decree (*Acuerdo Ministerial*) No. 0037 dated April 17, 2019 and	Prior Action #8. The Borrower has: (i) submitted to the National Assembly, for approval thereof, amendments to the Organic Code of Planning and Public Finance to: (a) introduce a four-year medium-term fiscal framework and a fiscal management risk framework, (b) reduce from 15 percent to 5 percent the margin for changes to the central government budget without prior approval from the National Assembly, and (c) integrate the forward looking cost implications from public investment decisions into annual budgets; as evidenced by the *Oficio* No. T.581-	(Indicative) Trigger #8. The Borrower approved key regulations to implement amendments to the Organic Code of Planning and Public Finance to introduce a medium-term fiscal framework and a fiscal risk management framework, revised downwards to 5 percent the current margin of 15 percent for changes in	Results Indicator #8: Difference between approved and actual budget	16.3% (2017)	8% (2021)

[41] Co-movements is proxied by the ratio between standard deviation of monthly interest rate ceiling and the standard deviation of the effective interest rate measured with monthly data over an 18-month period

published in the Official Gazette (*Suplemento*) No 474 on April 24, 2019; and the Borrower's signed Membership to the Coalition of Finance Ministers for Climate Action dated April 9, 2019.	SGJ-20-0179 from the Borrower's Presidency, dated April 16, 2020; and (ii) established a Committee of Public Finance (*Comité de Finanzas Públicas*) to oversee fiscal risk assessment and mitigation; as evidenced by the Ministerial Decree (*Acuerdo Ministerial*) No. 0017 dated January 31, 2020, and published in the Official Gazette on March 2, 2020.	the budget without consulting the National Assembly, and created an integrated national and subnational public investment system.			
Prior Action #2. The Borrower has improved spending in goods and services by issuing a resolution that introduces a strategic approach to procurement, through expanding the use of framework agreements and competitive processes; as evidenced by Resolution No. RE-SERCOP-2019-000096 dated January 24, 2019, published in the Official Gazette No. 743 on January 30, 2019.	Prior Action #9. The Borrower has eliminated redundancies in staff by adopting and implementing an inter-ministerial agreement to cut duplicative posts in deconcentrated offices; as evidenced by the Inter-ministerial Agreement *(Acuerdo Interinstitucional SENPLADES-MEF-MDT-001-2019)* entered into between the Borrower's National Secretariat for Planning and Development, MEF, and the Ministry of Labor on June 24, 2019 and published in the Official Gazette on July 25, 2019.	(Indicative) Trigger #9. The Borrower has approved a decree to further improve the efficiency of public sector human resource management through institutional reorganization to reduce duplications and reform the salary scale. The Borrower has enacted reforms to the Public Procurement Law to further increase transparency and competition in public procurement.	Results Indicator #9: Spending in goods and services and personnel in the NFPS as a share of GDP	14.7% (2017)	13.3% (2021)
Prior Action #3.The Borrower has issued decrees and regulations to: (i) eliminate subsidies for premium gasoline, industrial diesel, and natural gas for commercial and industrial use and reduce subsides for other fuel, and (ii) strengthen the Regulatory Agency for Hydrocarbon's mandate/governance by granting this Agency the responsibility of setting final prices of fuel products; as evidenced by Executive Decree	Prior Action #10. The Borrower has: (i) appointed a commission within the Regulatory Agency for Hydrocarbon (ARCH) to set fuel prices and increase transparency in price setting by making final prices and reference prices publicly available; and (ii) launched the competitive auction for renewable energy opening the market to the private sector while reducing the fiscal impacts of electricity by applying the least cost generation expansion plan for generation and by allowing the pass-	(Indicative) Trigger #10. The Borrower has i) implemented a compensation mechanism to mitigate the impact of fuel subsidy price reforms and ii) issued a decree introducing a gradual removal of gasoline subsidies and further empowered ARCH to improve its pricing	Results Indicator #10: Fuel subsidies as a share of GDP	2.1% (2017)	0.8% (2021)

No. 619 dated December 21, 2018 published in the Official Gazette No. 394 on December 26, 2018 and Executive Decree No. 724 dated April 24, 2019 and published in the Official Gazette No. 475 on April25,2019, respectively. Prior Action #4. The Borrower has reduced electricity subsidies by issuing regulations to: (i) improve targeting of social tariffs, (ii) eliminate subsides to off-peak electricity industrial tariffs, and (iii) enforce effective pricing discipline by reducing non-payment and arrears; as evidenced by ARCONEL Resolution No. 005/19 dated April 16, 2019, ARCONEL Resolution No. 006/19 dated April 16, 2019; and ARCONEL Resolution No. 043/18 dated November 6, 2018 and published in the Official Gazette No. 647 on November 27, 2018.	through of all costs to end user prices; as evidenced, respectively, by ARCH Resolution No. RE-2019-075, dated June 13 2019, and published in the Official Gazette on July 3, 2019, ARCH webpage: *www. Controlhidrocarburois.gob.ec/precios-combustibles,* Presidential Decree No.856 dated August 15, 2019 and published in the Official Gazette on August 20, 2019 and Minutes of the pre-qualification processes for the El Aromo and Villonaco II and III auctions. .	methodology, notably through a price smoothing formula.			

ANNEX 2: FUND RELATIONS ANNEX

This Annex will be updated with the press release of th IMF board meeting for Ecuador RFI, expected on May 1

MF Executive Board Concludes Second and Third Reviews of the Extended Arrangement Under the Extended Fund Facility for Ecuador, Approves US$498.4 Million Disbursement (December 19, 2019)

The Executive Board of the International Monetary Fund (IMF) today completed the combined second and third reviews of Ecuador's performance under its economic program supported by the Extended Arrangement under the Extended Fund Facility (EFF). The completion of both reviews allows the authorities to draw the equivalent of SDR 361.3 million (about US$498.4 million). The 36-month Extended Arrangement with a total access of SDR 3.035 billion (about US$4.2 billion), the equivalent of 435 percent of Ecuador's quota in the IMF, was approved by the IMF's Executive Board on March 11, 2019 (see *Press Release 19/72*).

Following the Executive Board discussion, Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair, summarized the Board's findings:

"The Ecuadorian authorities have continued to make progress in strengthening the country's fiscal and external positions and have appropriately recalibrated their economic program to include a more moderate fiscal consolidation and international reserves' paths in response to recent developments and to protect pro-poor growth and social spending.

"The Ecuadorian authorities have demonstrated commitment to fiscal prudence, which remains key to fiscal sustainability. In this context, the recently approved tax reform will raise revenues and make the tax system more growth-friendly, simple, and equitable.

"Protecting the poor and increasing the social safety net are central priorities in the government's program. The authorities have introduced new measures to improve the adequacy and coverage of the social safety net. Continued work is needed to upgrade the social registry, which will allow for a better targeting of social assistance spending. To support the authorities' efforts, the program's floor on social assistance will be raised.

"Public financial management reforms are paramount to secure fiscal sustainability in the longer term. The revised reform of the Organic Budget Code will be key to fortifying expenditure controls, limiting budget discretion, introducing mechanisms to address arrears, and improving the framework for fiscal rules. Continued work will be needed in the area of debt management to reduce borrowing costs and ensure a more efficient allocation of resources.

"The reform of the Central Bank aimed at strengthening Central Bank autonomy, accountability, and governance will be instrumental in supporting the dollarization regime, boosting reserves, and ensuring their prudent management.

"The financial system continues to be stable, and sustained reforms will help solidify the system. In this context, strengthening credit risk regulation and closing other regulatory gaps are priorities. Upgrading banking and cooperatives' supervision, building the macroprudential framework, and simplifying liquidity requirements will help reinforce the financial system in the longer term.

"Efforts to raise competitiveness should continue to focus on improving transparency, strengthening governance, increasing efficiency of the public sector, and creating conditions in the labor market to facilitate hiring and female participation."

IMF Communications Department

MEDIA RELATIONS

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@IMFSpokesperson

Statement by IMF Managing Director Kristalina Georgieva on Ecuador

March 23, 2020

Ms. Kristalina Georgieva, Managing Director of the International Monetary Fund (IMF) issued the following statement:

"Like many other countries, *Ecuador*'s economic challenges have been compounded by the devastating effects of the COVID-19 outbreak and the sharp fall in world oil prices. President Lenin Moreno and his government have responded quickly and decisively to help protect Ecuadorians from the impact of these rapidly evolving global developments, by putting in place a series of measures to stabilize the economy and prevent the further spread of the virus. In the context of adverse global developments, Ecuador is facing severe financing constraints and will require the support of all its stakeholders.

"In light of urgent need to quickly step up action to protect people and the economy, the Government of Ecuador expressed its intention to seek our financial support through the Fund's Rapid Financing Instrument (RFI). This emergency financial tool will allow the government to address urgent balance of payments needs and will support policies that would make it possible to direct funds swiftly to Ecuador's most affected sectors, including the healthcare system and social protection, to bolster its response to COVID-19. Our team is working expeditiously to respond to this request so that a proposal can be considered by the IMF's Executive Board.

"In parallel, my staff is immediately engaging with the authorities on a successor Fund-supported arrangement that builds on the current Extended Fund Facility (EFF), to bolster Ecuador's economic performance, strengthen the foundations of dollarization, and deliver broad based benefits for all Ecuadorians, especially the most vulnerable part of the population.

"Our objective is to provide immediate support to help Ecuador address the effects of a mounting global health crisis, while continuing to support the authorities' unwavering commitment to implement much-needed economic and structural reforms aimed at fostering strong, sustainable and inclusive growth."

IMF Communications Department

MEDIA RELATIONS

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ANNEX 3: LETTER OF DEVELOPMENT POLICY

MINISTERIO DE ECONOMÍA Y FINANZAS

Oficio Nro. MEF-DM-2020-0026

Quito, 15 de abril de 2020

Señor
David Malpass
Presidente
BANCO MUNDIAL
En su despacho

Ecuador: Préstamo Programático bajo la modalidad *Development Policy Loan (DPL),* Segundo Tramo.

Desde 2018, el gobierno ecuatoriano ha avanzado con decisión en una agenda de recuperación económica, social y democrática hacia el crecimiento inclusivo, la igualdad de oportunidades, la transparencia y la sustentabilidad. Esta agenda, de por sí retadora, se ha tornado mucho más compleja con la crisis sanitaria provocada por el COVID-19. Los efectos humanitarios, económicos y sociales de esta crisis aún se están desarrollado a nivel global y las implicaciones para nuestro país son enormes y de múltiples dimensiones.

La economía de Ecuador había acumulado vulnerabilidades que hoy no nos permiten responder en la magnitud que nos gustaría con políticas contra-cíclicas similares a las de nuestros vecinos. Nuestro margen de maniobra es muy limitado. Ecuador no tiene moneda propia, no cuenta con reservas internacionales suficientes, no tiene espacio fiscal, no tiene acceso a mercados financieros internacionales y no puede expandir el crédito sin recibir recursos de afuera. A estas restricciones, se suma la caída del precio del petróleo. Nuestra respuesta a la emergencia requiere entonces del apoyo de la comunidad internacional, de la solidaridad interna de los que más tienen y de profundizar la agenda de eficiencia en el gasto. Además, debemos cubrir la demanda fiscal provocada por la migración venezolana que supera las 400 mil personas y que llega al país en busca de paz y mejores oportunidades.

En este contexto sin precedentes, hemos adaptado nuestro programa para enfrentar esta emergencia y -a la vez- sentar las bases de la recuperación bajo nuevas reglas de juego para acelerarla y mantener el empleo. El programa que respalda el préstamo que aquí presentamos refleja ambos esfuerzos: aquellos encaminados a evitar un mayor deterioro de la situación económica y fiscal del país; y, aquellos que responden al impacto social y económico de la emergencia sanitaria producto de la pandemia del COVID-19. A continuación, las organizamos en cuatro ejes:

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Bloque 1, color amarillo, piso 10 / Quito-Ecuador
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Lenín Toda una Vida EL GOBIERNO DE TODOS

1. **Respuesta a la emergencia del COVID-19**

Este es el eje prioritario al momento. La estrategia implementada pretende proteger la vida, cuidar de los más vulnerables y mantener los medios de vida. Hemos asignado oportunamente los recursos necesarios para la atención del sistema de salud ante la emergencia sanitaria. Hemos creado una asignación monetaria para quienes no estaba dentro del sistema de transferencias y aspiramos-con más recursos- llegar adicionalmente a dos millones de hogares que viven del día a día. Iniciamos apoyos para dar oxígeno a los ciudadanos y empresas. Diferimos pagos de impuestos, eliminamos aranceles para insumos médicos, normamos el refinanciamiento de créditos, implementamos normas laborales necesarias en esta coyuntura como el teletrabajo y modificaciones de jornadas, prohibimos la suspensión de servicios básicos y activamos las pequeñas tiendas de barrio para abastecimiento local y descentralizado.

2. **Eficiencia y calidad en el gasto público**

El Gobierno había afrontado los problemas fiscales reduciendo el déficit del sector público no financiero. Nuestro fin ha sido generar ahorros sin afectar la provisión de servicios. El ámbito político ha sido limitado, la decisión de focalizar los subsidios a los combustibles fósiles que tuvimos que rever, hubiera permitido cumplir las metas fiscales y avanzar en nuestra política energética y de acción climática. Sin embargo, establecimos instancias de coordinación para acciones en materia fiscal y entregamos a la Asamblea una reforma al Código de Planificación y Finanzas Públicas que mejora los procesos presupuestarios, establece reglas fiscales y corresponsabilidad de todos los actores del Estado. Eliminamos posiciones redundantes y mejoramos los procesos de compras públicas. En el mercado de derivados de petróleo establecimos una unidad reguladora que, con transparencia, establecerá y publicará los precios y mejorará los procesos de compra y venta.

3. **Empleo, desarrollo productivo e incentivos a la inversión privada**

En este campo hemos promovido políticas en varios frentes. Se promulgó una Ley de Emprendimiento e Innovación para establecer un marco normativo que incentive la creación, el desarrollo y la expansión de empresa. Facilitamos el comercio reduciendo los aranceles de insumos agrícolas y equipamiento tecnológico. Hemos eliminando barreras no arancelarias y obstáculos regulatorios para abrir y cerrar empresas, motivando la actividad privada.

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4. **Inclusión social e igualdad de oportunidades**

Nuestro compromiso con la inclusión social pasa también por lo financiero, para que toda la población pueda acceder a los beneficios del ahorro y del crédito. Con eso en mente, hemos promovido la penetración y uso de telefonía móvil, en especial en sectores vulnerables. Complementariamente, se simplificó el esquema de fijación de salarios mínimos sectoriales, fortaleciendo su rol para brindar una base de protección social de una manera técnica y más acorde a la realidad nacional.

Con el objetivo de regularizar la situación de los migrantes venezolanos y de proveer los servicios requeridos de manera eficiente, hemos emitido una visa humanitaria y constituido un registro para que las decisiones de política migratoria se nutran de datos precisos y pueda ser aún más efectiva.

Sobre la base de todas estas acciones presentamos este crédito de $500 millones de dólares que es parte de un programático de tres tramos. El ejecutor será el Ministerio de Economía y Finanzas, en coordinación con las entidades relevantes. Esta operación nos ayudará a enfrentar la emergencia que estamos viviendo por lo que esperamos el desembolso los primeros días de mayo.

La mayor aspiración de quienes hemos sido llamados a estar al frente de este proceso es que la consolidación democrática, social y económica se mantenga a pesar de esta crisis. Solamente el apoyo internacional hará esto posible y así el país avanzará en una agenda de prosperidad sostenida con inclusión social y oportunidades para todos. El Grupo Banco Mundial es un aliado estratégico en este proceso para responder a la crisis y sentar reformar que sean la base para una recuperación adecuada, más y mejor empleo, más protección a los vulnerables y más transparencia.

Quedo a su entera disposición para seguir colaborando en este camino. Reciba mi cordial saludo y haga extensivo mi agradecimiento a todo su equipo.

Atentamente,

Richard Martínez Alvarado
MINISTRO DE ECONOMÍA Y FINANZAS

Copia: Sr. Fabián Anibal Carrillo Jaramillo
Viceministro de Finanzas

d.t.

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Sir
David Malpass
President
WORLD BANK
At his office

Ecuador: Second Loan under the Development Policy Loan (DPL) Programmatic Series.

Since 2018, the Ecuadorian government has decisively advanced on an economic, social, and democratic recovery agenda towards inclusive growth, equal opportunities, transparency, and sustainability. This agenda, in itself challenging, has become much more complex under COVID-19. Although the humanitarian, economic and social effects of this crisis are still unfolding globally, the implications for our country are already enormous and multi-dimensional.

The Ecuadorian economy had accumulated vulnerabilities that today do not allow us to respond to the extent that we would like with counter-cyclical policies similar to those of our neighbors. Our room for maneuver is very limited. Ecuador does not have its own currency, it does not have sufficient international reserves, it does not have fiscal space, it does not have access to international financial markets and it cannot expand credit without receiving resources from outside. The fall of the oil price adds to these challenges. In addition, Ecuador must cover the fiscal demands caused by the Venezuelan migration. More than 400 thousand migrants have come to the country in search of peace and better opportunities. Therefore, our response to the emergency requires the support of the international community, the internal solidarity of those who have the most, and the deepening of the spending efficiency agenda.

In this unprecedented context, we have adapted our program to face this emergency and, at the same time, have laid the foundations for recovery under new rules of the game that accelerate growth and maintain employment. The program presented here, supported by this loan, reflects both efforts: those aimed at preventing further deterioration of the country's economic and fiscal situation; and, those who respond to the social and economic impact of the health emergency resulting from the COVID-19 pandemic. We organize them into four pillars as follows:

1. **Response to the COVID-19 emergency**

This is the priority at the moment. The implemented strategy aims to protect life, care for the most vulnerable and maintain livelihoods. We have appropriately assigned the necessary resources for emergent service provision to the health system. We have created a monetary allocation for those who were not part of the cash transfer system and we aspire - with more resources - to reach additional two million households that live day by day. We have made decisions to support and give oxygen to citizens and firms. We deferred tax payments, eliminated tariffs for medical supplies, regulated the refinancing of credits, implemented necessary labor regulations to allow for remote work and allowed changes in labor working hours. We also prohibited the suspension of basic services and activated small neighborhood stores for local and decentralized supply of basic goods.

2. Efficiency and quality in public spending

The Government had faced fiscal problems by reducing the deficit of the non-financial public sector. Our purpose has been to generate savings without affecting the provision of services. The political scope has been limited. The decision to eliminate the fossil fuel subsidies, which had to be reverted, would have allowed us to meet fiscal targets and advance our energy policy and climate action. However, we did established coordination instances for actions in fiscal matters and delivered to the Assembly a reform to the Code of Planning and Public Finances that improves budgetary processes, establishes fiscal rules and co-responsibility of all State actors. We eliminated redundant positions in the civil service and improved public procurement processes. In the market mark of oil fuels, we established a regulatory unit that, with transparency, will establish and publish prices and will improve the buying and selling processes.

3. Employment, productive development and incentives for private investment

In this field, we have promoted policies on several fronts. An Entrepreneurship and Innovation Law was enacted to establish a regulatory framework that encourages the creation, development and expansion of companies. We facilitated trade by reducing tariffs on agricultural inputs and technological equipment. We have also eliminated non-tariff barriers and regulatory obstacles to open and close companies, motivating private activity.

4. Social inclusion and equal opportunities

Our commitment to social inclusion also considers financial aspects, so that the entire population can access the benefits of savings and credit. With that in mind, we have promoted the penetration and use of mobile phones, especially in vulnerable sectors. In addition, the sectoral minimum wage setting scheme was simplified, strengthening its role to provide a base of social protection in a technical way and more in line with national reality. In order to regularize the situation of Venezuelan migrants and to provide the required services efficiently, we have issued a humanitarian visa and created a registry so that migration policy decisions are nourished by accurate data and can be even more effective.

Based on all these actions, we present this $ 500 million loan, which is part of a three-operation program. The executing agency will be the Ministry of Economy and Finance, in coordination with the relevant entities. This operation will help us to face the emergency we are experiencing, therefore we expect the disbursement the first days of May.

The greatest aspiration of those of us who have been called to be at the forefront of this process is for the democratic, social and economic consolidation to continue despite this crisis. Only international support will make this possible and enable the country to advance in a sustained prosperity agenda with social inclusion and opportunities for all. The World Bank Group is a strategic ally in this process of responding to the crisis and laying reforms that are the basis for an adequate recovery, more and better employment, more protection for the vulnerable and more transparency.

I remain at your entire disposal to continue collaborating on this path. Receive my cordial greetings and extend my thanks to all your team.

Sincerely,

Richard Martinez Alvarado
MINISTER OF ECONOMY AND FINANCE

Copy: Mr. Fabián Anibal Carrillo Jaramillo
Deputy Minister of Finance

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Pillar I: Responding to COVID-19 to protect the vulnerable		
Prior Action #1: Emergency cash transfers	No significant environmental impacts are expected.	Significant positive welfare impacts for beneficiaries' households.
Prior Action #2: Flexibility in work arrangements and telework	No significant environmental effects expected.	Positive welfare impact on workers who can work from home (telework) and prevent destruction of jobs.
Prior Action #3: Fiscal Space	No significant environmental effects expected.	Positive welfare impacts for those eligible to the tax deferment
Prior Action #4 Migratory Registry	No significant environmental effects expected.	No potential effects on welfare in the short run. Gathering information of migrants through the Migratory Registry will set the bases for a well-design of integration policies that would improve the socioeconomic conditions of Venezuelan migrants and host communities.
Pillar II: Remove barriers for private sector development		
Prior Action #5: Entry and growth of young firms	No significant environmental impacts are expected.	No significant welfare effects in the short run. Indirect positive impact on welfare in the medium-long-run through enhancing labor conditions (i.e., increase in formal employment) and might have positive gender impacts.
Prior Action #6: Minimum wages	No significant environmental impacts are expected.	No potential effects on welfare in the short run. However, in the medium and long term, it is expected to improve socioeconomic conditions by the increase of formal employment.
Prior Action #7: Expanded reach of the financial sector	No significant environmental impacts are expected.	No adverse welfare effects in the short run. Positive effects in the medium-term, mostly to financial inclusion of lower segments of the population by reducing barriers to remote uptake and usage of digital financial

		services. Neutral impacts in poverty and shared prosperity in the short run. Potential positive effects through increase in growth and investment in medium-long run.
Pillar 3: Promoting public sector efficiency and fiscal sustainability during the recovery		
Prior Action #8: Budget processes and institutions	No significant environmental impacts are expected.	No distributional effects are expected in the short run. The improvement in budget control from MEF is not expected to have significant effects on poverty in the short run.
Prior Action #9: Eliminating redundancy of staff	No significant environmental impacts are expected.	The reduction in staff would have a negligible negative impact in poverty in the short run but policies under Pillar II which promote private sector development and creation of formal employment would help compensate for this effect in the medium term.
Prior Action #10: Energy pricing	The overall environmental impact is expected to be positive as a result in particular of reduced greenhouse gas emissions. However, risks to biodiversity from the construction and operation of the energy projects will need to be appropriately managed.	Enhancing transparency in communicating the true cost of subsidies would not have any impact on household welfare. The implementation of reforms in the electricity sector would have a negligible impact on social outcomes in the short run because of a future marginal increase (i.e. less than 5%) which would not prevent vulnerable households from benefiting from *tarifa dignidad*.

POVERTY AND SOCIAL IMPACT ASSESSMENT (PSIA)[42]

PILLAR I: RESPONDING TO COVID-19 TO PROTECT THE VULNERABLE

Prior Action 1: *In the context of the COVID-19 crisis, the Borrowers has created an emergency cash transfer to vulnerable households that are not covered by social assistance programs.*

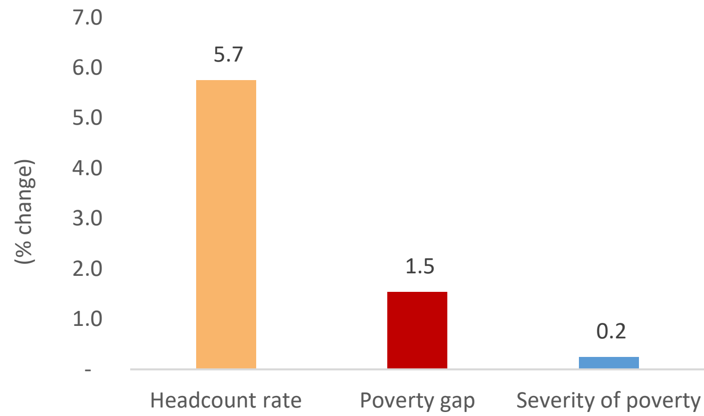
1. **Ecuador is facing a triplet crisis -second plummeted of oil prices, COVID-19, and limited access international finance- which has eroded the poverty reduction gains of the past.** Estimates show that poverty falling back to 2010 levels (from 25 to 31.4 percent) and a 34 percent increase in the number of the poor (1.5 million additional poor people) and significant deterioration of welfare conditions of the already poor.[43] The triplet crises would have not impacted the population uniformly. The incidence of poverty is higher among informal workers than the rest of the population. 4 out of 10 informal workers would become poor as consequence of the crises and these make up a third of Ecuador's 5 million poor.

2. **The income per capita levels of this group have shrunk by more than double that for the population on average**. Household income per capita would have decreased by almost 9 percent between scenarios. These were mainly driven by a significant reduction in labor income (i.e. -10 percent) as a consequence of job loss and the lock-down period. Unemployment rate would triple among this population similarly to the increase suffered by the whole population.

3. **The lack of employment with a significant reduction in labor income implies a significant increase in the incidence of poverty among households with at least one member working in the informal sector**. Simulation results show that the headcount rate would have grown by 6 percentage points from 28 to 34 percent reaching a 2 percentage points higher incidence of poverty than the whole population (Figure 5). In other words, almost 4 out of 10 informal individuals would have become poor as consequence of the crises. More importantly, the poverty gap would also increase by 2 percentage points for this population.

Figure 5. Changes in Poverty for Informal workers (crisis vs. BaU)

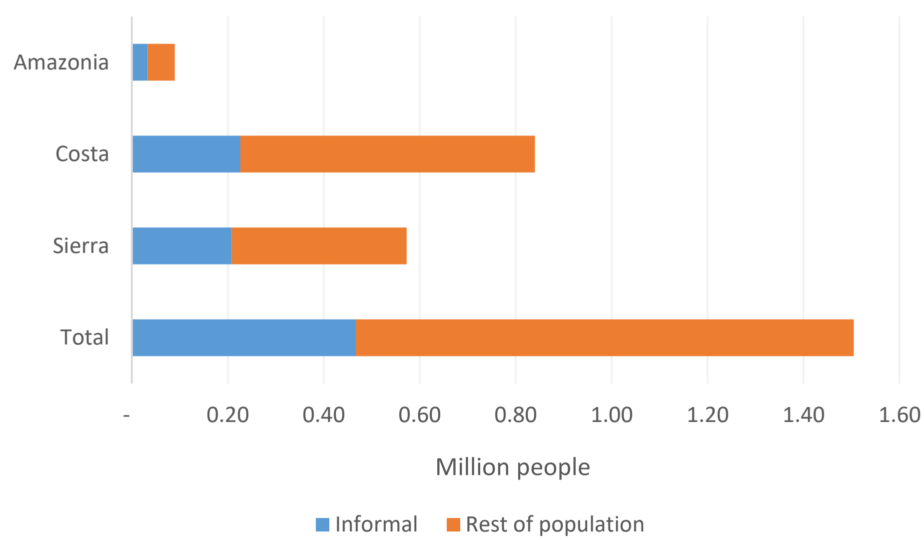
[42] This PSIA has been prepared by Sergio Olivieri (ELCPV), Ivan Gachet (ELCMU), Ana Rivadeneira (ELCPV) and Jaime Fernandez (ELCPV)
[43] Olivieri (2020)



Source: Olivieri, S (2020).

4. **Informal workers alone account for half a million of the additional poor people as a consequence of the triplet crises** (**Figure 6**). This represents one third of the increase in the total number of poor (i.e. 1.5 million poor). Having said this, not all informal workers would have become poor as consequence of the triplet crises. Poor informal workers comprise almost a third (31 percent) of the total number of 5 million poor people in the crisis scenario and only 1 out of 10 of them would have experienced a worsening of their welfare status large enough to have fallen into poverty as consequence of the crises.

Figure 6. Additional number of poor classified by informality



Source: Olivieri, S (2020).

5. **The impact of the cash transfer program for cushion COVID19 impacts is significant among beneficiary households**. The Government has already designed and implemented a cash transfer program of 60 USD per month to households who gain less than USD 400 dollars per month, are

poor, do not receive any program from the Government and have at least one member employed in the informal sector. This benefit will be transferred by 2 consecutive months, April and May 2020 and 400,000 households will be beneficiaries of this transfer. Results show that the program would have negligible impacts on Ecuador's overall poverty incidence by less than 1 percentage point reduction. However, poverty incidence and gap among beneficiary households would reduce by 12 and 5 percentage points respectively.

Prior Action 2: *The Borrower has increased flexibility in work arrangements in the context of the COVID-19 crisis by regulating telework and allowing for emergency adjustments or suspension of work shifts.*

6. **The COVID-19 measures would prevent a significant destruction of jobs and would have a neutral impact in poverty**. Workers who could work from home or adjust their workday because of curfew and quarantine period would benefit from the increase flexibility in work arrangements through regulating telework and allowing for emergency adjustments or suspension of work shifts. This would not only allow these workers (most of them formal workers) not only to keep their jobs but also and more importantly their labor incomes. This would prevent these workers from job loss or wage reduction as well as their families from welfare losses and this will have a neutral impact on poverty. It is relevant to notice that formal workers only represent less than 1 percent of the 1.5 million new poor accordingly to the 2020 crisis scenario. These measures might prevent these workers to fall into poverty.

Prior Action 3: *The Borrower has created fiscal space for crisis response by: (i) increasing the withholding of income taxes for large corporations in resilient segments while deferring payments from firms in the most affected segments; and (ii) reduced the costs associated with purchased medical equipment by eliminating import tariffs and restrictions applied to these goods in response to the COVID-19 crisis.*

7. **The temporary contribution set for companies that have generated a taxable income equal to or greater than one million dollars in the fiscal year 2018 is not expected to have impacts on the welfare at the bottom of the distribution in the medium to long term, although a limited impact in employment could exist in the short term**. In accordance with article 55 of the recently approved reform, the contribution rate ranges from 0.1 to 0.2 percent of the taxable income declared in 2018. This contribution has an exclusive collection purpose since the effective amount of application of the rate would range from USD 1,000 for a medium-sized company, whose taxable income was one million in 2018 to, for instance, USD 20,000 for a large company whose taxable income was USD 10 million. Being an annual contribution, even in the latter case, the amount would correspond to the aggregate salary of three workers who receive a unified basic salary. This implies that very little significant impacts on the reduction in employment would be expected. Romer and Romer (2010) point out that "literature examining the effects of changes in the level of taxes on output is relatively small".[44] The same country, under different economic scenarios, could respond in different manners to the same tax increase (decrease). Ljungqvist and Smolyansky (2014) find out that permanent increases in corporate tax rates lead to significant

[44] Romer, C., & Romer, D. (2010). The macroeconomic effects of tax changes: Estimates based on a new measure of fiscal shocks. American Economic Review 100, 763– 801.

reductions in employment and income.[45] Nevertheless, this might not be the case of the reform in Ecuador since the proposed contribution rate will be in effect for a relatively short period of time (i.e. three years) and labor costs of firing are one of the highest in the region. Similarly, the additional contributions impose for coping with current COVID19 crisis to large firms would not have a significant impact on jobs.[46] As a result, no distributional impact is expected in the medium and long term.

Prior Action 4: *The Borrower has: i) created a Migratory Registry based on the information of the Migratory Census to ensure the effective provision of public services to Venezuelan migrants and refugees and ii) extended the amnesty to irregular Venezuelan migrants by 60 days allowing their permanence in the country ratified the validity of Venezuelan passports expired up to 5 years, in the context of the COVID-19 crisis.*

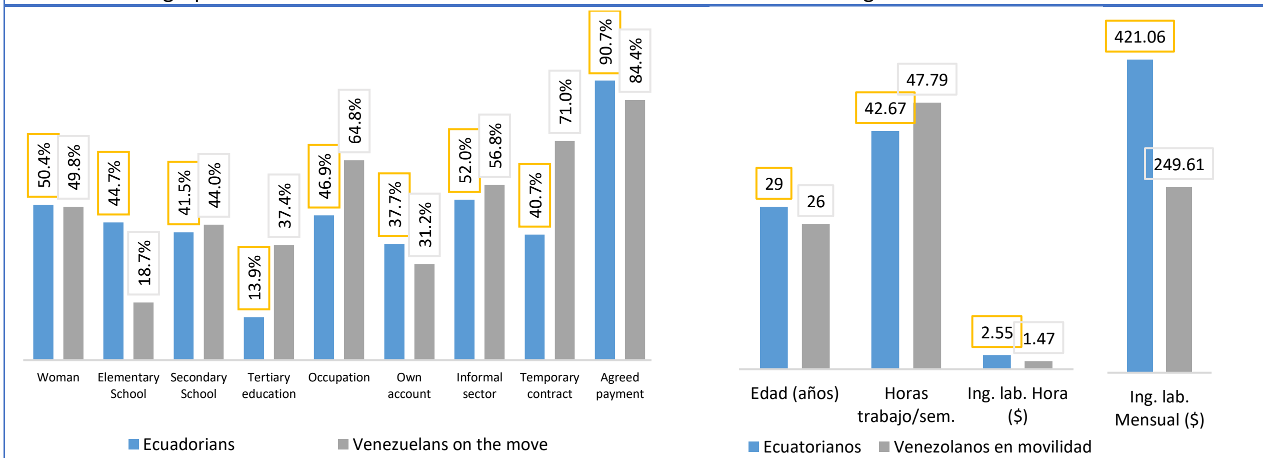
8. **Creating a Migratory Registry for Venezuelan nationals is not expected to have any impact on welfare in the short run. In the medium to long run, provided this information is used to design integration policies, there should be positive impacts on living conditions for all.** Since 2015, more than 1.15 million Venezuelans passed through Ecuador in a "humanitarian corridor" and almost 400,000 settled in the country. As of July 2019, more than 80 percent of the people who entered the country were registered by a migration official, but 54 percent are in an irregular migratory situation. Ecuador has responded to the increase in the demand for education, health, and social protection services through the implementation of tailored measures, but recent diagnostic shows that Venezuelans still face challenges in accessing these services. For instance, more than half of school-age migrants do not attend the education system.[47] In the labor market. Venezuelan migrants are in a precarious situation: almost 60 percent work in the informal sector, 71 percent have a temporary job and only 84 percent have received the agreed payment for their work; compared to 52, 41 and 95 percent of Ecuadorian counterparts, respectively. On average, Venezuelan workers have higher education levels and work five hours more per week than Ecuadorians but receive an average monthly pay that is 42 percent less (Figure 6). Not working at the highest level of qualification prevents migrant workers from realizing their full potential. On the other hand, the arrival of Venezuelans has added more pressure to an already stressed labor market. Negative effects have been found related to the quality of employment but limited to the less qualified young workers, and in cities where there is a greater concentration of the Venezuelan population. Even though the lack of job opportunities and inefficient allocation of workers are not new problems in the Ecuadorian labor market, migrants face more barriers. For instance, less than 15 percent of Venezuela's mobile population has a migration status that allows them to work formally. Only 20 percent of Venezuelans with a degree of third-level education has

[45] Ljungqvist, A., & Smolyansky, M. (2014). To cut or not to cut? On the impact of corporate taxes on employment and income (No. w20753). National Bureau of Economic Research.
[46] World Bank (2017), Ecuador's Labor Market: Challenges and Recommendations, Policy Note, World Bank (2018), Systematic Country Diagnostic, Washington DC. Alaimo et al. (2017) Measuring the Cost of Salaried Labor in Latin America and the Caribbean. Technical Note No (IDB-TN-1291), Interamerican Development Bank.
[47] World Bank (2020) Between countries: challenges and opportunities of Venezuelan migration in Ecuador.

been able to register it in Senescyt.[48] Migratory status regularization is one of the most urgent measures to level the field for Venezuelan migrants.

FIGURE 7. THEY ARE EDUCATED YOUNG PEOPLE WHO WORK MORE, BUT IN WORSE CONDITIONS

Panel A: Demographics | Panel B: Stock averages



Source: Own estimations base on EPEC, 2019.

9. **The information provided by the Registry is the primary input to procure regularization and help design better policies that enhance the net benefits of immigration and improves welfare for everyone.** On July 25, 2019, the government approved the Executive Decree 826 that creates a humanitarian visa to regularize Venezuelans. This visa grants multiple entries to the country and gives beneficiaries permission to work during a two-year period. The Migratory Registry is first step to apply. Regularization would contribute to insertion in the formal market, access to better jobs (working hours and income) and reduction of the burden on the most vulnerable workers. World Bank (2020) estimates that the reallocation of human resources and certification of migrants' education could generate gains of between 1.6 and 1.9 percent of GDP. The registry gathers information that will also help the government and the development community to define a roadmap to better target social assistance aid, promote the local integration of migrants, and help family reunification.

10. **COVID-19 temporary measures would protect Venezuelan migrants' residency in Ecuador with neutral impact in this vulnerable population**. The amnesty extension to irregular Venezuelan migrants by 60 days allows their permanence in the country and ratified the validity of Venezuelan passports expired up to 5 years would help migrants cope the COVID19 crisis in the short run.

PILLAR II: REMOVE BARRIERS FOR PRIVATE SECTOR DEVELOPMENT AND SUPPORTING THE ECONOMIC RECOVERY

Prior Action 5: *The Borrower enacted provisions in the Entrepreneurship and Innovation Law to facilitate*

[48] Ibid.

firm entry and growth of small young firms through, including (i) the creation of a simplified regime for registering a corporation and (ii) the creation of entrepreneurship-enhancing programs in the education system.

11. **The Law for Entrepreneurship and Innovation could encourage firm entry, survival, and growth, but is not expected to have a direct effect on welfare in the short-run. In the medium, to long run, an indirect positive welfare effect and gender impacts are expected as a result of improved labor conditions (increase in formal employment).** The Entrepreneurship Law, approved on December 7, 2019, creates a comprehensive legal framework to foster entrepreneurial activity as a State policy. Among the most important introductions are: (i) the definition of entrepreneurial activity as young firms having less than 5 years of operation, below 49 workers and up to 1 million USD in annual sales; (ii) creation of the National Council for Entrepreneurship and Innovation at the Vice-Minister level, with the participation of representatives from the private sector and academia; (iii) a physical and online single window for entrepreneurs will also be created to reduce the asymmetry of information on the procedures required to create and operate a business; (iv) possibility of registering companies within a simplified regime (the Simplified Stock Corporation modality); (v) new financing instruments such as crowdfunding and regulation of such platforms, as well as a public credit program; (vi) restructuring and closure provisions for entrepreneurial activities; (vii) A more flexible contractual labor modality for young firms; and (viii) foster entrepreneurial-oriented human capital through the introduction of soft and hard entrepreneurship skills at all levels of the education system.

12. **Implementation of this Law is expected to increase the number of entrepreneurs, new businesses and formal jobs in the medium to long run.** The simplified regime for company registration will reduce the fixed cost to register a business by: (i) allowing contributions in cash to the minimum social capital to be paid up to two years after firm registration; and (ii) eliminating the need to hire a lawyer and a notary. This will support firm formalization and facilitate the registry of new startups. Restructuring provisions should reduce exit costs. Entrepreneurs are more willing to enter new markets, experiment and innovate, and invest in new growth opportunities if they face low entry and exit costs, and have the legal certainty that such costs will not increase in the future. In Ecuador, the cost to start a business as a percentage of income reached 33 percent in 2019, which is higher than the LAC country average of 31 percent. Businesses, particularly MSMEs and farmers, unsurprisingly consider access to finance to be an important obstacle to operate. Barriers to entry, exit and growth affect disproportionately young and small firms, which represent the bulk of Ecuador's private sector. In 2015, more than 97 percent of firms were micro and small firms and nearly 40 percent were less than five years old. Existing research shows that while young firms are on average relatively smaller in terms of sales than incumbents, they generate on average relatively more jobs. [49]

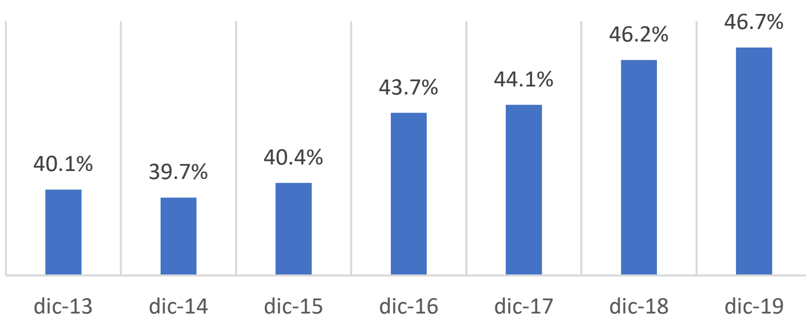
13. **Non-causal empirical evidence suggests that regulations on firm entry and exit are inversely correlated with productivity and firm creation, with stronger effects in sectors that tend to have higher turnover rates.** Cross-country correlations indicate that countries with more burdensome entry regulations have larger informal sectors, and those costly entry regulations are associated

[49] INEC 2017, Panorama Laboral y Empresarial del Ecuador.

with lower creation of limited-liability firms. Evidence for Mexico, Peru and Colombia[50] indicates that easing entry requirements helped increase business registration and employment. Moreover, these reforms contribute to more institutional development (i.e. too low entry and exit barriers, well-defined property rights, and effective contract enforcement) that is conducive to competition and private commercial transactions, which helps alleviate smaller firms' growth constraints (especially for SMEs), leveling the playing field between firms of different sizes (OECD, 2012). The report Doing Business 2005[51] shows that once regulation is relaxed and administrative processes simplified, the number of formal businesses increases, for example, the rate of formal registration on Ethiopia, France, Morocco, Slovakia and Turkey grows 2 to 4 times the rate of other countries, since its reform in 2003.

14. **Policies in this Prior Action intend to support the creation of more opportunities for workers to enter the formal sector either as entrepreneurs or as employees of new or young firms.** The specific hiring regime for young firms is more flexible but also guarantees social security registration of employees and other standard benefits. Although the implications of such a hiring regime on job stability and career development for workers are unclear, these provisions could help improve the labor conditions of existing informal jobs. Ecuador has had a stable low unemployment rate (3,8% in December 2019) but has a high prevalence of informality (46,7% of total employment for the same period), which has increased in the last 5 years (**Error! Reference source not found.**). Since 2014, as economic and labor market conditions deteriorated, more people re-entered the labor force than in the preceding years. However, most engaged in 'low quality' jobs, especially the young, the elderly, and women (**Error! Reference source not found.**).[52] Considering these facts, policies under this prior action are expected to have positive social impacts through the formalization of micro and small enterprises as well as the jobs they generate, and might also have a positive gender impact.

Figure 8. Percentage of employment in the informal sector



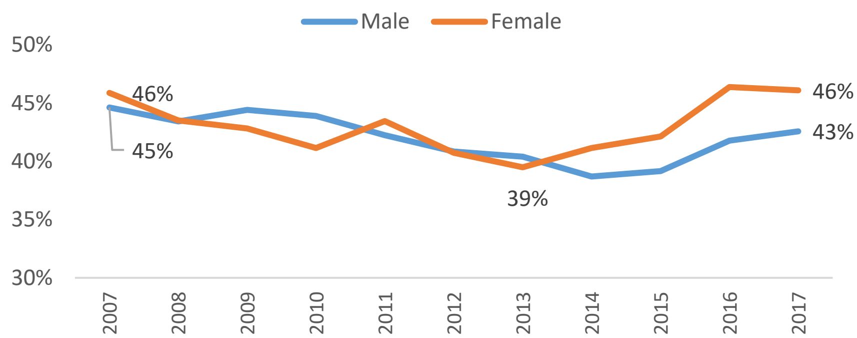
[50] Research in Mexico (Bruhn, 2011; Bruhn 2013; Kaplan et al, 2011), Peru (Mullainathan and Schnabl, 2010), Colombia (Cárdenas and Rozo, 2009) and Portugal (Branstetter et al, 2010) documented an increase in business registration rates following business registration reforms.

[51] Business, D. (2005). Removing obstacles to growth. Retrieved from Doing Business Web Page: http://www. doingbusiness. org/Downloads.

[52] World Bank. 2018. Ecuador - Systematic Country Diagnostic (English). Washington, D.C.: World Bank Group. Available at: *http://documents.worldbank.org/curated/en/835601530818848154/Ecuador-Systematic-Country-Diagnostic*

Source: INEC, Tabulados de la Encuesta Nacional de Empleo, Subempleo y Desempleo.

Figure 9. Informality rates by gender



Source: WB estimations based on ENEMDU (December rounds).

15. **However, evidence from developing countries suggests that fixed entry costs to enter formality are not the main drivers of firm informality and that effects of formalization policies are short-lived**. Empirical studies by De Mel et al. (2008, 2013) evaluate the influence of different types of interventions on a firm's decision to operate in the formal sector in Sri Lanka. The authors find that when actual payments are made, in addition to the provision of information and the reimbursement of registration costs, firms were more likely to decide to formalize. However, solely proving information about the formal registration process and the possibility of obtaining reimbursements for direct registration costs did not have any effect on the formalization decision. Moreover, Andrade et al. (2014) implement a field study in Belo Horizonte (Brazil) to test the effect of alternative government interventions to encourage informal firms to register. The authors find that information and free cost treatments have zero or negative impact in formalization (similarly to the results from De Mel et al. 2013 and Galiani et al. 2015), while inspections have a small but positive effect in formalization. These results show that most informal firms will not formalize unless forced to do so, suggesting that these firms perceived the benefits of operating formally to be negligible. Thus, joint evidence from De Mel et al. (2008, 2013), Andrade et al. (2014) and Galiani et al. (2015) seem to suggest that informal firms remain operating in the informal sector because they perceive the benefits of formality to be modest, not because burdensome entry costs deter them from operating formally (De Mel et al., 2013). Experimental evidence for Colombia in Galiani et al. (2015) suggests that assistance through the bureaucratic process and the removal of fixed costs of formalizing increase the likelihood of formalization, however, these effects did not persist over time. After a year experimenting with a formal operation, the firms decide to opt-out of formality suggesting that they did not find advantages in continuing operating as a formal sector enterprise. According to this evidence, the effects of the simplification in the registration of enterprises on firm formality, labor market outcomes or poverty might be smaller and non-lasting.

16. Whether policies in this Prior Action operate via formalization of existing informal firms and jobs or creation of new ones, positive welfare and gender impacts are expected in the medium to long-run. However, the magnitude might not be important.

Prior Action 6: *The Borrower has adopted measures to reduce the number of sectoral and occupational minimum wages fixed and improve the timeline for setting minimum wages*

17. **Simplifying the process of scaling down the number of minimum wages is expected to have a neutral effect on welfare in the short run. However, in the medium and long run, an indirect positive effect is expected as a result of an increase in formal employment.** The main objective of the minimum wage is to protect low-income workers (unskilled workers) by establishing an effective wage floor. In Ecuador, the minimum wage is composed of a national minimum wage, and by more than 2,000 minimum wages by sector and occupations.[53] These wages are determined by a bargaining process between workers, employers, and Government representatives at the end of each year.[54] In a system with multiple minimum wage levels, such as Ecuador, it can be difficult to keep the tripartite process balanced in terms of workers' participation in many sectors, enforce the changes, ensure compliance, and avoid creating distortions in the labor market. Given these inefficiencies of a system with multiple minimum wages, the general trend around the world is to move away from differentiating wage levels by geography, occupation, sectors, and industries. This is the case of Asian countries that are moving toward having only one national level of the minimum wage. In 2012, the Government of Thailand unified level of minimum wages in Bangkok and the richest provinces in the country. In Vietnam, recent reforms have gradually unified the minimum wages for the private domestic sector and the foreign sector. Indonesia is also considering reducing the dispersions of minimum wages. Moreover, North Korea and Singapore are examples of countries with a single minimum wage applied without regional, sector, or occupational differences.[55] Simplifying the process of setting minimum wages in Ecuador will have a neutral effect on poverty or social outcomes. The constitution prohibits reducing wages of any workers which implies that the minimum wage will keep protecting low-income workers (unskilled workers) while high-skill workers will have a wage floor to negotiate their wages. The latter is a common practice in Nordic countries, and the evidence suggests that skill-workers could benefit from this. For instance, Plasman et al. (2007) found that multiemployer bargaining, single-employer bargaining has a positive effect both on wage levels and on wage dispersion in Belgium, Denmark, and Spain.[56] In the medium term, when key an integral labor reform will be in place, significant impacts on the creation of formal employment and its positive effect in terms of reducing poverty will come to the fore.

18. **Improving the timeline for setting the universal minimum wages is expected to have a neutral effect on wellbeing in the short and medium-term.** In Ecuador, the new structure of minimum wages by sector and occupation is usually announced in January of each year, making it difficult

[53] Wages for the same occupation could differ across sector creating distortions in the labor market.
[54] Setting the minimum wages in Ecuador is a two-stage process: First, workers, employers and Government representative meet to set the national minimum wages at the end of each year. If no agreement is reached in the negation process, which is usually the case, minimum wages are set by the Ministry of Labor. Once the national minimum wage is determined, representatives of workers, private-sector employers, and the Government meet again in Sectorial Wage Councils to decide increases of sectoral minimum wages, including minimum wages by occupations within each sector. There are 21 sectorial councils in charge of fixing minimum wages with more than 2.000 occupations.
[55] For a complete discussion about minimum wage system in the ASEAN region see: Del Carpio, Ximena, and Laura Pabon. "Minimum wage policy: Lessons with a focus on the ASEAN region." Washington, DC; World Bank Group. (2014).
[56] Plasman, Robert, Michael Rusinek, and François Rycx. "Wages and the bargaining regime under multi-level bargaining: Belgium, Denmark and Spain." European Journal of Industrial Relations 13, no. 2 (2007): 161-180.

for firms to adjust their cost to the new wage structure. In most countries around the world, the minimum wage legislation does not define the frequency of reviews/adjustments but is a common practice to have a revision on an annual basis or when trigger by demand or economic conditions. For instance, South Korea reviews minimum wage in August of each year, Malaysia make changes every two years, and Hong Kong, SAR, China, adjusted up or down depending on the economic conditions (Del Carpio and Pavon 2014). Therefore, improving the timeline will have a direct effect on firms' investment decisions that won't have a direct on welfare in the short run.

19. **Finally, this prior action is the starting point for establishing an integral minimum wage system that could have positive and significant effects on poverty and social outcomes in the long-run.** Between 2007 and 2018, around 43 percent of workers had a job in the formal sector and 20 percent of those have an income below the legal minimum wage. The latter is about 3 times higher for workers in the informal sector. The main reason for this is not only that minimum wages are higher and grew at a faster rate in Ecuador than other Latin American countries,[57] but also because the minimum wage structure in the economy does not reflect differences in productivity within and across firms.[58] In addition, there is plenty of evidence pointing to job losses from higher minimum wages, particularly of the least-skilled workers.[59] For instance, Gindling and Terrell (2007) found that a 10 percent increase in the minimum wage reduces employment in the formal sector by 1.09 percent in Costa Rica at the time this country had a minimum wage setting structure in some way similar to Ecuador with 520 minimum wages.[60] It is worth pointing out that occasionally positive effects of minimum wages on employment have been found in the literature. Card and Krueger (1994) found that the 1992 increase in the state minimum wage in New Jersey slightly increased employment in fast food establishments relative to a control sample of fast-food restaurants in Pennsylvania.[61] Yet, this is an effect particular to the fast-food industry characterized by unskilled teenage workers. The evidence also indicates that minimum wages do not affect the wages of those at the very bottom or very top of the distribution. In Colombia, Arango and Pachon (2003) found that only households in the 25th to 80th centiles of the income in the distribution benefit from increases in minimum wages.[62] Also, the adverse effects of minimum wages are greater for small firms, lower-income firms' owners and productivity. A recent study from Drucker et al. (2019) using tax records from Israel found that the minimum wage hike between 2003 and 2010 reduced firms' profits, with minimum-wage intensive firms (higher shares of minimum-wage workers) bearing the bulk of the cost and adjusting their workforces more aggressively than larger firms, and profits declining more for lower-income firms owners. Alvarez and Fuentes (2018) found that the minimum wage increase at the end of the

[57] Between 2006 and 2017, the real minimum wages in real terms (USD 2011 PPP) in Ecuador increased from 368 to 567, in Colombia from 424 to 483 and in Peru from 370 to 446.
[58] Gachet, Packard, and Olivieri (2020) Ecuador labor market regulations: a case for reform. World Bank, (unpublished manuscript), Washington DC
[59] For a comprehensive review of recent evidence, see Neumark (2019). "The econometrics and economics of the employment effects of minimum wages: Getting from known unknowns to known knowns." German Economic Review 20, no. 3 (2019): 293-329
[60] Gindling, Tim H., and Katherine Terrell. "The effects of multiple minimum wages throughout the labor market: The case of Costa Rica." Labor Economics 14, no. 3 (2007): 485-511.
[61] See Card, David, and Alan B. Krueger. "Minimum wages and employment: a case study of the fast-food industry in New Jersey and Pennsylvania: reply." American Economic Review 90, no. 5 (2000): 1397-1420.
[62] Arango, Carlos, and Angelica Pachón. "Distributive Effects of Minimum Wages on Household Incomes: Colombia 1997-2002." memo Banco de la República/World Bank (2003).

1990s in Chile is partially accountable for the slowdown in firms' productivity and is higher in sectors with higher exposure to minimum wage, in particular, in more unskilled labor-intensive industries. Therefore, simplifying the structure of the minimum wage and establishing a more reasonable timeline for setting the minimum wage are a starting point for a future labor reform that could compensate the negative effects of the minimum wages found in the literature, particularly on those individuals at the bottom of the income distributions by increasing formal employment and reducing the percentage of workers with incomes below the legal minimum wage.

Prior Action 7: *The Borrower has helped expand the reach of the financial system by: (i) reducing barriers to digital financial services for underserved populations, including by allowing for remote uptake of basic accounts via mobile phones; and (ii) reducing the cost of getting financing from abroad by expanding the criteria for exemption of the outward foreign exchange tax (Impuesto a la Salida de Divisas-ISD) associated with financial transactions.*

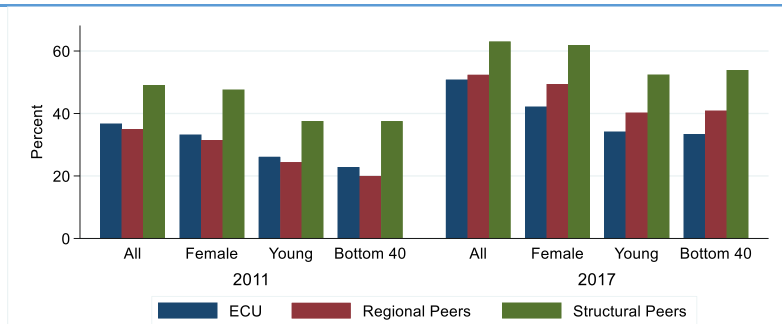
20. **Reduce barriers to remote uptake and usage of digital financial services is not expected to have adverse welfare effects in the short run, while positive effects could appear in the medium-term due to financial inclusion**. Financial inclusion in Ecuador has increased in recent years, from 37 percent in 2011 to 51 percent in 2017. This places Ecuador slightly above the average regional peers but below the average structural peers (Figure 12 – Panel A).[63] Despite this progress, particularly among disadvantaged groups, more than 5.8 million people remain excluded from the formal financial sector and Ecuador and significant gaps remain particularly among women, young adults and the bottom 40 (Figure 12 – Panel A). The last available microdata of Global Findex database for 2017, show that among the bottom 40 only 37 percent of adults has an account at a financial institution, compared to 60 percent for the top 60. This yields a 65 percent gap between the bottom and the top of the distribution. There is also a significant gender gap of 34 percent, which has been shrunken from 43 percent in 2011. In addition, savings in financial institutions have decreased from 15 percent in 2011 to 12 percent in 2017, while loans from financial remained the same during the same periods, and mobile accounts only reach 3 percent of the population in 2017. Therefore, reducing barriers to promote financial inclusion might have positive impacts on welfare in the medium-term by financial inclusion of lower segments of the population.
21. **Empirical evidence suggests that technology-driven models are critical to accelerating financial inclusion progress.** Digital financial services have the potential to lower transaction costs, improve product design and delivery, and lower informational asymmetries between providers and consumers. It also provides households and firms with greater access credit from formal financial institutions to face consumption and investment needs as well as to manage financial risks, smooth consumption, and entrepreneurial capital. For instance, digital payments (M-Pesa) have become an integral part of Kenya's economy and are extensively used for diverse purposes such as domestic and international money transfers, paying school fees, paying utility bills, and point-of-sale transactions. In 2011, money transferred through M-Pesa reached more than 30%

[63] Regional and structural peers are selected based on the following criteria: GDP per capita, population, and dependence on commodity revenues. As a result, the countries identified as Ecuador's peers are the following: Argentina, Brazil, Colombia, Chile, Mexico, and Peru (regional peers); Azerbaijan, Kazakhstan, Malaysia, Romania, South Africa, and Thailand (structural peers).

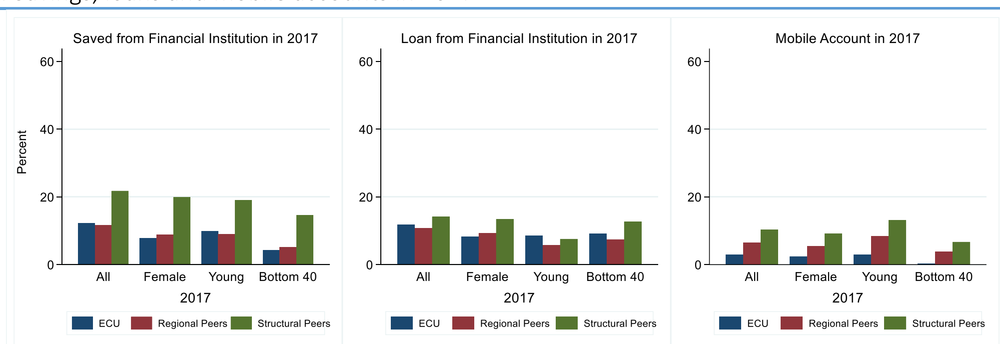
of Kenya's GDP, and some estimates suggest that it has help lift at least 2% of the country's population out of extreme poverty.[64] Digital payment services in Kenya has also reduced transaction costs in informal markets, strengthening and growing risk-sharing networks, and thus facilitating households' ability to respond to shocks.[65] In Bangladesh, the uptake of mobile banking by poor rural households and family members who had migrated to the city in Bangladesh increase urban-to-rural remittances increased by 26 percent which leads to an increase in rural consumption and savings. Also, rural households using mobile banking borrowed less.[66] In India, biometrically authenticated cards for workers employed by a 19-million-person public works program reduced corruption, increased labor market competition, with private-sector wages rising more than public-sector wages, suggesting an overall economic benefit for the population.[67]

FIGURE 10. FINANCIAL INCLUSION IN ECUADOR AND PEER COUNTRIES

Panel A: Account in Financial Institution



Panel B: Savings, loans and mobile accounts in 2017



Source: WB staff elaboration using the Global Findex Database. Financial inclusion is defined by ownership of a basic deposit or transaction account.

22. **Financial inclusion can promote growth and reduce poverty and inequality by providing households and firms with greater resource access to face consumption and investment needs**

[64] Lashitew, Addisu A., Rob van Tulder, and Yann Liasse. "Mobile phones for financial inclusion: What explain the diffusion of mobile money innovations?" Research Policy 48, no. 5 (2019): 1201-1215.
[65] Jack, William, and Tavneet Suri. "Risk sharing and transactions costs: Evidence from Kenya's mobile money revolution." American Economic Review 104, no. 1 (2014): 183-223.
[66] Lee, Jean N., Jonathan Morduch, Saravana Ravindran, Abu S. Shonchoy, and Hassan Zaman. Poverty and migration in the digital age: Experimental evidence on mobile banking in Bangladesh. IGC Working Paper C-89233-BGD-1, 2017.
[67] Demirguc-Kunt, Asli, Leora Klapper, and Dorothe Singer. Financial inclusion and inclusive growth: A review of recent empirical evidence. The World Bank, 2017.

as well as to manage financial risks. This will require the expansion of financial intermediation services, by mobilizing savings and reducing credit constraints and cope with potential policy distortions, markets frictions, and inefficiencies.[68] As summarized by a World Bank analysis: "Evidence shows that financial inclusion allows people to make many everyday financial transactions more efficiently and safely and expand their investment and financial risk management options by using the formal financial system. This is especially relevant for people living in the poorest 40 percent of households. Yet not all financial products are equally effective in reaching development goals, such as reductions in poverty and inequality. Current evidence suggests that the biggest impacts come from savings accounts – provided that they are inexpensive and serve a specific purpose – and digital payments. Research on microcredit's impact is mixed and shows modest, if any, effects. Some studies show that people with insurance invest in riskier, higher return technologies, though little is known about its impact on welfare measures."[69]

23. **Prior Action 7 (ii) is expected to have a neutral impact on poverty reduction and shared prosperity in the short run and a small positive effect on economic growth through increased investment in the medium to long-run**. The tax law approved on December 2019 introduces exemptions from the ISD for payments abroad to service loans extended by international financial or non-financial institutions (accredited by the authority) when such financing has terms of 180 calendar days or more. Before the reform, the exemption was applicable only for financing terms of 360 days or more. This provision should lower the cost of financing for productive activities, with the consequent expansion of production and employment generation in the medium to long-run. However, the magnitude might not be important since the change is not of magnitude. Other changes in ISD exemptions free from this tax the dividends distributed by resident firms to all non-residents eliminating the condition that recipients must not be domiciled in tax havens or jurisdictions with lower tax rates. Also, financial yields, capital and capital gains paid to investments from abroad on the Ecuadorian stock market are exempted from ISD in general; previously these investments need to be in the country at least 360 days. These last two changes are aimed at fostering foreign direct and financial investment.

24. **Reducing financing costs could foster private sector development and investment.** In the period 2007-2014, private investment per capita and FDI as a share of GDP were the lowest among all of Ecuador's structural and regional peers. Access to finance is considered by business to represent an important obstacle to investment and innovation. Access to credit is particularly difficult for SMEs. While 23 percent of large firms finance their investments through banks, only 13 percent of SMEs are able to do so. Increased access to credit could positively affect productivity, not only by increasing investment in more productive technology, but also by reducing the incentives to informality (World Bank, 2018). According to Doing Business 2020, Ecuador ranks below LAC average in the getting credit index with a score of 45 out of 100 points. It has been widely

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[68] Evidence for Ecuador finds market frictions or policy distortions for household financial inclusion and excesses or inefficiencies for firms' financial inclusion. Dabla-Norris Era, Yixi Deng, Anna Ivanova, Izable Karpowicz, Filiz Unsal, Eva VanLeemput and Joyce Wong, (2015). "Financial Inclusion: Zooming in on Latin America". IMF Working Paper, WP/15/206.
[69] Demirguc-Kunt, Asli Klapper, Leora and Singer, Dorothe. 2017. "Financial Inclusion and Inclusive Growth: A review of recent empirical evidence". World Bank Policy Research Working Paper #8040.

documented that financing is a key factor for business development. Ayyagari et al. (2008)[70] find that three out of then business environment obstacles reported in surveys have a direct impact on firm growth –finance, crime and policy instability. Of those, finance is the most robust and has the largest effect regardless of which countries and firms are included in the sample. And within finance, capital, only the cost of borrowing is directly associated with firm growth. Beck (2013) surveys the literature and finds evidence that financial deepening can contribute to economic growth and ultimately poverty reduction by easing SMEs' financing constraints.[71] Policies in this Prior Action, however, could have a meager impact in firm growth and job creation, if any, considering they are reducing costs only for financing from abroad, not in general.

25. Lower taxes for capital gains could foster foreign investment and have positive indirect effect on welfare in the medium to long run but the magnitude might not be significant. However, quantitative and qualitative evidence are not concluding on whether lower taxes attract foreign direct investment. Tavares-Lehmann et al. (2012: 112) conclude that "…while taxes are an important aspect of FDI decisions among managers, they are probably not the main driver of the decision; and that they may only play a 'marginal' role compared with other determinants of FDI".[72] Nonetheless, FDI depends on a combination of factors in order to materialize. That explains why there should not be any short-term welfare impacts.

26. **Economic literature argues that FDI is an important determinant of poverty reduction by its positive effect on the economic growth rate** (although, authors such as Mold (2004) or Stiglitz (2002) hold a more skeptic view[73]). However, the link between FDI and poverty reduction is complex, and does not boil down to the combination of the average effects of FDI on GDP growth and the average effects of growth on poverty. In particular, FDI is a good mechanism for the rapid and efficient transfer and adoption of best practices across borders, as well as to upgrade human capital, with the potential to promote not only economic growth but also economic development.[74] These benefits are expected to contribute to a higher economic growth and economic development, which are considered as the most effective ways to foster the reduction of poverty.

27. **FDI can have both direct and indirect effects on poverty reduction.** The direct effect of FDI on poverty reduction comprises increases in employment and reduction of people living below the poverty line due to a higher labor demand, as well as the improvement of workforce and safety

[70] Ayyagari, M., Demirgüç-Kunt, A. and Maksimovic, V. (2008). "How Important Are Financing Constraints? The Role of Finance in the Business Environment". The World Bank Economic Review, Vol. 22, No. 3, pp. 483–516.
[71] Beck, T. (2013). Bank financing for SMEs – Lessons from the literature. National Institute Economic Review No. 225, August 2013, pp. R23-R38. Available at: https://doi-org.libproxy-wb.imf.org/10.1177/002795011322500105
[72] Tavares-Lehmann, A., Coelho, A. and Lehmann, F. (2012) "Taxes and foreign direct investment attraction: a literature review". In: *Van Tulder, R., Verbeke, A. and Voinea, L. (Ed.) New Policy Challenges for European Multinationals (Progress in International Business Research, Vol. 7).* Emerald Group Publishing Limited, Bingley, pp. 89-117. Available at: https://doi.org/10.1108/S1745-8862(2012)0000007007.
[73] For Stiglitz (2002), FDI is frequently a mixed blessing, since multinationals exert pressures on developing countries governments which they are typically poorly equipped to resist (see Globalization and its critics, Stiglitz 2002). In addition, other authors point out to the fact that FDI projects may create additional competition to the local industry, endangering local demand for labor.
[74] Klein, Aaron and Hadjimichael (2002). "Foreign direct investment and poverty reduction." World Bank. Available at: *http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-2613*

nets.[75] The economic literature argues that the indirect benefits accrued from FDI include being a source of both capital and transfer of knowledge, but in addition may also include the acquisition of new technology, the contribution to international trade integration, and the increase of tax revenues, all associated with a higher growth rate. From the empirical perspective, Moczadlo (2010) argues that the impact of FDI on growth and poverty reduction could be rather ambiguous,[76] since authors like Klein, Aaron and Hadjimichael (2002) conclude that under competitive conditions FDI can upgrade productivity. In the particular case of Latin America, using information from 20 countries from the region during the decade of the 1990s, Calvo and Hernandez (2006) suggest that FDI is a potential contributor to poverty reduction.[77] In particular, the authors argue that capital shortage is a factor affecting poverty, and hence FDI can help relax these constraints and be an important path for poverty reduction.

28. **However, certain conditions are necessary for countries to take full advantage of the benefits from FDI.** In principle, FDI is a key ingredient for successful economic growth in developing countries, and since growth is one the most important factors affecting poverty reduction, FDI would be central to this goal (see Klein, Aaron and Hadjimichael, 2002). In addition, it is argued that FDI provides a relatively stable, risk-free, form of finance for development in capital-poor countries. Moreover, FDI has the potential to contribute to technological acquisition and competitive upgrading of national economies,[78] as well as improve management and labor skills in host countries. However, to achieve the positive outcomes of FDI on poverty reduction, the existence of an equal and competitive playing field without special protections and a general framework of reasonable regulations (i.e., not unduly burdensome and not arbitrary) are necessary.[79] Importantly, using a panel data of 20 Latin American countries, Calvo and Hernandez (2006) suggests that the impact of FDI varies across countries, so that FDI reduces poverty only under certain circumstances, while fails under others.[80]

[75] Hung, T. T., (2004). "Impacts of Foreign Direct Investment on Poverty Reduction in Vietnam" IDS Program, GRIPS. Available in: http://www.grips.ac.jp/vietnam/VDFTokyo/Doc/18TTHungPaper.pdf

[76] Moczdlo, R. (2010). "Foreign direct investment: a mead for poverty reduction." Available at: *https://www.hs-pforzheim.de/fileadmin/user_upload/uploads_redakteur_wirtschaft/Fakultaet_zentral/Dokumente/2013/Turmthesen/TT_Bd2_07_Moczadlo.pdf*

[77] Calvo, C. and Hernandez, M. (2006). "Foreign Direct Investment and Poverty in Latin America." Prepared to be delivered at the Globalization and Economic Policy Fifth Annual Postgraduate Conference. Leverhulme Centre for Research on Globalisation and Economic Policy. 2006. Available at: *https://www.nottingham.ac.uk/gep/documents/conferences/2006/postgradconf2006/hernandez-postgradconf2006.pdf*

[78] Mold, A. (2004). "FDI and poverty reduction: A critical appraisal of the arguments". *Revue Region et Developpement, No. 20, 2004.*

[79] Klein, Aaron and Hadjimichael (2002:3-4). "Foreign direct investment and poverty reduction." World Bank. Available at: *http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-2613*

[80] Calvo, C. and Hernandez, M. (2006). "Foreign Direct Investment and Poverty in Latin America." Prepared to be delivered at the Globalization and Economic Policy Fifth Annual Postgraduate Conference. Leverhulme Centre for Research on Globalisation and Economic Policy. 2006. Available at: *https://www.nottingham.ac.uk/gep/documents/conferences/2006/postgradconf2006/hernandez-postgradconf2006.pdf*

PILLAR III: PROMOTING PUBLIC SECTOR EFFICIENCY AND FISCAL SUSTAINABILITY POST CRISIS

Prior Action 8: *The Borrower has: (i) submitted to the National Assembly, for approval thereof, the amendments to the Organic Code of Planning and Public Finance to: (a) introduce a four-year medium-term fiscal framework and a fiscal risk management framework, (b) revise downwards the margin of 15 percent to 5 percent for changes to the central government budget without prior approval from the National Assembly,* [81] *and (c) strengthen the link between public investment planning and budget preparation and execution, by integrating the forward-looking cost implications from public investment decisions into annual budgets; and (ii) established a Committee of Public Finance (Comité de Finanzas Públicas) to oversee fiscal risk assessment and mitigation.*

29. **The improvement in budget control from the Ministry of Economy and Finance (MEF) and the establishment of the Committee of Public Finances is not expected to have significant effects on poverty in the short run.** These prior actions aim to improve fiscal discipline by increasing the consistency between macro-fiscal programming and budget preparation. The regulatory reform focuses on regulatory changes that can be introduced by the executive and can have an immediate impact on the 2021 budget preparation cycle. The regulatory reform also reestablishes fiscally consistent aggregate ceilings and ceilings for budgetary institutions, that are properly shared with institutions at the beginning of the budget preparation cycle. Finally, the regulation simplifies budget forecasting and programming, strengthening the roles and responsibilities of MEF at this stage. In sum, all the above promotes better and clears budget ceilings, prioritization of spending, and budget planning. Evidence does not suggest that legislation, regulations, and code practices have a direct impact on "sufficient and timely funding for policy implementation" nor on "resource allocation better reflects policy".[82] However, the medium-term expenditure framework (MTEFs) shows positive effects in these outcomes as well in "planned and timely funding releases and budget processes."

30. **Nonetheless, we could expect some positive welfare impacts for the poor in the medium term if budget execution follows the improvement in budget formulation.** Extreme Poverty eradication can only be achieved with well-targeted, effective, efficient and sustainable pro-poor programs. To this end, sound budget management is essential to eliminate waste and rigidities and improve service delivery. The budget is both an instrument of economic management and an implicit policy statement, as it sets priorities and relative levels of spending for different programs and activities. Weaknesses in the budget processes and institutional bottlenecks could play a significant role in the poor performance of social programs and public policy in general. Eliminating these barriers is critical for improving budget execution and translating public priorities to outcomes. Budget control could enhance the quality of spending (i.e., targeting, efficiency, and effectiveness) and budget programming could insurance resource availability for prioritized government programs. Thus, this prior action could strengthen the public policy impact on the most vulnerable in the medium-long run.

[81] There are some exceptions that allow for emergency situations.

[82] See De Lay, S., Mills, L., Jadeja, K. & Lucas, B. (2015) Public Financial Management Evidence Mapping. Birmingham, UK: GSDRC, University of Birmingham.

Prior Action 9: *The Borrower has i) eliminated redundancies in staff by adopting and implementing an inter-ministerial agreement to cut duplicative posts in deconcentrated offices.*

31. **This prior action is expected to have a mildly negative impact on wellbeing in the short-run; however, this negative effect is expected to be mitigated in the medium and long-run by the indirect effects in economic growth from prior actions in Pillar II which aim to remove barriers to private sector development.** The immediate effect of this prior action is a reduction of about 2.3 percent of public sector workers. Public sector service delivery is not expected to be affected because lay off workers are from management positions, supporting staff not related to service delivery and duplicate positions in public institutions. However, poverty is expected to increase between 0.05 and 0.39 percentage points.[83] This small and insignificant effect in poverty is explained by the low probability of public sector workers to be poor, because they are on average well educated, live in urban areas, and have a higher income than private-sector and informal workers (World Bank 2018).[84] It is important to clarify that the government will compensate affected public servants accordingly to the current public sector lay-off rules (for instance, paying severance payment if needed). Thus, lay-off public sector workers are expected to be indirectly and positively affected by prior actions under Pillar II, such as incentives to invest in small businesses, easier access to credit, elimination of tariffs, and others in their transition period form public to private employment. Therefore, a positive effect on economic growth is expected through increased entrepreneurship and formal labor demand is expected to occur at the medium to long run, since investment decisions take time to adjust to new rules and are made after consideration of a combination of factors and given a set of conditions, that are particular for developing economies.[85] [86] Also, this dynamic role expected to be taken by the private sector would further contribute to the fiscal and external sustainability through higher tax revenues and exports and generation of formal employment in the long-run.

Prior Action 10: *The Borrower has: (i) appointed a commission within the Regulatory Agency for Hydrocarbon (ARCH) to set up fuel prices and increase transparency in price setting by making final prices and reference prices publicly available; and (ii) launched the competitive auction for renewable energy opening the market to the private sector while reducing the fiscal impacts of electricity by applying the least cost generation expansion, and allowing pass through of all costs to end user prices.*

32. **The appointment of a commission within the Regulatory Agency for Hydrocarbon (ARCH) in charge the responsibility of setting final fuel product prices and making them available on-line would not have any impacts on poverty or inequality.** Having an independent institutional body in charge of setting fuel product prices is an important step towards sustained fuel subsidy

[83] WB staff estimates using labor surveys.

[84] World Bank. 2018. Ecuador - Systematic Country Diagnostic (English). Washington, D.C: World Bank Group.

[85] Zoltan J. Acs and Nicola Virgill (2010). "Entrepreneurship in developing countries". In: Z.J. Acs, D.B. Audretsch (eds.). Handbook of Entrepreneurship Research. International Handbook Series on Entrepreneurship 5.

[86] Garry Bruton, David Ahlstrom and Krysztof Obloj (2008). "Entrepreneurship in emerging economies: Where we are today and where should the research go in the future". Entrepreneurship Theory and Practice Vol. 32 Issue 1. Baylor University.

reform[87] [88]. Moreover, having an independent institution publish terminal prices for all fuel types for each sector together with the reference prices, represents a major first step in enhancing transparency and in communicating the true opportunity cost of subsidies, that will be available to the whole population whether they are direct consumers or not. Since the methodology for setting fuel prices is still not in place, nor are we analyzing fuel subsidy removal per se, this prior action would help people's understanding of subsidies and enhance the public debate on their removal, but it would not have any impacts on poverty or inequality.

33. **The implementation of reforms in the electricity sector is expected to have limited impacts on social outcomes in the short-run.** The implementation of a pass-through mechanism is expected to create fiscal space and help balance the Government's budgetary position with negligible impacts at the bottom of the income distribution. The introduction of renewable energy in the power generation mix is being implemented according to best practice, moving from feed-in tariffs –which represent essentially a subsidy for renewables– to competitively awarded auctions. Considering the small size of the added generation in solar PV and wind (300 MW in an overall system of about 8,000 MW), the increases in the cost of generation, transmission and distribution are expected to be marginal and well below 5 percent. Also, for the first time in Ecuador, ARCONEL has included on the basis of tariff calculations all costs, including CAPEX, which will be passed through to end-user tariffs. The expected increase in prices is expected to be only marginal, because of the size of the expansion in the generation. According to the last available budget survey,[89] electricity consumption rises sharply with income. Furthermore, 54 percent of households consume less than the dignity tariff (Tarifa de la Dignidad) threshold, with a higher proportion of households for the lower deciles –the share of eligible households for the dignity tariff is almost 90 percent for the poorest decile, 80 percent for decile 2, and 72 percent for the third decile. Therefore, price increases resulting from policies in this prior action will probably not affect the most vulnerable consumers, since they still benefit from the reduced price as set up in the dignity tariff which will remain unchanged.

[87] Arze del Granado, F., Coady, D. and Gillingham, R. (2012). "The Unequal Benefits of Fuel Subsidies: A Review of Evidence for Developing Countries". World Development Vol. 40, No. 11, pp. 2234–2248, 2012. Available at: http://dx.doi.org/10.1016/j.worlddev.2012.05.005

[88] Rentschler, J. and Bazilian, M. (2017). "Principles for Designing Effective Fossil Fuel Subsidy Reforms". Review of Environmental Economics and Policy, volume 11, issue 1, Winter 2017, pp. 138–155. Available at: https://doi.org/10.1093/reep/rew016

[89] ENIGHUR 2011-2012.

ANNEX 5: ORIGINAL DPF 2 vs PROPOSED DPF 2/DPF 3

Original IT for DPF 2	DPF 2 PA	DPF 3 IT	Comments
Pillar 1: Promote a more efficient allocation and mobilization of government resources. (DPF 1)		***Pillar 3: Promoting public sector efficiency and fiscal sustainability post-crisis (DPF 2 and 3)***	
OIT1. The Borrower amended the Organic Code of Planning and Public Finance to introduce a medium-term fiscal framework, revised downwards the current margin of 15% for changes in the budget without consulting the National Assembly, and created an integrated national and subnational public investment system.	PA8: The Borrower has submitted to the National Assembly the amendments to the Organic Code of Planning and Public Finance to: (i) introduce medium-term fiscal framework and fiscal risk framework, ii) revise downwards the margin of 15 percent to 5 percent, for changes to the central government budget without prior approval from the National Assembly, and (iii) strengthen the link between public investment planning and budget preparation and execution, by integrating of forward looking cost implications into annual budgets from public investment decisions. In order to strengthen the coordination and oversight of fiscal policy and risk management, the Borrower has also issued a ministerial agreement establishing a Committee of Public Finance.	IT8: The amendments to the Organic Code of Planning and Public Finance to: (i) introduce a medium-term fiscal framework and fiscal risk framework, ii) revise downwards the margin of 15 percent to 5 percent, for changes to the central government budget without prior approval from the National Assembly, and (iii) strengthen the link between public investment planning and budget preparation and execution, by integrating of forward looking cost implications into annual budgets from public investment decisions have been enacted by the National Assembly.	The original IT was kept as IT for DPF3, with a small upgrade regarding the introduction of a fiscal risk management framework. DPF 2 supports intermediary implementation steps (such as the submission of the law to congress and the creation of a Public Finance Committee, responsible for implementing key aspects of the reform.
OIT2. The Borrower has made spending in personnel more efficient by issuing a presidential decree introducing changes to: (i) its salary structure, particularly the pay scales; and (ii) pay-for-performance system; and it has further improved spending in goods and services amending the Procurement Law to improve transparency and competition in	PA9: The Borrower has i) eliminated redundancies in staff by adopting and implementing an inter-ministerial agreement to cut duplicative posts in deconcentrated offices	IT9: The Borrower has approved regulation to improve the efficiency of public sector human resource management the public employment law to improve fiscal sustainability of public sector wage bill. The Borrower has enacted reforms to the Public Procurement Law to further increase transparency and competition in public procurement.	On public sector HR management, the proposed IT was later identified as unconstitutional by authorities. Instead of pursuing changes in the payment system, authorities have been focusing on the public sector organization, eliminating duplicate or unnecessary positions. On Procurement, the original IT was

public biddings.			kept as IT for DPF III.
OIT3. The Borrower has issued a decree ensuring the fiscal separation between the hydrocarbon sector SOEs and the General government accounts; The Borrower has amended the Organic Law of Public Service of Electric Energy to, inter alia, allow the inclusion of all costs as bases for tariff calculation.	PA10: The borrower has strengthened the Regulatory Agency for Hydrocarbon (ARCH) price setting capacity and increased transparency by making final prices and reference prices publicly available. The borrower has launched the competitive auction for renewable energy opening the market to the private sector while reducing the fiscal impacts of this segment by: i) applying the least cost generation expansion and ii) allowing pass through of all costs to end user prices.	IT10: The Borrower has issued a decree introducing a gradual elimination gasoline subsidy and grant the regulator the responsibility to set a smoothing formula to determine final liberalized prices. In addition, the Borrower has promoted transparency in the management of resources from extractive activities by joining the EITI initiative.	While the overall objective of reducing fiscal impact of the energy sector has been preserved, the PA and IT were completely changed and to some extent upgraded. The government has anticipated the implementation of the subsidy reform, which is now included as IT for DPF 2 and delayed the SOE reform agenda associated with the original indicative triggers. DPF 2 supports intermediary steps associates with both agendas. The strengthening of the regulator and publication of subsidy amounts contribute to the subsidy reform agenda, while the consideration and pass through of both capital and operational costs of generation is a important first step on a broader recognition and pass through of costs.
OIT4: The Borrower has reformed its tax structure to increase revenue collection and reduce distortions.			The tax reform approved has a narrower scope than originally expected. OIT4 refereed to a broader tax reform, including VAT reform, that was expected to generate around 1.4% of GDP in revenues. PA4 does not introduce significant changes in VAT. It is expected to generate 0.5% of GDP in additional revenues. Other elements of the original reform, such simplifications and reduction of distortions were preserved. The reform was not considered as a prior action due to risks associate with two

			legal demands for unconstitutionality of two articles of the Law.
Pillar 2: Remove barriers for private sector development (DPF 1)		***Pillar 2: Removing barriers to private sector development and supporting the economic recovery (DPF 2 and 3)***	
OIT5. The Borrower has amended the Fiscal Incentives Law to align it with best international practices on Public Private Partnerships to, among others, clarify at strategic level the roles and responsibilities of the different government agencies along the PPP project cycle and decision-making process.			This objective is not pursued by DPF 2 and 3. The complex political and social context forced the government to prioritize among the areas for legal reform it intended to pursue. PFM, Tax, Subsidy, and Monetary Code were identified as more urgent while the PPP reform might be considered on a second round of reforms if the political environment is conducive.

OIT6: The Borrower has enacted a Law and regulations introducing a simplified regime for registering a corporation.	PA5: The Borrower has adopted measures to facilitate firm entry and growth of young firms through the enactment of a Entrepreneurship and Innovation Law, including provisions to: (i) the creation of an institutional set-up to identify, monitor and evaluate the implementation of entrepreneurship and innovation policies; (ii) the creation of a simplified regime for registering a corporation; and (iii) the introduction of entrepreneurship-enhancing programs in the education system.	IT5 The borrower has approved regulations to strengthen competition and enforcement power of the Competition Authority.	This PA represents a significant upgrade with respect to the original IT. The Law approved by the government goes beyond the simplified regime originally contemplated and introduce measures to support new entrepreneurs and to design innovation policies. The government also advanced the trade facilitation agenda further than originally anticipated.
OIT7: The Borrower has reduced financial distortions by i) reforming the governance and sources of funding of public banks, ii) partially liberalizing interest ceilings; and iii) reforming the Financial and Monetary Code to allow banks to have	PA7 ii) The Borrower has : i) reduced the cost of getting financing from abroad by expanding the criteria for exemption of the outward foreign exchange tax (*Impuesto a la Salida de Divisas- ISD*) associated with financial transactions	IT7: The Borrower has reduced financial distortions by i) reforming the governance and sources of funding of public banks, ii) introducing a new methodology for calculating interest rate ceilings; and iii) reforming the Financial and Monetary Code to allow	The original IT was kept as IT for DPF3. DPF2 supports an unanticipated element of the tax reform, that focus on reducing the incidence of the tax on outflows on financial transactions, facilitating access to external financing by the private sector.

subsidiaries that foster capital market development.		banks to have subsidiaries that foster capital market development.	
Pillar 3: Protect and include vulnerable segments of the population (DPF 1)			
OIT8: The Borrower has implemented a compensation mechanism to mitigate for the impact of fuel subsidy (gas, diesel, and electricity) price reforms.		IT10 i): The Borrower has implemented compensation mechanisms to mitigate for the impact of gasoline price subsidy reform.	The OIT8 was kept as IT for DPF3.
OIT9: The Borrower has approved a labor reform aimed at reducing informality, particularly among vulnerable segments of the population such as women and youth.	PA6. The Borrower has: i) adopted measures to reduce the number of sectoral and occupational minimum wages fixed and improve the timeline for setting minimum wages. (moved to new pillar 2)	IT6: The Borrower has approved regulations improved the minimum wage setting process by committing to adjust wages follow an objective pre-defined formula if no agreement achieved by 3-part negotiations. (moved to new pillar 2)	The complex political and social context forced the government to prioritize among the areas for legal reform it intended to pursue. PFM, Tax, Subsidy, and Monetary Code were identified as more urgent/feasible while the ability to pursue a reform of the Labor Code is still uncertain. Instead the government is pursuing regulatory reforms that will help improve the wage setting process and increase its flexibility and predictability.
OIT10: The Borrower has issued regulations strengthening the regulatory framework and supervision for cooperatives and enacted regulations to facilitate the development of an electronic payment system to which vulnerable sectors of the population may have access. This system would need to be connected to the payment system used by commercial banks, public banks and cooperatives.	PA7 i). The Borrower has approved regulations reducing barriers to digital financial services for underserved populations, including by allowing for remote uptake of basic accounts via mobile phones.		The first part of OIT10 is still being monitor as part of the dialogue under DPF III, while the second part was upgraded to consider a recent reform allowing for the creation of remote opening of accounts and access to financial services.

		Pillar 1: Responding to COVID-19 to protect the vulnerable (new, DFP 2 and 3)	
new	PA1: In the context of the COVID-19 crisis, the Borrower has created an emergency cash transfer scheme to vulnerable households that are not covered by social assistance programs.	IT1: The Borrower has expanded the emergency transfers to reach the poor and vulnerable, including those covered by social assistance programs.	New crisis response measures, not contemplated in DPF 1
new	PA2: The Borrower has increased flexibility in work arrangements in the context of the COVID-19 crisis by regulating telework and allowing for emergency adjustments or suspension of work shifts.	IT2: The Borrow has facilitated the access to unemployment benefit.	
new	PA3: The Borrower has helped create fiscal space for crisis response by i) increasing the withholding of income taxes for large corporations in resilient segments while deferring payments from firms in the most affected segments and ii) reducing the costs associated with purchased medical equipment by eliminating import tariffs and restrictions applied to these goods in response to the COVID-19 emergency	IT3: The Borrower has created a Solidarity Fund to provide financial support to vulnerable households and firms.	
new	PA4. The Borrower has: i) created a Migratory Registry based on the information of the Migratory Census to ensure the effective provision of public services to Venezuelan migrants and refugees and ii) extended by 60 the amnesty to irregular Venezuelan migrants by allowing their permanence in the country and ratified the validity of Venezuelan passports expired up to 5	IT4: The Borrower has prepared a new migrant strategy informed by the implementation of the Migratory Registry.	A new objective related to the protection and integration of migrate population was introduced to support the GCFF

	years, in the context of the COVID-19 crisis.		

ANNEX 6: COORDINATION WITH MULTILATERALS

1. Structural Reform Agenda

Area	WB	IMF	IADB	Other
Fiscal Adjustment	*	*	*	
Fiscal policy framework				
Other PFM (budget processes, cash management, transparency)	*	*		
Quality of current spending	*	*		
Wage bill, HR	*	*		
Procurement	*			
Subsidies	*			
Debt management	*	*		
Tax policy	*	*		
Tax/custom administration		*	*	
Capital spending				
PIM	*		*	
Asset management			*	
Institutional strengthening of MEF			*	
Social Sectors and Safety Nets				
Efficiency of social spending	*			
Targeting and effectiveness of social programs	*			
Compensation Mechanisms	*			
Pension Reform				
SOE Reform (horizontal)			*	
Monetary/Dollarization		*		
Financial Sector	*	*	*	
Interest rate ceilings, liquidity requirements	*	*	*	
Commercial banks Regulations and supervision				
State-owned banks	*			
Cooperatives	*			
Capital Markets Development				
Private Sector/Private Investment	*		*	
Entry	*		*	
Operation	*		*	
Competition				
Insolvency/bankruptcy				
Arbitration	*			
PPPs	*		*	
Opening/Governance of energy sector[+]	*		*	
International Trade	*		*	*
Facilitation			*	CAF
Non-tariff barriers	*			
Tariffs and quotas				
Agriculture price floors				
Labor Reform	*			
Anticorruption				
Overall strategy	*	*		UN
Integrity				

[+] support by WB through technical assistance

areas not covered by any IFIs

2. *COVID-19 Response*

	WB	IMF	IADB	CAF
Health system support				
Inmediate Response	*		*	*
Human Resources			*	*
Medical supply	*		*	*
Emergency kits (food and hygiene kits)				
Infrastructure and equipment	*		*	
Short term Response	*		*	*
Medium term Response			*	
Social Protection and Safety Nets				
Targeting and effectiveness of social programs	*	*	*	
Cash-transfers* and contingecy Mechanisms	*		*	