PD-AAN-274

UNCLASSIFIED

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

ECUADOR

PROJECT PAPER

REVENUE GENERATION FOR DEVELOPMENT

AID/LAC/P-143

Project Number: 518-0036

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) — Amendment Number: _____

DOCUMENT CODE: 3

2. COUNTRY/ENTITY: Ecuador

3. PROJECT NUMBER: 518-0036

4. BUREAU/OFFICE: LAC — 05

5. PROJECT TITLE (maximum 40 characters): Revenue Generation for Development

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 10 DD 31 YY 84

7. ESTIMATED DATE OF OBLIGATION (Under 'B.' below, enter 1, 2, 3, or 4)
A. Initial FY 83 B. Quarter 4 C. Final FY 83

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 83 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total	980	20	1,000	980	20	1,000
(Grant)	(980)	(20)	(1,000)	(980)	(20)	(1,000)
(Loan)	( )	( )	( )	( )	( )	( )
Other U.S. 1.						
Other U.S. 2.						
Host Country	-	500	500	-	500	500
Other Donor(s)						
TOTALS	980	520	1,500	980	520	1,500

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	2. Loan	D. OBLIGATIONS TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan	F. LIFE OF PROJECT 1. Grant	2. Loan
(1) EH	652 B	720				1,000		1,000	
(2)									
(3)									
(4)									
TOTALS									

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 710 | 810

11. SECONDARY PURPOSE CODE: 662 B

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code	DEL						
B. Amount	430						

13. PROJECT PURPOSE (maximum 480 characters)

To develop mechanisms for improved revenue generation and fiscal management at both central and municipal levels of the GOE.

14. SCHEDULED EVALUATIONS
Interim MM YY MM YY Final MM 10 YY 84

15. SOURCE/ORIGIN OF GOODS AND SERVICES
☒ 000 ☐ 941 ☐ Local ☐ Other (Specify) _____

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

17. APPROVED BY
Signature: [signature]
Title: Robert Jordan, Acting Director, USAID/Ecuador
Date Signed: MM 07 DD 06 YY 83

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION
MM DD YY

AID 1330-4 (9-79)

Revenue Generation for Development
Project No. 518-0036

	Page
SUMMARY AND RECOMMENDATION	i-v
I. BACKGROUND	1
A. Problem Setting	1
B. GOE Actions and Request for Assistance	3
C. USAID Response	5
D. Project Rationale	6
1. Relationship to USAID Strategy	6
2. Relationship to A.I.D. Policy	6
E. Other Donors	7
F. Issues	7
1. GOE commitment to tax reform	7
2. Project impact	7
3. Choice of organizations	8
4. FAA Section 660	8
II. PROJECT DESCRIPTION	9
A. Goal and Purpose	9
B. Project Strategy	10

	Page
C. Project Activities	11
1. Ministry of Finance Tax Administration	11
2. Municipal Revenue Generation	15
D. Project Inputs	20
1. Budget	20
2. Description	22
III. PROJECT ANALYSES	22
A. Technical	22
1. Ministry of Finance Tax Administration	22
a. Previous efforts	23
b. Alternative approaches	23
c. Replicability	24
d. Conclusion	25
2. Municipal Revenue Generation	25
a. Previous efforts	25
b. Alternative approaches	26
c. Replicability	26
d. Conclusion	27
B. Financial and Economic Feasibility	27
C. Social Soundness	29
1. Ministry of Finance Tax Administration	29
a. Incidence of revenue generating programs	29
b. Attitudes toward tax compliance	29
2. Municipal Revenue Generation Activities	30
a. Nature and incidence of benefits	30
b. Impact on municipal autonomy and decentralization	30

Page

D. Institutional Feasibility 30

1. Ministry of Finance 30

a. Commitment 30
b. Organizational constraints 31
c. Legal constraints 32
d. Conclusion 32

2. Municipal Support Organizations 33

a. Organizational profiles 33
b. Choice of implementing organization 35

E. Environmental Soundness 36

IV. PROJECT IMPLEMENTATION 36

A. Implementation Schedule 36

B. Contracting and Procurement Responsibility 37

C. Monitoring and Evaluation Arrangements 37

D. Conditions, Covenants, and Negotiating Status 37

E. Waivers 38

ANNEXES

A. Sources

B. Logical Framework

C. Applications

D. DAEC PID Guidance Cable

E. Statutory Checklist

F. IEE Threshold Decision

G. Procurement List

H. Benefit/Cost Calculations

I. Analysis of Municipal Financial Situation

PROJECT AUTHORIZATION

Name of Country: Ecuador

Name of Project: Revenue Generation for Development

Number of Project: 518-0036

1. Pursuant to Sections 105 and 106 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Revenue Generation for Development Project for Ecuador, involving planned obligations of not to exceed One Million United States Dollars (US$1,000,000) in grant funds ("Grant") over a two (2) year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the project. The planned life of the project is one year and three months from the date of initial obligations.

2. The project ("Project") consists of assistance to the Ecuadorean Ministry of Finance and Public Credit and to the Ecuadorean Development Bank (BEDE) to develop mechanisms for improving revenue generation and fiscal management at both central and municipal levels of the Government of Ecuador, and to strengthen the capacity of the organizations to maintain and expand those mechanisms. The Project will be executed under two separate Project Grant Agreements, one with the Ministry of Finance and Public Credit and one with BEDE.

3. The Project Agreements, which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority, shall be subject to the following essential terms, covenants, and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

4. a. Source and Origin of Commodities, Nationality of Services

Commodities financed by A.I.D. under the Grant shall have their source and origin in the United States or in Ecuador, except as A.I.D. may otherwise agree in writing. Except for ocean shipping and except as provided in Section 4.d. below, the suppliers of commodities or services shall have Ecuador or the United States as their place of nationality, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by A.I.D. under the Grant shall, except as A.I.D. may otherwise agree in writing, be financed only on flag vessels of the United States.

b. Condition Precedent to Disbursement to BEDE

Prior to any disbursement, or the issuance of any commitment document under the Project Grant Agreement with BEDE to finance a specific pilot technical assistance or training activity for one or more municipalities, BEDE shall furnish in form and substance satisfactory to A.I.D., evidence of a signed written agreement between BEDE and any participating organization, which agreement defines the responsibilities of the parties with regard to that activity.

c. Covenants

The GOE shall covenant that, except as A.I.D. may otherwise agree in writing, it will cause the Ministry of Finance and Public Credit to:

(1) assign adequate personnel at the central, regional, and provincial levels of the General Directorate of Revenues to each of the pilot revenue programs to ensure that these programs are carried out in accordance with their planned scope and schedule; and

(2) review its data processing capacity and to take whatever actions may be necessary to ensure that adequate data processing support is provided to the Project activities throughout the life of the Project.

d. Waiver of Nationality Requirements

A.I.D. nationality requirements are hereby waived to permit financing under the Grant of technical assistance services up to $200,000 from suppliers included in A.I.D. Geographic Code 941.

Robert Jordan
Acting Mission Director
USAID/Ecuador

7/7/83
Date

CLEARANCES:

GDO: LGarza
OPE: CLuzuriaga
RDO: BKernan
CONT: WRoss
O/DP: PMaldonado
U/H: EKessler
O/DR: RRoeser
RLA: AAdams (in draft, 6/29/83)

SUMMARY AND RECOMMENDATION

A. Recommendation

The Project Committee recommends that the USAID/Ecuador Director approve the Revenue Generation for Development Project and authorize an A.I.D. grant for $1,000,000.

B. Background

Ecuador's declining economic prospects in the 1980s are having a direct and serious impact on fiscal revenues. Oil export revenues, which are a major source of GOE current income, have fallen well below projected levels over the past two years due to declining world prices and stagnating domestic producton. At the same time, Ecuador's access to external commercial credit has been severely restricted as a result of an onerous debt burden acquired by the military governments in the late 1970s. This fiscal impact is being felt by the central government and by municipalities which in recent years have grown heavily dependent on revenue transfers from the central level.

The fiscal situation poses an immediate threat to Ecuador's development. The 1983 central government budget imposes drastic real reductions on the budgets for all major economic and social sectors. Investment levels set forth in the 1980-84 National Development Plan have been scaled back, and many important projects and programs introduced by the democratic government in recent years may not be maintained for lack of recurrent cost funding. This problem is particularly acute in municipalities which have invested heavily in basic infrastructure but now face the certainty of sharply declining revenues. In short, the excellent start which the GOE has made toward stimulating broad based, sustained development may die aborning.

The central government has recently attempted to improve revenues, primarily by reducing subsidies on gasoline and wheat. These measures, while easy to implement, have been highly unpopular and have contributed to the weakening of the democratic regime. Moreover, they have failed to close the deficit despite the simultaneous austerity measures taken by the GOE. The long term solution to Ecuador's fiscal dilemma lies in more effective administration of the principal domestic revenue sources. These include income and sales taxes at the central level and property taxes and other fees at the municipal level. All of these sources are presently yielding well below their

potential. The abundance of oil revenues and external financing through the 1970s weakened the incentive to improve domestic revenue performance, and administrative mechanisms deteriorated. The GOE is now keenly aware of the need to improve internal revenue generation, both to sustain the development process and to promote the more active participation of municipalities in that process, and has requested USAID assistance to achieve those objectives.

C. Project Description

The purpose of this project is to develop mechanisms for improved revenue generation and fiscal management at both central and municipal levels of the GOE. The project will consist primarily of a series of pilot revenue activities to be carried out over a period of 15 months. In addition, various activities will be undertaken to build the necessary organizational capacity to maintain and replicate the pilot revenue activities. This short, high impact project is intended to respond to the immediate fiscal concerns of the GOE. At the same time, it will provide the basis for USAID dialogue with the new GOE administration which will take office in August 1984 regarding further efforts to expand and strengthen revenue generation.

Project activities at the central level will be carried out by the Ministry of Finance with support from long and short term technical advisors. The pilot revenue programs will focus on three major areas of non-compliance where significant revenue gains can be made in the short term: non-filing, underrreporting of taxes, and delinquent payments. Improved information and administrative systems will be developed to help identify cases of non-compliance and to evaluate Ministry follow-up efforts. The project will also support the more efficient and effective operation of these revenue programs through streamlined document processing procedures, recommendations for rationalization of the Ministry's tax administration functions, and short term training in modern tax administration concepts.

At the municipal level, project activities will be coordinated by the Ecuadorean Development Bank (BEDE). The project will strengthen the capacity of BEDE's newly created municipal technical assistance unit to analyze municipal revenue needs, plan pilot interventions, and coordinate the resources of other central level organizations to carry out those interventions. In addition to providing a long term advisor, the project will support the BEDE unit through establishment of a municipal data bank, short term training, and short term assistance in the design of training manuals and the planning of pilot activities. The project will also support the execution of a small number of pilot activities including technical workshops and direct technical assistance to selected municipalties. The pilot activities will seek to improve administration of specific local revenue instruments such as cadastres. They will also seek to strengthen municipal financial planning and management as a means of increasing the efficiency of revenue expenditures.

D. Summary Financial Plan

	- - - - Funding ($000) - - - -		
	AID Grant	National	Total
Ministry of Finance Tax Administration			
A. Technical Advisors	325	-	325
B. Short Term Training	169	-	169
C. Equipment	36	-	36
D. Ministry Resources	-	350	350
Subtotals	530	350	880
Contingencies	40	-	40
Totals - Ministry of Finance	570	350	920
Municipal Revenue Generation			
A. Technical Advisors	256	9	265
B. Short Term Training	10	-	10
C. Equipment and Materials	97	27	124
D. Logistical Support	7	9	16
E. GOE Personnel Resources	-	80	80
Subtotals	370	125	495
Contingencies	60	25	85
Totals - Municipal	430	150	580
PROJECT TOTALS	1000	500	1500

E. Project Development Personnel

The USAID Project Committee which participated in the development of the the Project Paper was composed of the following USAID officers:

Randall Roeser	Project Development Officer/Chairman
Carlos Luzuriaga	Program Economist
Leopoldo Garza	General Development Officer
Patricio Maldonado	Program Officer
Earl Kessler	Housing Officer
William Ross	Controller

Extensive guidance was also provided by Robert Jordan, Chief of the Office of Development Resources, and Paul Fritz, USAID Acting Director.

The following GOE personnel participated in the development of the project:

Ministry of Finance

Ing. Pedro Salas	Director of Revenues
Lic. Roberto López	Subdirector of Processing
Econ. Patricio Rubianes	Special Assistant to the Minister
Econ. Alfredo Cárdenas	Director of Organization and Systems
Ing. Luís Basabe	Director of Cadastres and Property Valuation

BEDE

Dr. Marco Antonio Gúzman	General Manager
Dr. Nestor Vega	Deputy General Manager
Econ. Hernán López	Director of Studies
Lcda. Marcia Chiriboga	Chief, Technical Assistance Unit

The following consultants and TDY personnel assisted in design studies for the preparation of the Project Paper:

Mr. William Newnam	Private consultant, tax administration generalist
Mr. James Watson	U.S. Internal Revenue Service, systems analyst
Dr. Pirie Gall	Private consultant, municipal development expert
Dr. David Greytak	Syracuse University, municipal revenue export

Dr. James Hicks, Dr. Ronald Johnson, and Mr. Richard Harper	Research Triangle Institute/Urban Financial Management Program
Dr. Mauricio Silva	Private consultant, municipal development and institutional expert
Mr. Jack Rosholt	USAID/Peru, cadastre expert

The project was reviewed and approved by:

Robert Jordan	USAID Acting Director
Annette Adams	Regional Legal Advisor

I. BACKGROUND

A. Problem Setting

The fiscal situation of Ecuador's public sector has taken a dramatic turn for the worse in the early 1980s. The roots of this problem are clear. Since Ecuador began to export oil in 1972, the public sector has grown increasingly dependent on this source for current revenues. In addition, during the 1970s the military governments embarked upon a strategy of "aggressive indebtedness" to foreign commercial lenders to finance ambitious infrastructure projects. Foreign lenders, impressed with Ecuador's burgeoning oil exports, confidently backed this strategy. In fact, since 1975 the public sector deficit has been entirely financed by external borrowing. Under these circumstances, the incentives to improve internal generation of fiscal revenues have been few.

The legacies of the past decade are now taking their toll on Ecuador's fragile democracy. The unexpected drop in world oil prices and a reduced rate of growth in the exportable surplus of oil have severely reduced current revenues. Looking to the future, oil exports, which supply about 30 percent of central government current revenues and which play a large role in municipal budgets, are expected to peak in 1984 at 45 million barrels (net) and decline steadily thereafter, according to the latest projections by the Ministry of Natural Resources.

At the same time, Ecuador's ability to go to international capital markets for deficit financing has been sharply curtailed. At the end of 1982, Ecuador's external public debt (medium and long term) exceeded $4 billion and service payments amounted to two thirds of export earnings. Ecuador has entered into renegotiation of the foreign debt, and a stand-by agreement has been reached with the IMF. As part of its agreement with the IMF and to facilitate renegotiation of its existing external debt, the GOE is committed to reducing the public sector deficit from an estimated 7.5 percent of GDP in 1982 to four percent and to limit new external debt.

The fiscal impact of these circumstances is being felt throughout the public sector. At the central government level, the most recent estimates for 1982 indicate that current revenues would cover only 57 percent of total expenditures, compared to an average of 87 percent during 1976-1980. A principal cause of the increased deficit was the lower than anticipated prices for oil exports; actual 1982 export receipts by the central government were only 70 percent of the budgeted level. In 1983, restricted access to credit will have a major impact on central government expenditures. The recently approved 1983 budget allows borrowing equal to only 44 percent of the previous year. To minimize the deficit, the 1983 budget projects that current revenues will rise dramatically to cover 87 percent of total expenditures. However, the GOE's consistent record of overestimated revenues leaves much room for doubt; in particular, oil export revenues for the 1983 budget were based on an average price of $30 per barrel, which is $2-3 higher than the long term sales contracts recently signed by the state oil company.

Even if revenues were to meet expectations, the 1983 central government budget would impose stern austerity. The budgets for the economic ministries (agriculture, natural resources, industry, and public works) have been reduced by 6.1 percent in nominal terms from the estimated 1982 levels. The social ministries (including health and education) would realize only a 3.9 percent nominal increase in their funding over 1982. With inflation currently running at about 50 percent and expected to rise, it is clear that the important development programs of these ministries stand to suffer drastic cuts in real terms.

The revenue problems now visible at the central level of the public sector will soon affect local government. Under the public finance laws, decentralized government units (especially municipalities and provinces) are strongly dependent on the central government to collect and redistribute tax revenues. This dependency was aggravated by the large inflows of oil revenues which the central government channeled to local governments through various mechanisms. The principal mechanisms include the National Participations Fund (FONAPAR) for transfers and the Ecuadorean Development Bank (BEDE) for credits. In recent years, municipalities in Ecuador have drawn heavily on these credits and transfers to finance new investments in social infrastructure such as water, sewerage, and electrification. They have also used transfers to cover a large portion of current expenditures. In 1981, municipalities funded only 46 percent of current operations out of own-source revenues, relying on central government transfers for the balance. This strategy has so far enabled municipalities on the whole to avoid deficits. In return, however, municipalities have paid a large price in terms of reduced financial autonomy and increased exposure to risks emanating from revenue reductions at the central government level.

The easy money of the 1970s has left government units poorly prepared to increase internal revenues. At the central government level, a series of studies carried out by the U.S. Internal Revenue Service between 1977 and the present has documented numerous administrative weaknesses in the Ministry of Finance which limit its capacity to collect internal taxes, particularly on income and sales. These weaknesses are reflected in various statistics. A 1977 IMF comparison of nine Latin American countries at a similar level of development ranked Ecuador last in terms of tax effort (income and indirect taxes) as a percentage of GDP. Income and sales taxes have each accounted for only 10-15 percent of central government current revenues since 1976. The IBRD estimated in 1981 that the income tax was yielding only about one sixth its potential yield; despite this high potential, increases in income tax revenues have only risen slightly faster than GDP in recent years. As would be expected, evasion of both income and sales tax payments is rampant, especially among higher income categories of taxpayers. (See Sec. II.C.1. for a detailed description of problems affecting Ministry of Finance tax administration.)

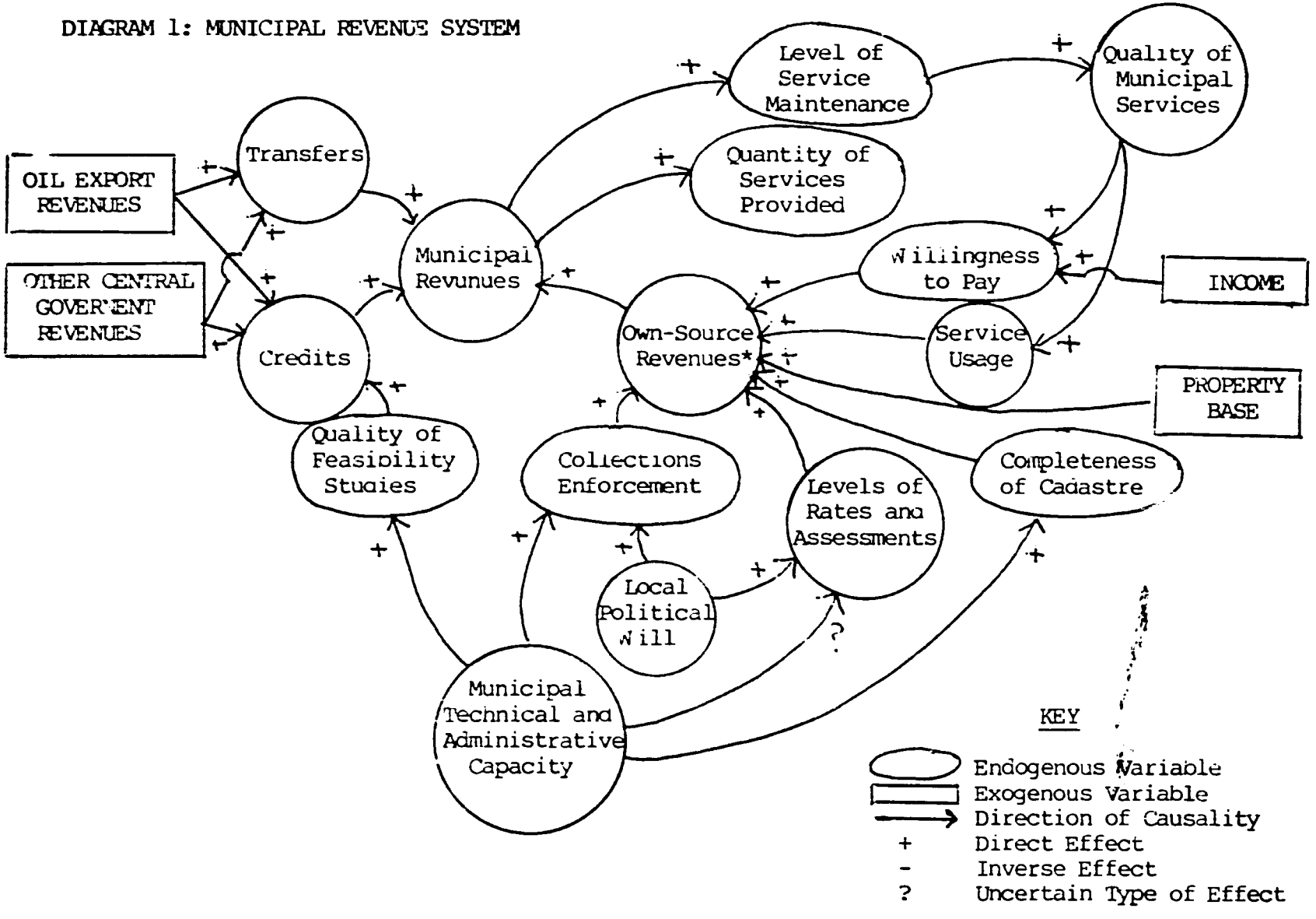
Similarly, municipalities have felt little incentive in recent years to boost local revenues. While central government transfers grew by an average of 40 percent per year between 1975 and 1981, own-source revenues increased by only four percent per annum; thus, in real terms, municipal revenue generation has actually declined over that period. The Municipal Law vests municipalities with several potentially lucrative revenue authorities, including property taxes, betterment levies, and users' fees. However, none of these sources is being fully tapped. Assuming a declining trend in central government transfers, it is evident that municipalities will soon be facing strong pressures to augment local revenues (see Annex I). The effectiveness with which municipalities respond to this challenge will depend on a variety of factors, including local administrative and technical capacity, local politics, and institutional coordination and support at the national level. (See Diagram 1 and the detailed analysis in Sec. II.C.2.) At stake is not only the capacity of the municipalities to operate and maintain the large infrastructure investments that they have made in recent years, but their capacity to play a more active, independent role in promoting decentralized development in Ecuador.

B. GOE Actions and Request for Assistance

Confronted by a rapidly deteriorating fiscal situation, the central government has taken several remedial measures in the past year to boost internal revenues. In October 1982, the executive decreed an average 100 percent increase in the domestic retail price for gasoline and eliminated the subsidy on wheat. Early in 1983, the executive raised the prices of all other petroleum by-products, and the legislature approved increased taxes for beer, cigarrettes, and certain luxury items and imposed a new surcharge on imports. These and other measures as well as increased local currency receipts for oil imports due to the March 1983 devaluation are expected to increase 1983 current revenues by 45 percent over 1982, although as in the past these projections may be overly optimistic. At the same time, the GOE realizes that the long term fiscal stability of the country depends on improved administration of the income and sales taxes which are potentilally major sources of revenue. This is reflected in the GOE stabilization program recently accepted by the IMF as a basis for the stand-by loan; the GOE declared its intent to reduce the public sector deficit, in part by reducing tax evasion and by bringing more taxpayers onto the rolls. To help achieve these goals, the Ministry of Finance has requested the USAID support an intensive technical assistance effort to decrease non-compliance and increase income and sales tax revenues over the short term.

As previously indicated, there is growing concern about the future financial soundness of municipal governments. Among leaders of secondary municipalities recently interviewed there was nearly unanimous agreement on the need for increased local revenues to reduce vulnerability to declining central transfers and to increase financial autonomy. These concerns have

DIAGRAM 1: MUNICIPAL REVENUE SYSTEM



* Principally property taxes, betterment levies, and users' fees.

caused BEDE to consider expanding its support to municipalities beyond mere project financing. BEDE, together with the National Preinvestment Fund (FONAPRE), held a series of regional meetings with municipal leaders earlier this year to survey municipal concerns. Subsequently, BEDE has requested USAID assistance in establishing a technical assistance function which would address the broader needs of municipalities. In particular, BEDE recognizes the importance of strengthening municipal revenue generation, both to protect its own portfolio and to help bring about a greater decentralization of the development process in Ecuador.

C. USAID Response

USAID has responded quickly and positively to these requests. USAID contracted a tax administration generalist and an IRS PASA specialized in systems analysis to work with the Ministry of Finance during March 1983. The result of their efforts was an updated analysis of key administrative constraints and specific recommendations for programs to improve revenues in the short term. They also recommended project activities for the longer term organizational strengthening of the Ministry's tax administration operations. The consultants' report has been reviewed and accepted by the Ministry. Given the short time frame of the project, USAID has already undertaken some of the short term training activities recommended by the consultants for high level Ministry officials using PD&S funds. These activities include a two week executive level orientation course in the IRS for the directors of Revenue and of Organization and Systems (data processing). In addition, the subdirector of Organization and Systems was given an intensive one week introduction to the use of data processing to support tax operations in IRS field units in Utah.

USAID, with the support of S&T/MSD, PRE/H, and PPC, has also contracted a series of studies on municipal revenue generation. In particular, USAID drew upon the local government finance expertise available from Syracuse University and Research Triangle Institute. The portion of USAID's Social and Institutional Profile (SIP) dealing with municipalities was also undertaken during intensive review. Finally, USAID invited an expert in cadastres in Latin America to investigate possibilities for improving municipal revenues from property taxes. Given the paucity of information regarding municipalities in Ecuador, these studies were designed to provide a broad understanding of the situation and problems of municipalities and their potential role in the country's development. At the same time, the studies addressed in depth the question of municipal finances and revenue generation capacity. The studies were carried out in close collaboration with BEDE and provided an excellent opportunity for BEDE to refine its thinking regarding its proposed technical assistance program. On the basis of these studies, USAID and BEDE have proceeded to outline a set of pilot and organizational development activities to be carried out under the project.

D. Project Rationale

1. Relationship to USAID strategy

USAID's CDSS for 1985-89 reflects the dramatic turnabout in the Ecuadorean economy which has occurred since the initiation of the present A.I.D. program in 1979. The deepening fiscal crisis is recognized as a key development constraint, limiting the capacity of government to maintain important public services and to provide large scale infrastructure which is needed to stimulate private sector investment and growth. The CDSS proposes to address the fiscal constraint by strengthening the institutional base needed for increasing public sector revenues at the central and municipal levels through technical assistance and training in tax administration. The present project, to be completed in FY 1984, is intended to help the GOE manage its immediate fiscal problems while setting the stage for the longer term efforts contemplated during the CDSS period.

2. Relationship to A.I.D. policy

a) Institutional development. A.I.D. has assigned a high priority to institutional development as a means for providing a country with the self-sustaining capacity to solve critical development problems. The A.I.D. policy paper on institutional development specifically endorses efforts which seek to enhance a country's ability to marshall its own financial resources for development, including improved tax administration. At the same time, the policy paper recognizes the vital role of local institutions in supporting sustained, broad based development and encourages decentralization of public sector activities. Supplementary A.I.D. guidance on local government programs (82 STATE 199220) specifically encourages the strengthening of local revenue generation capacity to allow greater local responsibility and initiative in development programs.

b) Recurring costs. There is strong reason to believe that the serious economic and fiscal problems are having an adverse impact on the GOE's capacity to finance the costs of maintaining important development programs undertaken in recent years. Although a rigorous recurrent cost analysis is beyond the scope of this Project Paper, there are indirect signs that a problem exists. These indications include growing budget deficits, a freeze on public hiring and other austerity measures, and substantial borrowing to finance current expenditures. Moreover, the projected low rates of GDP growth over the next few years portend increasing recurrent cost problems. Where recurrent cost problems appear to exist, A.I.D. policy is that necessary internal reforms should be undertaken. In particular, where the level of internal tax effort is relatively low, as is demonstrably the case in Ecuador, A.I.D. has determined that assistance to improve tax administration is an appropriate response. A.I.D. assistance of this nature is further justified by the fact that the GOE has already taken major policy decisions in other areas to help reduce the fiscal deficit, including removal of subsidies, increased domestic prices for fuels, and reductions of capital investment levels.

E. Other Donors

Other major international donors have addressed various aspects of the GOE's revenue problems. Since the 1960s, the IBRD and IDB have invested heavily in hydroelectricity generation. The first major generating capacity is now coming on line and will help improve Ecuador's fiscal situation by reducing expenditures for imports of diesel fuel which is currently used for thermal generation plants. The IBRD is also considering a major loan for petroleum resource development which could have a more significant fiscal impact by helping to sustain the exportable surplus of crude. Finally, a long term IMF consultant is working in the Office of the Controller General to develop a standardized, consolidated accounting system for the public sector. This system is intended to improve the efficiency of public budgeting and expenditures. None of these efforts, however, will directly improve internal revenue generation which is essential for the long term fiscal soundness of Ecuador. Nor have the major donors been actively involved in municipal development. The only significant initiative in this area is a $35.7 million loan for secondary city housing and urban development approved by the IBRD in 1982. However, this program will have little direct impact on municipal administration or finance.

F. Issues

The DAEC review of the PID for this project raised several issues (see guidance cable, Annex D). These issues are addressed below, with reference to the corresponding paragraph of the PID guidance cable.

1. GOE commitment to tax reform (para. 2). A 1981 IRS study of the Ministry of Finance noted that Ecuadorean tax law contains a number of provisions which inconvenience taxpayers, hinder effective administration, and discourage compliance. The Director of Revenues has acknowledged these impediments and requested that, as part of its assistance under this project, USAID support an analysis of the tax law which would provide the basis for reforms. The two tax consultants who assisted in the design of the Ministry of Finance component of the project agreed with the need for legal changes over the long term. However, it was their conclusion that significant improvements in revenue generation could be made within the existing legal context and that legal reforms need not be made a precondition of A.I.D. assistance for this short term project. Rather, they recommended that the demonstration activities under this project be used as a means of graphically pointing out to Ministry officials how the elimination of specific legal and procedural constraints could enhance the long term effectiveness of Ministry tax administration. Thus, an important part of the scopes of work for the project advisors will be to identify and present to the Ministry specific recommendations for reforms. These reforms could then be addressed as part of a longer term program. Given the sensitivities to the appearance of outside influence on Ecuadorean tax law, USAID believes that this is the most effective strategy to pursue.

2. Project impact (para. 3). The DAEC expressed concern that the broad scope of this small project would limit its impact. In this regard,

USAID was requested to clarify the extent to which activities are intended to have a high revenue impact in the short term or are intended as pilot activities for future replication. Both components of the project are expected to have short term revenue impacts. However, the magnitude of this impact will be less at the municipal level since activities will only be undertaken in a small sample of municipalities. Activities at both the central and municipal level also are considered of a pilot nature. The revenue activities in the Ministry of Finance will be carried out on a selective basis using ad hoc teams of Ministry employees. It is expected that the demonstrable success of these activities will lead to their expansion and institutionalization within the Ministry, and that collateral legal and procedural reforms will be made to increase their effectiveness. Similarly, the municipal component will seek to demonstrate effective revenue generation activities and also develop the institutional mechanism for promoting their replication in municipalities on a wide scale. (See Sec. III.A. for a discussion of the replicability of the project pilot activities.) It should further be noted that the scope of possible activities outlined in the PID has been narrowed during intensive review. No efforts will be taken to improve customs administration. Moreover, all of the pilot municipal activities will be carried out in a coordinated fashion through BEDE.

3. Choice of organizations (para. 4). The DAEC questioned whether BEDE was the most appropriate agency to carry out municipal development activities. During intensive review, the various national level organizations having an impact on municipal development were analyzed in depth. These analyses conclude that BEDE is appropriate because: (a) BEDE enjoys a high level of credibility among municipalities; (b) other possible implementing agencies have limited resources or multiple institutional objectives that could attenuate their commitment to municipalities; and (c) experience has demonstrated that technical support functions are most effective when organizationally linked to municipal credit. However, it was also recommended that at this time BEDE's role be one of coordinating the activities of other organizations which have competence in particular areas. An important objective of the project is precisely to test this mode of cooperation. (See Sec. III.D.2. for further discussion of the institutional arrangements.)

4. FAA Section 660 (para. 5). The DAEC noted that A.I.D. is prohibited from providing financial or other support for discernible police-like functions. The project funded activities are limited to developing more effective systems for identifying various forms of non-compliance which will lead to increased revenues assuming that the Ministry follows through on collections. The project itself will not provide any direct support to collections enforcement actions and will not introduce any changes to current collections techniques. These techniques consist primarily of a series of written and personal notifications of taxpayers regarding tax liabilities. Delinquency is initially treated with modest fines and interest charges on overdue taxes. Continued failure to pay may result in the confiscation of personal property. Non-compliance is not considered a criminal act in Ecuador, and offenders cannot be imprisoned. All steps of the collections process are carried out by civilian employees of the Ministry in complete independence of the police and other law enforcement agencies. USAID has consulted with the RLA who has agreed that no aspects of the project are inconsistent with Section 660.

II. PROJECT DESCRIPTION

A. Goal and Purpose

The project goal is to strengthen GOE capacity to finance broad based development activities on a sustained basis. Sustained development will be supported through the demonstration and replication of activities which increase the mobilization of internal resources. These resources will allow the public sector to maintain or expand important services and investments while reducing budget deficits which divert capital from the private sector and impose long term debt service burdens on the balance of payments. Broad based development will be supported by strengthening the local revenue capacity of municipal governments. Enhanced revenue capacity will allow municipalities to play a more active role in promoting decentralized development. Increased local revenues will permit municipalities to maintain the quality of basic services and undertake important investments for which external resources are not available.

The project purpose is to develop mechanisms for improved revenue generation and fiscal management at both central and municipal levels of the GOE. The EOPS for the central level (Ministry of Finance) component of the project are:

- o Institutionalization within the Ministry of improved procedures for analyzing non-compliance among selected categories of taxpayers (specifically, in the areas of tax filing, tax reporting, and collections).

- o New collections of approximately s/ 315,000,000 from non-complying taxpayers as a result of pilot revenue programs.

The EOPS for the municipal component are:

- o BEDE technical assistance unit functioning with a program which includes at a minimum two technical workshops per year and technical assistance to 12 secondary municipalities per year.

- o Average increased municipal assessments of:

  - 50 percent for cadastres, or
  - 20 percent for betterment levies, or
  - 50 percent for users' fees

  in approximately 10 secondary municipalities participating in pilot technical assistance activities in one of these revenue areas.

(See Annex B for Logical Framework.)

B. Project Strategy

The project will consist principally of a series of pilot activities carried out over a short period of time (15 months). A.I.D. inputs will consist primarily of technical assistance. A limited amount of short term training and equipment will be financed with the grant where these inputs are critical to the success of the pilot activities. The pilot nature and short time frame of the project are dictated by economic and political circumstances in Ecuador. During the latter part of 1984, a new regime of elected public officials, from the Presidency down to municipal mayors and councils, will enter office. Regardless of the political views of the newcomers, they will face the worsening fiscal situation described above. This project will allow USAID to try out innovative mechanisms for addressing the fiscal problem at the central and municipal levels of government. The results can then be presented to the new administration. At that time, USAID will be prepared to discuss longer term cooperation to expand and replicate the pilot activities and thus achieve a greater fiscal impact.

At the central level of the GOE, the project will test new procedures to improve revenues from the income and sales taxes. These procedures will be introduced on a selective basis, both geographically and in terms of taxpayer categories, in order to maximize the revenue impact. In the process of project implementation, key administrative and legal bottlenecks will also be identified. At the end of the project, USAID expects to enter into a dialogue with the Ministry of Finance regarding a longer term effort to institutionalize and expand the pilot activities and to pursue administrative and legal reforms that would enhance their effectiveness.

At the municipal level, the project will test new modes of providing assistance to secondary municipalities to improve their revenue generation capacity. The primary channel for this assistance will be BEDE which is expanding its role vis-a-vis municipalities to include a technical support function in addition to its credit activities. The project will promote this process by helping BEDE design and manage pilot activities in a small sample of municipalities. BEDE will identify appropriate national level organizations to participate in these activities (e.g., the National Cadastre Directorate - DINAC, FONAPRE, Association of Municipalities) and coordinate their efforts. By project end, USAID expects to have demonstrated various simple, low cost methods for improving municipal revenues. At the same time, institutional mechanisms for supporting and replicating those models on a nationwide basis will also have been tested.

C. Project Activities

1. Ministry of Finance Tax Administration

a. Analysis

The internal tax adminstration performance of the Ministry of Finance has stagnated in recent years. With abundant revenues available from exports and external credit, administrative procedures atrophied and enforcement became lax. Under these circumstances, tax evasion, underreporting of income, and delinquency prospered.

In 1979, only about 40 percent of the economically active population (including businesses) in Ecuador filed income tax returns. Even assuming that a large number of the non-filers had incomes so low that they owed no taxes, it is clear that tax evasion is a major problem. A recent study by the Center of Studies and Data (CEDATOS) indicates that only about 50 percent of businesses are filing income tax returns. Another study by USAID found that only about 28 percent of the estimated 120,000 professionals (doctors, lawyers, etc.) in the country filed in 1979. Compliance in reporting the sales tax may be even worse. The best available data from the Ministry indicate that about 28 percent of establishments registered to pay the sales tax actually file.

Underreporting of income and taxes is also prevalent. Of the 985,000 taxpayers filing in 1979, only 17.3 percent paid any taxes. This low figure suggests significant underreporting, even when the progressive nature and various exemptions of the Ecuadorean income tax are taken into account. A second indication of underreporting is the declining average tax per return filed. Between 1975 and 1979, when the economy was growing at a seven percent annual rate in real terms, the average tax fell from 8,940 sucres to 6,660 sucres at 1975 prices. A final measure of underreporting is the high return to audits. In 1982, 4,106 audit cases were completed with an average proposed additional assessment of 389,000 sucres.

The inventory of delinquent accounts has risen from 3,354 million sucres in 1978 to 6,959 million sucres by the end of 1982. It is estimated that about half of the inventory consists of non-tax bills. Thus, there would appear to be a potential of about 3,500 million sucres in uncollected tax bills. This is equal to about 60 percent of 1982 estimated income tax revenues.

This poor performance can be attributed in large part to administrative weaknesses in the General Directorate of Revenues (D.G.R.), the key Ministry unit responsible for internal tax administration. These weaknesses include: improper organization which dilutes responsibility for carrying out programs and delays processing; the lack of a comprehensive

taxpayer accounts system; limited audit capacity; the lack of follow-up on non-filers; and absence of controls on employers who should be withholding taxes. In addition, the D.G.R. makes little innovative use of the taxpayer data available in the Ministry's data processing system located in the General Directorate of Organization and Systems (D.O.S.) to improve revenue performance. (See Sec. III.D.1. for a more detailed institutional analysis of the Ministry of Finance.)

b. Activities

The core of the Ministry of Finance component of the project will consist of three short term pilot programs to improve income and sales tax revenues. These programs will be focused on functional and geographic areas of greatest revenue potential. The three functional areas to be addressed are returns filing compliance, tax reporting audit, and collections of delinquent accounts. Innovative procedures in these areas will be tested in the largest tax administration jurisdictions where revenue impact can be maximized (e.g., Quito, Guayaquil, Cuenca). An important part of the programs will be to strengthen D.O.S. support to D.G.R. in tax administration functions. Recommendations for organizational and legal changes that would enhance the long term effectiveness of the programs will also be developed in the course of program implementation.

The USAID grant will finance a long term advisor to the Ministry to provide overall guidance and coordination for the project. The tasks of this advisor, who would preferably be a tax administration generalist, would include: (a) organization of Ministry working groups for the various programs; (b) scheduling of program implementation and visit of short term advisors; (c) handling of all logistical matters for short term advisors; (d) preparatory work on the specific programs prior to the arrival of the short term advisors, and follow up of the programs after the short term advisors have departed; and (e) periodic progress reports to Ministry officials and USAID. The three revenue programs will be carried out with the support of specialized short term advisors funded by the grant. Descriptions of the proposed programs are given below. The specific activities under each program will be refined by the project advisors and their Ministry counterparts at the outset of the project.

1) Returns filing compliance. The objective of this program is to test procedures for selecting taxpayers on the Ministry's tax rolls who have stopped filing and potential taxpayers who have never filed. The program will focus on categories of taxpayers from which high revenue returns can be expected (e.g., professionals, self-employed businessmen, corporations and partnerships). Taxpayers who have stopped filing may be identified through computer-generated comparisons of earlier and most recent tax returns data. A similar analysis of employee withholding agents could be carried out on a manual basis. Taxpayers who have never filed may be identified through comparisons of computer-generated lists of actual filers

and specially developed lists of the universe of potential filers. A computer-based system for cross-checking businesses paying the income tax and those paying the sales tax could also indicate businesses which may be reporting one but not the other. A small cadre of field-level employees (auditors and analysts) will be assigned and procedures developed to follow up on these leads. The program activities will be continuously assessed to stimulate productivity and resolve problems as they occur. A short term advisor for four months will be required for this program.

2) Tax reporting audit. The objective of this program is to test systems to identify underreporting of income and sales tax receipts through broader audit coverage. More effective auditing is expected to result in both increased collections and improved compliance in tax reporting. Broader coverage will be achieved through rapid, selective audit techniques which will complement the existing program of comprehensive audits. More effective use of the Ministry's data processing system will again be critical for identifying potential audit targets. For example, cross checks of income and mercantile transaction returns from the same business could indicate underreporting of one of those taxes. The computer could also be used to develop taxpayer profiles which would assist in the identification of returns which appear to be below average. The short term advisor and responsible Ministry officials will develop specialized audit techniques and select and instruct a group of auditors to carry them out. The results of the rapid, selective audits will be analyzed on a continuous basis to improve their efficiency. Five months of specialized advisory services will be required.

3) Delinquent collections. The objective of this program is to develop effective procedures for identifying large outstanding tax bills (Títulos de Crédito). The assistance of the D.O.S. will be required to list and identify the largest delinquent accounts. It will then be necessary to determine which of these bills are in appeals status and which are collectible. Special collections teams and workplans would then be developed and implemented at the field level by the D.G.R. As in the other programs, a reporting system will be established to monitor and stimulate the performance of the collections teams. Four months of technical assistance will be required.

In addition to seeking short term revenue gains through the three pilot programs, the project will support various other activities with the objective of strengthening the organization of the Ministry's tax administration program. These activities will help ensure the long run effectiveness and expansion of the revenue programs.

1) More efficient document processing. New procedures will be designed and implemented to reduce duplication, over-centralization, and delays in the processing of income and sales tax documentation. More efficient flows of documentation will be established between D.G.R. and D.O.S., and between the central and field levels of the D.G.R. Quality control systems may also be introduced to ensure that the more efficient processing does not result in increased errors. Four months of technical assistance will be funded by the grant for this purpose.

2) Organizational study. This study will present recommendations for improved organization of the Ministry's tax administration services. The study will focus on the D.G.R., with attention also given to other units in the Ministry whose functions bear directly on tax administration. The study will include recommendations regarding overall organizational structure and lines of authority, as well as detailed job descriptions. Recommendations regarding the training of personnel will also be developed. This study will derive in part from the specific organizational constraints identified in the implementation of the three revenue programs. The grant will finance four months of consultant services to perform this study.

3) Short term training. Although a small amount of observational and orientational training for high level Ministry officials is being undertaken prior to project initiation, project grant funds will support continued short term U.S. training. The general objective of this training is to strengthen concepts of tax administration and management. The training is expected to facilitate implementation of the project as well as provide the necessary skills to support longer term organizational improvements. The proposed training activities include:

- additional orientation visits to the IRS for high level officials of the D.G.R. and D.O.S. who will oversee project implementation;
- an IRS management training course focused on the specific functional areas addressed under the project, attended by field level chiefs and supervisors responsible for the revenue programs;
- conferences, courses, and publications to provide D.O.S. with updated knowledge of uses of computer techology to support tax administration.

In addition to technical assistance and training, the grant will finance three microcomputers and software for the Ministry of Finance. The microcomputers will be located in the three field offices (Quito, Guayaquil, and Cuenca) in which the pilot programs will take place. This equipment will help provide the types of information needed for the revenue programs to be operated out of the field offices. Although initially much of this information will be provided from the Ministry's central computer facilities, the project will help identify the extent to which the data bases and analyses can be decentralized. The microcomputers will also support the

decentralization of document processing. They will allow the field offices to process incoming returns more quickly and to perform various functions which are now done centrally with significant delays, such as initial data verification and checking for disallowances. The D.G.R. has shown great interest in procuring this type of equipment but has been prevented from doing so by import restrictions and government austerity measures.

2. Municipal Revenue Generation

a. Analysis

The fiscal problems facing municipalities (described in Sec. I.A.) are: a high dependence on central government transfers to cover operating costs; accumulation of infrastructure projects that will place a heavy mortgage on future municipal revenues; dependence on central government investment priorities which limit municipal autonomy in planning local and regional development. In the face of declining central government financial support and continuing local pressures, municipalities must improve their revenue generation capacity to ensure that infrastructure projects are completed and maintained and to enable the municipalities to play a more active role in promoting decentralized development.

Three main revenue authorities are available to municipalities: property taxes, users' fees, and betterment levies. All three sources are, in general, largely underutilized. Rural and urban property cadastral surveys are often 10 years or more out of date; valuations are also outdated. The property tax system is further weakened by inadequate legal identification of land parcels and poor collections systems. As a result, it has been estimated that property taxes, which now account for about two thirds of municipal own-source revenues, are only rendering about half their potential. Users' fees on services such as water, sewerage, garbage collection, and markets tend to be highly subsidized and insufficient to cover operation and maintenance. Tariffs for these services are set by each municipality and seldom revised; collection is irregular and without effective sanctions. Betterment levies are rarely used in Ecuador.

The various factors contributing to this poor local revenue performance are shown in Diagram 1. They may be classified as political, technical, and institutional and are briefly analyzed below:

o Political. The lack of political will to take strong measures to improve local revenues is an often cited constraint. In its case studies of representative municipalities, USAID has found that mayors (who cannot be re-elected) are generally aware of the revenue problem and willing to act. More often that not, however, they confront a municipal council which is of a different political stripe and ready to foil the mayor's ambitions under the guise of the taxpayers' defender. Nevertheless, several municipalities have taken positive steps, including the updating of cadastres and more vigorous collections.

o Technical. The technical capacity of local government to administer effective revenue programs is weak, especially among the smaller municipalities. The latter usually have only one professional in their ranks (an engineer) if any. They lack skills in conducting urban cadastres and property valuations, and in analyzing costs to set users' fees for services. Financial planning is normally limited to line item expenditure budgeting for a given fiscal year and is divorced from any urban/regional planning which may occur.

o Institutional. Ecuador is rich in central level organizations which have an impact on municipal affairs. As further described in Sec. III.D.2., many of these organizations are seen by the municipalities as being overly paternalistic and obstructionist. Others promise worthwhile services but lack the resources to be effective on a wide basis. The very proliferation of organizations appears to be self-defeating. Training courses are offered in an ad hoc, uncoordinated fashion. Technical assistance, training, and financial services are usually housed in different agencies and are not usefully combined to address municipal needs. The newly created technical assistance unit in BEDE offers a promising opportunity to begin to bring about a more rational institutional framework for municipal support.

b. Activities

The municipal component of the project will test various means of improving the technical capacity of municipalities to raise their own revenues. At the same time, the project will support the improved coordination of technical support from central level organizations. These closely related objectives will be achieved by directing project activities through the technical assistance unit of BEDE. The project will assist BEDE to analyze municipal revenue needs, plan pilot interventions, and coordinate the resources of other central level organizations as appropriate to carry out the interventions. Six activities will make up the municipal component of the project: (1) short term training for BEDE; (2) inter-organizational coordination; (3) establishment of a municipal data bank; (4) preparation of manuals; (5) technical workshops; and (6) pilot technical assistance activities to improve municipal revenues. The first part of the project will be focused on strengthening the new BEDE unit and preparing for pilot action activities that will take place during the balance of the project.

The grant will finance a long term advisor to BEDE. This advisor should have extensive experience with municipal development organizations in other Latin American countries. This advisor will provide day-to-day guidance to BEDE in the organization and programming of the new technical assistance unit. The advisor will help BEDE to: (a) design a management information system based on the municipal data bank to be created under the project; (b) analyze the information to identify priority municipal revenue problems; (c) design pilot interventions; (d) locate consultants to assist in the pilot programs; (e) establish a program evaluation system; and (f) identify needs for short term technical assistance and training to support and strengthen the BEDE unit. Other inputs are noted in the activity descriptions which follow.

(1) Short term training for BEDE. The grant will finance short term U.S. training for two or three members of the BEDE unit. This training, to occur at the outset of the project, will provide a general orientation to municipal revenue and development activities and will examine experiences of similar technical assistance units in other Latin American countries.

(2) Inter-organizational coordination. A series of meetings involving representatives from the various central organizations related to municipal affairs will be sponsored by BEDE early in the project. The purpose of these working level meetings will be to define municipal technical support needs and to develop a strategy for coordinated action among the organizations. BEDE counterpart funds will finance the logistical costs of these meetings, including per diem of participants and materials.

(3) Municipal data bank. The project will assist BEDE to gather the considerable information which exists on municipalities and organize a municipal data bank. The data bank will be kept on a microcomputer and will be regularly updated. An important use of the data bank will be to compare the financial performance of various municipalities in order to target BEDE's technical assistance activities on specific problems and specific regions or municipalities. It will also provide guidance to BEDE's municipal lending program. Finally, the data bank will be a valuable tool for evaluating the revenue and financial impact of BEDE's activities.

The grant will finance the purchase of a microcomputer and software. Grant funding is justified because of the importance of this equipment for the establishment of the BEDE unit and because of import restrictioins and budgetary limitations which prohibit BEDE from making this procurement in the foreseeable future. Two person/months of specialized short term technical assistance in setting up and using the data bank will also be provided under the grant.

(4) Preparation of manuals. The project will finance the design of various instructional manuals and technical bulletins to address the revenue, financial planning and budgeting, and related administrative needs of municipalities. Where possible, BEDE will build upon existing manuals produced locally and by municipal development organizations in other Latin American countries. The manuals will be simple and practical, taking into account the needs and limited capacities of smaller municipalities. The manuals will be tested under the project and revised as necessary. Approximately five manuals will be produced under the project. Among the likely subjects are cadastral survey and mapping techniques, property registry systems, land valuation, cadastral maintenance, calculation of betterment levies and users' fees, and financial planning. The technical bulletins will be shorter and will be widely disseminated on a periodic basis. They will provide general information on technical support services available from central organizations and relate the experiences of municipalities which have taken specific actions to improve finances, administrative systems, etc. About six bulletins will be produced during the project.

Grant funds will be used to finance two person/months of specialized technical assistance and to co-finance with BEDE five person/months of local consultant services to develop the manuals. Grant and counterpart funds will be used for publication costs.

(5) Technical workshops. During the course of the project, BEDE will sponsor a workshop for municipal officials. Like the earlier BEDE/FONAPRE meetings, the workshop will be held on a regional basis; that is, it will be repeated in nine or ten regions over a three month period. Appropriate central level organizations would also participate. BEDE intends to hold approximately two workshops per year. Each workshop would cover a specific topic such as financial management and planning, management of basic services, and administration of various local revenue mechanisms. This project will support BEDE in planning and executing the first workshop. The manuals to be developed under the project will serve as instructional aids in the workshops and will be refined based on the results. A key objective of the workshops will be for participants to develop action plans for their own municipalities to apply some aspect of what they learn in the workshop.

The coordinator and general advisor will work with BEDE and other interested organizations in the design and implementation of the initial workshop. Grant and counterpart funds will be used to finance logistical costs of the workshop.

(6) Pilot revenue activities. The project will support pilot technical assistance efforts to improve revenue generation in a small number of municipalities. Initial identification of potential municipalities will be made with the support of the municipal data base to be established under the project. Site visits by BEDE will be required to make the final selections based on the willingness of the municipality to cooperate in a pilot program and the potential for significant revenue impact. Once a municipality is selected, BEDE and the general advisor will meet with municipal officials to plan the pilot activities. Agreement will be reached on the contributions of the parties. BEDE will be responsible for providing directly or through other central agencies the necessary technical resources. It is expected that a municipality would undertake a single pilot activity. Examples of the types of pilot activities are given below:

o Cadastre improvement. The cadastre pilot activity would encompass both urban and rural cadastres. Prerequisites for this pilot include: aerial photographic coverage of the whole jurisdiction at 1:30,000 or larger scale; listings of valid land inscriptions in the property registry; all agrarian reform records involving rural parcels within the jurisdiction; and listings of municipal tax records. The cooperation of DINAC

for the rural cadastral work would be required. Technical assistance for the urban cadastre and for maintenance of both would be coordinated by BEDE through FONAPRE. Technical assistance will be required for various preparatory activities such as: the compilation of valid property deeds; cross referencing of municipal tax records with the deeds; the preparation of the aerial photographs, agrarian reform material, and other data sources for the rural cadastre; and the design of urban cadastre forms. Further assistance will be needed to train field crews to carry out the cadastre. Finally, the municipality will receive assistance in maintaining cadastral, valuation, and property registry records over time. This assistance will be complemented with the manuals to be developed under the project. It is expected that three cadastre pilots will be undertaken, each with a duration of about two months.

Grant funds will be used to finance a technical advisor in cadastres and to co-finance with BEDE a local expert for three months each. The grant will also pay for stereo-compilation and drafting equipment for DINAC. The cadastre consultant contracted by USAID for project design determined that, although DINAC requires a substantial amount of equipment to strengthen its cadastral surveying program, these specific items are the minimum necessary to support the pilot activities under this project. DINAC has sought to acquire this equipment but has not received sufficient budget authority. Therefore, limited grant funding is warranted to ensure the quality of rural cadastres in the pilot activities. Under an interinstitutional agreement with BEDE, DINAC will secure aerial photography and enlargements and will provide field crews to carry out the rural surveying and property valuation. Municipal personnel will participate and be trained in various activities, including urban surveying and property valuation and cadastre maintenance.

o Users' fees. This pilot activity would assist the municipality to analyze its current and projected costs for various public services (water, sewerage, etc.). On this basis, a more realistic rate structure could be devised to meet the municipality's defined objective (e.g., full coverage of operation and maintenance, partial coverage). Manuals would be used as instructional aids in this process. Finally, BEDE would assist the municipaility in preparing an implementation plan for the rate increases, including a public education campaign. The participation of the appropriate service agency (e.g., IEOS or a semi-autonomous municipal enterprise) would also be necessary in the pilot. Approximately three pilots of two weeks each would take place in the area of users' fees. Grant funds will be used to finance one person/month of specialized U.S. technical assistance and to cost-share with BEDE counterpart two person/months of local consultant services.

o Betterment levies. The procedures for this pilot activity would be similar to those for users' fees. The BEDE technical assistance staff and the general advisor would work with the municipality in

analyzing the construction and maintenance costs of improvements and in determining the proper revenue policy objective (full or partial cost recovery). Again, the analyses will make use of the manuals developed under the project, both to reinforce the municipal learning process and to improve the design of the manuals. It may also be instructive for officials of the pilot municipalities to visit a municipality which has sucessfully instituted betterment levies. About four pilot activities would be carried out in this area, each lasting about two weeks. The grant will provide one person/month of services by a specialized U.S. consultant and co-finance with BEDE two person/months of local consultant services.

Additional technical support to the municipal component will be provided by a municipal coordinator to be contracted by USAID with PD&S funds for two years. The overall responsibility of this consultant will be to assist USAID in coordinating municipal related activities and in formulating a medium term strategy for municipal and market town development in Ecuador. This will involve drawing together the findings of recent analyses carried out for USAID and other exisiting research on municipal development. The coordinator will complement this information as necessary with special studies. The coordinator will also pursue contacts which USAID has developed with various municipal support organizations in relation to this project. These tasks will be closely linked to implementation of the municipal component of the project. In particular, the coordinator will help facilitate communication among the municipal support organizations and begin to develop a consensus on the proper mechanisms for coordinating technical support to municipalities. An important objective of these efforts will be to forge linkages to support BEDE in carrying out the pilot activities under the project. The coordinator will also provide advice to BEDE and the foreign advisors as needed and will participate in the final evaluation of the project.

D. Project Inputs

1. Budget

Component/Activity	- - - -Funding ($000)- - - - AID Grant	GOE	Total
I. Ministry of Finance Tax Administration			
A. Technical Advisors			
1. Long term (14 p/m)	140	-	140
2. Short term			
a. Returns compliance (4 p/m)	35	-	35
b. Reporting compliance (5 p/m)	45	-	45
c. Collections (4 p/m)	35	-	35
d. Processing (4 p/m)	35	-	35
e. Reorganization study (4 p/m)	35	-	35

B. Short Term Training			
1. IRS orientation (8 persons)	35	-	35
2. IRS middle-management course (24 persons)	125	-	125
3. Computer systems (1 person)	4	-	4
4. Publications	5	-	5
C. Computer Hardware/Software	36	-	36
D. Ministry Resources			
1. Staff	-	315	315
2. Computer services	-	35	35
Subtotals	530	350	880
Contingencies	40	-	40
TOTAL - MINISTRY OF FINANCE	570	350	920
II. Municipal Revenue Generation			
A. Technical Advisors			
1. General advisor to BEDE (14 p/m)	140	-	140
2. Short term international			
a. Municipal data bank (2 p/m)	24	-	24
b. Manuals preparation (2 p/m)	24	-	24
c. Cadastre pilots (3 p/m)	35	-	35
d. Other pilots (2 p/m)	24	-	24
3. Short term local			
a. Manuals preparation (5 p/m)	4	4	8
b. Pilots (7 p/m)	5	5	10
B. Short Term Training for BEDE (2 pers.)	10	-	10
C. Equipment and Materials			
1. Microcomputer and software	12	-	12
2. Cadastre equipment	80	-	80
3. Aerial photography	-	22	22
4. Publication of manuals and bulletins	5	5	10
D. Logistical Support			
1. Coordination meetings	-	1	1
2. Workshops	7	8	15

E. GOE Personnel Resources			
1. BEDE technical assistance unit (60 p/m)	-	18	18
2. DINAC cadastre field crews (24 p/m)	-	8	8
3. Municipal officials for workshops (15 p/m)	-	4	4
4. Municipal officials for pilot activities (200 p/m)	-	50	50
Subtotals	370	125	495
Contingencies	60	25	85
TOTAL - MUNICIPAL	430	150	580
PROJECT TOTAL	1000	500	1500

2. Description

The total cost of the project is estimated at $ 1,500,000. A.I.D. will provide up to $1,000,000 in grant funds and the GOE will contribute an estimated $500,000. USAID has budgeted a minimum FY 1983 obligation of $675,000 and will seek to obligate the project fully in FY 1983 if funding is available. Otherwise, the balance will be obligated early in FY 1984.

The A.I.D. grant will finance primarily technical advisors as well as limited short term training and a minimum amount of commodities, materials, and logistical support (e.g., per diem for local training participants) necessary to carry out the pilot activities. The counterpart contribution will consist of: (a) salaries for officials (both central and municipal) assigned to the project activities; (b) Ministry of Finance computer support services; and (c) various materials and logistical support to carry out the pilot cadastre and other municipal revenue activities. The GOE will thus be required to assume the bulk of the recurring cost burden of the project activities from the start.

III. PROJECT ANALYSES

A. Technical

1. Ministry of Finance Tax Administration

The project seeks to improve income and sales tax revenues through a number of short term, selective programs focused on key tax

administration functions of the Ministry of Finance. These programs will be supported by technical advisors working closely with Ministry counterparts at the level of field operations. In order to evaluate the technical appropriateness of this strategy, it is necessary to consider previous efforts in this area and alternative strategies.

a. Previous efforts

A.I.D. has funded various activities over the past 20 years bearing on central government finances in Ecuador. A loan funded Administrative and Fiscal Reform program in the early 1960s was designed to increase income and customs tax revenues and to improve the GOE's budgetary and fiscal control systems. The program had mixed results. Political sensitivities more than technical deficiencies contributed to the negative aspects of this effort. The fact that the Ecuador program was loan funded while similar programs being supported by A.I.D. in other Latin American countries at the time were all grant funded caused a certain amount of antagonism in the GOE. This was aggravated by the fact that the GOE was required to administer the contracts and salary payments of high-paid foreign technicians using those loan funds. Furthermore, the USG's access to internal GOE financial information also proved disruptive. Later, at the request of the GOE, A.I.D. funded two studies by the U.S. Internal Revenue Service. The first, in 1977, was a cost reimbursable diagnosis of the then-General Directorate of Collections of the Ministry of Finance. The second, a 1981 study funded under the Trade and Development Program, analyzed the broad range of Ministry tax administration functions carried out principally by D.G.R. with support from D.O.S. Both studies uncovered numerous administrative as well as legal problems and included recommendations for technical assistance. The Ministry's follow-up to the studies was minimal. This may be explained in part by the abundance of export revenues and ready availability of deficit financing at the time which reduced incentives for improved internal revenue generation. More important, perhaps, was the frequent turnover in Ministry leadership during that period.

b. Alternative approaches

Various alternative strategies to improve central government revenues should be considered:

o Legal reform. Both the 1977 and 1981 IRS studies pointed out the need for reform of the tax law. Certain aspects of the law were perceived by the IRS to be overly protective of the taxpayer, thus encouraging non-compliance while hindering efficient tax administration. However, A.I.D.'s limited resources and GOE sensitivities to the appearance of outside interference in matters of tax policy prevent a direct approach to tax reform. Moreoever, it would be unadvisable to enter directly into a policy dialogue at this time, since the current administration will be replaced in 1984. USAID's preferred approach is to identify key legal and administrative constraints in the context of revenue programs which respond to the GOE's immediate concerns. In this way, USAID hopes to develop the credibility and experience that will allow a productive dialogue with the new administration on tax policy.

o Reorganization. The IRS studies also noted the need for extensive reorganization in the Ministry to improve the efficiency and effectiveness of tax administration functions. Reorganization is a long term proposition which would require the full support of the new administration. However, under the present short term project, organizational constraints will be analyzed, again drawing on the concrete experiences of the pilot revenue programs. USAID will then be prepared to discuss this problem and possible follow-on assistance with the new administration.

o Participant training. The IRS studies have found Ministry personnel on the whole to be well trained and capable. What they require, rather than long term participant training, is orientation to modern concepts of tax administration and specialized training related to specific organizational needs. For this reason, the project proposes a number of short term training activities for key Ministry administrators and mid-level managers who will be directly involved in the revenue programs.

o Equipment. Data processing support from D.O.S. has been identified as a critical element in strengthening the Ministry's internal tax administration. A systems analyst from the IRS recently assessed the computer capacity of D.O.S. in relation to the proposed revenue programs to be implemented under this project. He concluded that increased capacity is highly desirable to ensure the efficient execution of those programs and is essential over the long run. He also found that the existing capacity could be roughly tripled at no marginal cost. In light of these facts, USAID financing of major computer hardware is not appropriate. However, on the basis of the IRS report, USAID has begun discussing with the Ministry the need for expanding its computer capacity. A covenant will be included in the project agreement to ensure that the necessary capacity is provided to the project activities. In addition, USAID is prepared to finance the acquisition of microcomputers as part of the pilot efforts to decentralize processing of tax documentation and data bases.

c. Replicability

The pilot revenue programs will be carried out in the three largest tax jurisdictions. Together, these jurisdictions account for over 90 percent of all internal tax revenues. Therefore, geographical spread of the pilot activities is not an issue. Rather, the question of replicability should focus on the capacity of the Ministry of Finance to maintain the programs and to follow up on the leads that are developed to reach an increasing portion of the non-complying population. In this respect, it is important to note that the types of procedures to be tested under the project will not add to the Ministry's existing workload. Instead, they are intended to create efficiencies and thereby justify the shift of personnel from current, relatively unproductive tasks. For example, the Ministry's audit staff now appears to be suboptimally utilized. The staff is adequate in size but is fully dedicated to so-called comprehensive audits. By shifting a portion of the staff to more selective, rapid "desk" audits, it is expected that the per auditor output can be significantly increased. Demonstration of the revenue impacts of the pilot activities should motivate the Ministry to assign more personnel and resources to those types of activities.

Two other project activities will also strengthen the capacity of the Ministry for replication. First, the formal and on-the-job training activities will provide a skilled, experienced human resource base to maintain and expand the programs. Second, the reorganization study will point out ways in which the Ministry can eliminate duplication and inefficiencies, and thus free up personnel to engage in priority revenue generating programs.

d. Conclusion

USAID has concluded that the project strategy for central government revenue generation is an appropriate technical response. The strategy takes into account the lessons learned from earlier activities in this area. The risk of offending political sensitivities should be minimized because: (a) more so than in the past, there now exists tremendous urgency in the GOE to improve fiscal revenues, and high Ministry officials have shown openness to USAID involvement; (b) advisors will be assigned on a short term basis to the specific revenue programs and will work primarily in the field offices, thereby avoiding the appearance of involvement in the Ministry's internal affairs; and (c) the advisors will be grant funded and their contracts directly executed and administered by USAID. The disruptive effects of high Ministry turnover should also be minimized under this short term project.

Also, the selected strategy is preferred among various project alternatives. The central concern of this component of the project is to help the GOE address its immediate fiscal needs. The IRS study team concluded that significant progress in this area could be made through a short term technical assistance program focused on key tax administration functions, coupled with selective short term training. While broader legal and organizational changes may enhance the long term benefits from this type of program, implementation of reforms is a prolonged process. As described above, the present project will begin to lay the groundwork for such follow-on efforts. Finally, the project makes adequate provision for replication of the revenue programs.

2. Municipal Revenue Generation

a. Previous efforts

A project of this type is virtually without precedent in Ecuador. Various central level organizations have provided training courses and technical assistance to municipalities in subject areas directly related to the organizations' interests (see Sec. III.D.2). However, these activities have not been sustained and their impact is difficult to judge.

On the other hand, several other Latin American countries have undertaken with A.I.D. assistance programs to strengthen municipal

revenue and development administration. Some of these efforts (e.g., INFOM in Guatemala, BANMA in Honduras) have achieved significant increases in municipal own-source revenues through mechanisms similar to those to be tested under the present project, including short courses, direct technical assistance, and preparation of manuals. A common feature that appears to have contributed to the success of these programs was the location of the technical support function in a single, central organization which was also the main public sector lender for municipal development. This project will promote a similar linkage in BEDE, although BEDE's function would be primarily to coordinate with other organizations rather than directly provide technical assistance to municipalities.

b. Alternative approaches

One alternative approach to the proposed strategy would be to support the establishment of a municipal development bank which centralizes technical support functions and links them to a lending program. As noted, this has been a successful model elsewhere. However, this concept is premature for Ecuador. As described in Sec. III.D.2., municipal support activities are dispersed among many organizations which are not eager to yield those responsibilities. A second approach to strengthening municipal revenues would be to focus on developing the economic base of municipalities to stimulate the growth that will feed the coffers. This involves the larger issue of decentralized growth which USAID intends to pursue over the coming years. Meanwhile, within the current constraints, there is merit in helping municipalities to tap a larger share of the existing revenue potential. This will help municipalities decrease their dependence on central government transfers and begin to play a more autonomous role in their own development.

c. Replicability

Several features of this project are intended to increase the probability that the pilot activities will be broadly replicated after project termination. First, the project will focus on revenue problems which are nearly ubiquitous among Ecuadorean municipalities. As central transfers decline and local demands continue to rise, there will be widespread concern among municipalities to rectify these problems and increase own-source revenues. Second, the project experience will be available for wide dissemination through manuals developed for various aspects of revenue generation and financial management. Third, the project will help BEDE to create a technical assistance unit that will serve as a central resource for municipalities seeking further assistance. Finally, the project requires BEDE co-financing for the recurrent costs that will be entailed in future expansion of the technical assistance program. These costs include the development and publication of manuals, consultants to design and execute workshops, workshop materials, and consultants to assist municipalities in carrying out pilot revenue programs. BEDE will also mobilize the support of other central organizations for the pilots. USAID will encourage BEDE to work toward putting its technical support programs on a self-financing basis.

d. Conclusion

The types of technical support activities contemplated under the project have had proven revenue impact in other Latin American countries. Since there has been little experience with these activities in Ecuador, a pilot approach is warranted. The proposed delivery mechanism for these activities takes into account the existing dispersion of technical suuport activities which prohibits a full-scale centralization at this time. However, the project represents a positive move toward greater coordination. Finally, there is a high likelihood that the pilot activities will be replicated beyond project termination. For these reasons, the design of the municipal component is considered to be technically adequate.

B. Financial and Economic Feasibility

Revenue generation projects like the present one do not lend themselves well to economic analysis. The transfer of resources (generally from the private to the public sector) causes a change in investment and consumption patterns which in turn may affect the economic return to those resources. However, it is not possible within the scope of this project design to determine with precision the sources or uses of the transferred resources.

Despite methodological problems, there are reasons to believe that the economic impact of the project activities would be positive. At the central government level, the current fiscal crisis will force major reductions in national investment levels over the next few years and real reductions in the operating budgets of key social and economic ministries. The government has already invoked various austerity measures, including a hiring freeze, to control public sector overhead expenses. In this context, it is reasonable to assume that any additional revenues generated by the central government will go primarily toward priority investments and maintaining basic services and programs of social value. At the municipal level, it has been noted that municipalities have been making large investments in basic infrastructure in recent years. With central government transfers projected to decline, municipalities will need to use locally generated revenues to maintain these investments.

The analytical problem then reduces to demonstrating the financial feasibility of the preferred project alternatives. The activities undertaken in the Ministry of Finance are expected to have a significant impact relative to the central government budget within the life of the project. For this reason, a simple comparison of project costs and benefits (incremental revenues) has been carried out for the three revenue programs during the first year of their implementation only. The summary results are presented below. (See Annex H for the full assumptions and calculations.)

Additional Revenues ($)[1]	
- Returns filing compliance	775,000
- Reporting compliance	437,500
- Delinquent collections	2,725,000
Total Revenues (Benefits)	3,937,500
Project Costs	920,000
Benefit/Cost Ratio	4.3

This benefit/cost ratio appears reasonable in light of the fact that the average Ministry auditor now generates unappealed assessments equal to 11 times his annual salary. The ratio is also based on the assumptions that only 50 percent of the assessments developed under the returns filing and tax reporting compliance programs are collected during the short life of the project, and that only 25 percent of collectible delinquent accounts are actually collected through the pilot program. These collections rates are commensurate with past performance but may be conservative given the Ministry's more active collections program in recent months. Continuation and expansion of the pilot revenue programs at low marginal cost can be expected to improve the benefit/cost ratio over a longer period.

The pilot activities at the municipal level will have a less pronounced revenue impact during the life of the project. However, once instituted in a given municipality, the various revenue programs can be expected to generate continuing benefits in years ahead. For this reason, a financial analysis of the revenue component was performed for a period of five years from project initiation, with both additional revenues and recurrent costs discounted. The summary data are given below with details provided in Annex H.

Additional Revenues ($)	
- Property tax	532,703
- Betterment levies	40,579
- Users' fees	98,737
Total Revenues (Benefits)	672,019
Total Costs[2]	601,909
Benefit/Cost Ratio	1.1

1/ Local currency (sucre) returns converted to dollars at May 1983 free market rate of 80 sucres = $ 1.00.

2/ Costs for the municipal component include recurrent costs of the pilot activities over the five year period of the analysis as well as the initial project costs of the municipal component itself.

Again, these results are conservative in that they do not take into account the opportunities for replication of the municipal revenue programs on a wide scale at low cost once the support systems are established under the project.

C. Social Soundness Analysis

1. Ministry of Finance Tax Administration

a. Incidence of revenue programs

One of the stated purposes of the Ecuadorean tax law is to achieve a more equitable distribution of national income. The income tax schedule is decidedly progressive, with marginal rates ranging up to 40 percent and a basic exemption which rises with the number of dependents. The other major tax addressed under this component of the project is the sales tax (actually, a value added tax in that it applies at all levels of elaboration of the final product). The current tax rate is five percent (but may soon be increased to six percent). However, basic foodstuffs (milk, bread, meat, eggs, wheat) as well as medicines and various agricultural inputs are exempt from the sales tax. Thus, the impact on the low income consumer and producer is reduced. Furthermore, the programs will be focused on specific areas of non-compliance which, as previously noted, appears to be relatively more common among professionals and private businesses. Wages and salaries in these categories are higher than in the public sector or agriculture. This would indicate that that the incidence of the targeted revenue programs may be somewhat more progressive than if the programs were intended to improve collections across the board.

b. Attitudes toward tax compliance

A common issue in tax administration programs is whether administrative measures can have a significant impact in cultures where attitudes toward tax compliance are notably weak. While recognizing that this cultural constraint exists in Ecuador, there are reasons to believe that improved administration can be effective. First, among Latin American countries of a similar level of development and with similar cultural values, Ecuador's tax effort (as a proportion of GDP) is relatively weak. This indicates that even within the cultural context, there is room for marked improvement. Second, unlike most other Latin American countries, Ecuador has recently enjoyed a fiscal boom resulting from the soaring prices of its oil exports. In this situation, it is to be expected that internal tax enforcement would deteriorate. Indeed, between 1975 and 1980, non-petroleum tax revenues rose more slowly than GDP. Third, recent efforts by the Ministry of Finance to improve collections have had modest success. Finally, in the face of its weakening fiscal position, the Ministry has recently mounted a highly professional media campaign to alter public opinion and improve compliance. It should also be recognized that the revenue programs themselves should have a positive effect on taxpayer attitudes. Knowledge that the Ministry is bearing down on non-filers, underreporting, and delinquencies is likely to bring about greater compliance.

2. Municipal Revenue Generation Activities

a. Nature and incidence of benefits

The magnitude and initial incidence of the increased revenue collections from the municipal pilot programs cannot be gauged with precision at this time. Within any given municipality, the distributive effects of the revenue measures will presumably be progressive. On the sources side, property taxes are progressive by nature, while users' fees and betterment levies are directly tied to benefits received. With regard to uses, it is likely that the additional revenues will substitute for decreasing central government transfers to operate and maintain the large infrastructure investments that most municipalities have recently undertaken. On a broader level, the project activities will be focused on medium and small municipalities. Administrative capacity and service levels tend to much lower there than in the larger municipalities. Thus, the project will promote a more even distribution of municipal development capacity.

b. Impact on municipal autonomy and decentralization.

The present project addresses two important aspects of decentralization: increased local government capacity and more responsive central government institutions. Increased own-source revenues, which can be expected from the workshops and pilot programs supported by this project, will better enable municipalities to cope with the anticipated decline in central government transfers. Increased own-source revenues will also give municipalities greater control over expenditures and financial planning to the extent that transfers and loans are to varying degrees tied to specific uses. The issue of more responsive central institutions will be addressed by channeling the project's technical assistance through BEDE. BEDE is a young and still flexible organization which promises to play an leading role in municipal development in Ecuador. Through this project, USAID hopes to influence the way in which BEDE perceives and responds to municipal needs so as to promote municipal autonomy and decentralization of development processes.

D. Institutional Feasibility

1. Ministry of Finance

a. Commitment

To ensure that sufficient revenues were available to finance the country's development, the 1980-84 National Development Plan called for the reduction of tax evasion. The recent revision of the Plan, taking into account the country's new economic realities, is more specific in this regard. It calls for actions through 1984 to: (a) set up systems for

identifying non-filers; (b) strengthen tax auditing; (c) focus investigations on upper income taxpayer categories which have high non-compliance rates; and (d) expedite collections of delinquent accounts. These objectives were recently reiterated in the GOE's letter of intent to the IMF. The Ministry has taken steps to address the fiscal problem. In addition to the public media campaign, a survey type program to detect non-filers has been introduced. The Ministry is also developing a new taxpayer control system that would make access to public services contingent upon evidence that taxes have been fully paid. However, the IRS team judged these measures to be only marginally effective. What the Ministry needs is assistance to devise more cost-effective systems. USAID believes that, under the present economic and fiscal conditions, GOE commitment to improved tax administration is high and that the needed assistance is justified.

b. Organizational constraints

The recent IRS team pointed out a number of serious organizational weaknesses within the D.G.R. and in its relations with other Ministry units. These weaknesses include:

- Poorly defined and improperly aligned tax administration functions, including the absence of clear responsibility for compliance enforcement activities;
- Confusion of managerial and operational tasks within the same offices and positions;
- A poorly defined and only partially implemented decentralization of operations;
- Vague lines of authority at the central and field levels and between those levels. Compounding these formal organizational problems is a deeply embedded network of personal working styles and relations which have developed over the years and which make changes in organizational behavior more difficult.

On the other hand, the D.G.R. and D.O.S. staff is reasonably capable. With the exception of the highest level officials in D.G.R. who tend to be political appointees, there is a low rate of turnover and considerable experience and dedication. These units do not suffer from understaffing but do operate inefficiently. Ministry officials are conscious of their organizational problems but unable to devise or implement solutions. They are in need of training in modern management techniques and specific tax administration operations that take advantage of automated information systems. Personnel at the central level also tend to be overburdened, a problem that could be solved by a more complete decentralization of operations.

c. Legal constraints

The capacity of the Ministry to address the country's fiscal problems is also limited by various legal rules and procedures. These were promulgated with the intent of protecting the taxpayer from overly zealous tax officials, but they have had the effect of weakening tax administration and encouraging evasion. According to the 1981 IRS study, the taxpayer has an opportunity to disrupt and delay the assessment and collection process at 20 different stages; there are no effective sanctions that can be imposed for willfully delaying the payment of taxes. Some of the more notable legal constraints are listed below:

- An insignificant error in a tax bill (e.g., a misspelled name) is sufficient to nullify the bill and delay the collections process.

- Approvals for installment payments of taxes are permitted for - and in practice given almost automatically to - all classes of taxpayers, regardless of immediate capacity to pay.

- Legally valid notification of a taxpayer debt requires several attempts at personal contact and witnesses.

- The interest charged to unpaid taxes is fixed below the commercial rate.

d. Conclusion

There exist serious organizational and legal constraints to effective tax administration in the Ministry of Finance. The needed reforms can only be achieved over the long run. Moreover, Ministry officials are preoccupied with the short term fiscal problem and specifically requested USAID assistance in that regard. The IRS team concluded that significant revenue gains could be made within the existing structures and that a revenue-oriented project would provide an opportunity to highlight the constraints to further revenue increases. The present project, therefore, is conceived as an effort to address the immediate fiscal concerns while at the same time getting the Ministry to begin to focus on the longer range institutional problems. An important task of the advisors to the revenue programs will be to point out specific legal and organizational impediments encountered in carrying out the programs. The reorganization study will build upon these findings and past IRS studies to provide a systematic basis for organizational reform. USAID is satisfied that this strategy deals adequately with the institutional constraints.

2. Municipal Support Organizations

a. Organizational profiles

There are several central level organizations related to municipal development and administration in Ecuador. Some are involved in budget and financial review and control (CONADE, Ministry of Finance, Controller General), while others support investments (BEDE, FONAPRE, technical agencies such as IEOS). In practice, responsibilities and functions are often unclear and overlapping. On the other hand, none of the organizations has developed a significant capacity to support municipal development in areas such as planning, revenue generation, and management of services. Brief profiles of the major organizations which affect municipalities follow:

o Ecuadorean Development Bank (BEDE). BEDE was created in 1979 to "finance programs, projects, works, and services in the public sector". BEDE lends to public sector entities at all levels. Loans to municipalities account for about one sixth of its total portfolio. Nevertheless, from the municipal standpoint, BEDE is the major source of investment capital. BEDE's investment criteria are tightly linked to the priorities of the National Development Plan which include water and sewerage, electrification, roads, and markets. In the past, BEDE has depended heavily on the assignment of oil revenues for capitalization. However, to protect itself against reductions in those transfers, BEDE has begun to seek other sources, including the IBRD and IDB. Also, BEDE officials have acknowledged the need to increase the interest rates on its loans - now slightly subsidized - to ensure adequate reflows to support a growing investment program. Overall, BEDE enjoys a good image among municipalities. Municipalities do rankle at the perceived restrictiveness of BEDE's investment criteria and at the complexity and delays of its project approval process. The recent series of municipal meetings co-sponsored by BEDE and FONAPRE were designed in part to address these issues.

At this stage, BEDE is basically a project bank and has adequate staff to carry out this limited mandate. However, BEDE wishes to expand its support to include technical assistance and training. Toward this end, a small technical assistance unit has been recently created. In part, this unit is intended to assist municipalities in preparing applications for BEDE loans. In addition, BEDE recognizes that the viability of its portfolio depends on the long term financial viability of its municipal clientele. Therefore, the terms of reference for the technical assistance unit have been broadened to include support for municipal finance and development administration.

o National Preinvestment Fund (FONAPRE). FONAPRE provides loan assistance to municipalities for the preparation of urban plans, cadastral surveys, and project feasibility studies. The latter commonly form

the basis for applications for BEDE loans. FONAPRE has a well qualified staff which provides assistance to municipalities in areas related to its loan activities, such as accounting, contracting, and preparation of loan applications. Like BEDE, FONAPRE is well received among municipalities, though again there are frequent complaints about the complexity of the loan application requirements.

o National Planning Council (CONADE). CONADE is the overall planning body for Ecuadorean development. Its greatest impact on municipalities is at the budgeting level. CONADE must review and approve all municipal budgets to ensure that they are adequately supported by revenues, technically sound, and in accordance with public expenditure laws. With a staff of only eight assigned to review all municipal and provincial budgets, delays are common. CONADE also reviews FONAPRE, BEDE, and other loans to municipalities prior to their approval. CONADE has provided some technical assistance to municipalities in the areas of planning, housing, and urban development. This assistance is sporadic and generally provided centrally out of Quito. CONADE would like to expand its assistance but currently lacks the staff to do it. Of all central level organizations, CONADE is probably the most commonly perceived by municipalities as interfering in their affairs and limiting their autonomy.

o National Cadastre Directorate (DINAC). DINAC is the unit of the Ministry of Finance with responsibility for rural cadastre surveys and land valuation. DINAC issues the rural property tax bills which are collected by the municipalities. DINAC is in the process of updating and completing the national rural cadastre. However, the organization has no recent experience in rural cadastre surveying and lacks the basic equipment. The technical staff is adequate in size and capacity, but requires some technical assistance in carrying out cadastral surveys.

o Ministry of Finance. The Ministry controls transfers to municipalities. There are several sources of these funds, the most important being the National Participations Fund (FONAPAR). A part of these transfers can be used only for priority investments. Theoretically, CONADE provides the Ministry with guidance on these priorities. In fact, CONADE does not follow through on this responsibility, and the Ministry assigns its own priorities in approving the disbursment of the transfer funds. Just recently, the Ministry has begun to impart courses on budgeting to municipalities.

o Controller General. The Controller performs administrative and financial audits of all public organisms. Municipal audits are specifically required under the Municipal Law. Under the present leadership, the Controller has deposed numerous officials from municipalities - both large and small - for improper conduct. This has been done, however, with an image of fairness and objectivity which has earned the respect of municipal leaders. The office has also established a prestigious training center with 12 permanent instructors to provide courses in law, accounting, audit, and project control for public officials.

o Association of Municipalities. The Association was created in 1979. Under the Municipal Law, all municipalities are members and contribute financially to support the Association. The Municipal Law also vests the Association with the responsibilities of representing municipal concerns before the central government and providing training and technical assistance to municipalities. In practice, the Association devotes most of its scarce resources to the former task. Of the Association's eight permanent staff members, only two are assigned to technical support. The Association perceives the need for support in the areas of contracting, budgeting, personnel administration, property valuation, revenue generation, and planning. To expand its resources, the Association recently signed an agreement with the International Association of Local Governments (IULA). Under this agreement, the Association will act as the Ecuadorean agent for a program of training and international exchange that IULA is planning for local administrators throughout Latin America. However, this arrangement will also impose additional responsibilities on the Association staff; they estimate that they will have spend 30-40 percent of their time on the international program. The leadership of the Association is traditionally shared by the mayors of Quito and Guayaquil, and smaller muncipalities argue that the Association is oriented toward the interests of those cities and the provincial capitals. The Association, of course, disputes that view but currently lacks the resources to prove otherwise.

b. Choice of implementing organization

There is a clear need to rationalize these dispersed efforts to reduce wasteful duplication and ensure that technical support is directed to priority municipal needs. The centralization of all support activities in a single organization - a mechanism deployed with success in other Latin American countries - is not feasible at this time given the substantial commitments that many organizations have made. A viable alternative is coordination through a single organization. For this purpose, BEDE is the most appropriate organization for three important reasons. First, as indicated, BEDE has a high degree of credibility among municipalities. Second, experience elsewhere has demonstrated the advantage of locating technical support and municipal credit in the same organization. The leverage gained by the central organization can often provide the external incentive and justification needed by municipal officials to undertake necessary, but politically unpopular, administrative reforms. Also, this model causes less confusion for municipalities and reduces bureaucratic paperwork. Finally, BEDE has demonstrated its strong interest in expanding its support to municipalities. The creation of the technical assistance unit is an important organizational commitment to that end. However, the unit is small and inexperienced. This further argues for a coordinating function at the outset. The present project will assist the unit in developing its capacity to carry out that function.

E. Environmental Soundness

A negative determination was recommended in the PID. The threshold decision, which concurs with the USAID recommendation, is presented in Annex F.

IV. PROJECT IMPLEMENTATION

A. Implementation Schedule

The key implementation events for each of the project components are listed below.

Ministry of Finance Tax Administration

Project Agreement signed	August 1983
First IRS orientation group	August 1983
Long term advisor on board	September 1983
Second IRS orientation group	September 1983
First IRS middle-management course	September 1983
Audit advisor arrives	September 1983
Filing compliance advisor arrives	October 1983
Collections advisor arrives	January 1984
Follow-up visits by audit and filing compliance advisors	Jan.-April 1984
Processing advisor arrives	March 1984
Second IRS middle-management course	May 1984
Follow-up visits by collections and processing advisors	May-August 1984
Reorganization study consultant arrives	July 1984
Final evaluation	October 1984
PACD	October 31, 1984

Municipal Revenue Generation

Project Agreement signed	August 1983
Inter-organizational coordination meetings	Aug.-Sept. 1983
Long term BEDE advisor on board	September 1983
Short term U.S. training for BEDE	September 1983
Preparation of manuals (with short term advisors)	Oct.-Dec. 1983
Installation of microcomputer and arrival of short term advisor for data bank	November 1983
Technical workshops	Jan.-April 1984
Cadastre pilots (with short term advisors)	Feb.-May 1984
Other pilots (with short term advisors)	May-Sept. 1984
Evaluation	October 1984
PACD	October 31, 1984

B. Contracting and Procurement Responsibility

Given the short term nature of the project, USAID, in consultation with the implementing agencies, will directly contract the long term advisors and other short term U.S. technical assistance. USAID will make direct payments against these technical assistance contracts as well as for U.S. short term training. USAID will also directly procure all imported commodities. These include stereo-compilation equipment for DINAC and microcomputers for BEDE and the Ministry of Finance (see Annex G for detailed procurement list). Initial steps in procuring these commodities will begin prior to formal project initiation. USAID will consult with SER/IRM to refine the specifications for the microcomputers and to obtain authorization for their purchase. USAID will also seek expert advice in developing specifications for the cadastre equipment. Shortly after project initiation, requests for offers will be prepared and publicized in the U.S. Payment will be made through Direct Letters of Commitment.

BEDE will contract local short term consultants and purchase local materials. USAID will reimburse BEDE for these expenditures upon presentation of proper documentation.

C. Monitoring and Evaluation Arrangements

Detailed implementation plans will be drawn up for each project component once the long term advisor is on board. The USAID General Development Office will monitor the project with support from the Office of Development Resources. Monitoring techniques will include: (a) day-to-day liaison with the project advisors; (b) periodic progress reports submitted by the long term advisors; (c) periodic joint review meetings with the implementing agencies; (d) periodic internal USAID project committee meetings; (e) utilization of USAID's computer-based project financial and implementation tracking systems.

Formal evaluation will begin shortly before project termination. It will be carried out by the long term advisors to the Ministry of Finance and BEDE and by the PD&S funded municipal coordinator. The evaluation will assess: (a) the success with which new revenue generation procedures and methods were developed and implemented; (b) the revenue impact of the pilot activities; and (c) the organizational commitment which has developed for maintaining and expanding these activities. Baseline data for estimating the revenue impact of the project activities will be collected at the outset of the project. The evaluation results will be a critical input to decisions by USAID management on whether and how to proceed with a longer term follow-on effort in the area of revenue generation.

D. Conditions, Covenants, and Negotiating Status

Two separate project agreements will be signed, one with the Ministry of Finance and the other with BEDE. The agreement with the Ministry of Finance will contain two covenants. The first will be to assign working

groups of specific individuals, both at the central and field units of the Ministry, to carry out the revenue programs. The second covenant will express the Ministry's intent to review its central computer hardware facilities and take the necessary action to enlarge that capacity in the degree needed to support the pilot revenue programs. The project agreement with BEDE will include a C.P. to disbursements for the pilot cadastre programs requiring that BEDE enter into formal agreement with cooperating organizations for the execution of the various pilot activities.

Draft project descriptions have been provided to the Ministry of Finance and to BEDE. The drafts reflect numerous working level meetings between USAID and these agencies as well as the conclusions of the project design studies which have also been shared with host country. Therefore, USAID anticipates no serious substantive impediments to negotiation of the agreements and the obligation of funds.

E. Waivers

The success of this short pilot project is heavily dependent on the ability of the technical advisors to transmit practical skills to their Ecuadorean counterparts in a rapid and effective manner. For the Ministry of Finance component, this type of expertise is readily available from the U.S. At the municipal level, there is a need for advisors with extensive experience in municipal finance and development institutions. Several Latin American countries have established effective institutions of this nature, often with assistance from A.I.D., whereas U.S. experience in this area is minimal. To be able to draw upon the expertise developed in Latin America, the Project Committee recommends that a nationality waiver be approved to allow procurement of technical services from A.I.D. Geographic Code 941 countries. The total amount of this waiver may not exceed $200,000. The waiver will be approved by the USAID Director as part of the Project Authorization.

BIBLIOGRAPHY

I. General

"Ecuador: A Macroeconomic Assessment of Trends in 1982 and Projections for 1983-87", report prepared for USAID by Clarence Zuvekas, Jr., LAC/DP International Economist, and Carlos Luzuriaga, USAID Program Economist, November 19, 1982.

Weekly Analysis, edited by Walter R. Spurrier, May 5, 1983 edition containing a detailed description and analysis of the 1981-83 central government budgets.

II. Central Government Tax Administration

"Diagnostic Study and Recommendations for Technical Asistance: Ministry of Finance and Public Credit, Government of Ecuador", report prepared by the Tax Administration Advisory Services Division of the IRS under the Trade And Development Program, February 1981.

"Diagnostic Study and Scope of Work for Technical Assistance: Dirección General de Recaudaciones, Ministry of Finance, Government of Ecuador", report prepared by the Tax Administration Advisory Services Division of the IRS under the Reimbursable Aid Program, March 9, 1977.

"Paper on Income Tax Evasion", staff report prepared by Carlos Luzuriaga, USAID Program Economist, October 8, 1982.

"Revenue Generation Project: Framework for Support and Development in the Ministry of Finance", report prepared for USAID by William W. Newnam, independent tax consultant, with technical annex by James Watson, U.S. Internal Revenue Service systems analyst, March 31, 1983.

III. Municipal Revenue Generation

"Consideraciones Sobre la Situación Política-Institucional de los Municipios del Ecuador", report prepared for USAID by Mauricio Silva, May 7, 1983.

"Considerations Concerning Some Current Issues Related to BEDE and Municipal Finances", report prepared for USAID by David Greytak, Syracuse University, April 7, 1983.

"Ecuador: Strengthening Secondary-City Municipalities: An Issue Analysis", report prepared for the IBRD by Mauricio Silva and Eleanor Hewitt, May 10, 1982.

"Ecuador: Analysis of Municipal Financial Status and Recommendations for Improvement", report prepared for USAID by James F. Hicks, Jr., Richard K. Harper, and Ronald W. Johnson of the Reasearch Triangle Institute, April 29, 1983.

"Observations and Considerations of the Structure and Operation of the Ecuadorean Development Bank and Some Observations on Municipal Finances", report prepared for USAID by David Greytak, Syracuse University, February 25, 1983.

"Preliminary Comments on the Situation and Prospects for Municipal Development in Ecuador", report prepared for USAID by Pirie M. Gall, April, 1983.

AID 1000-20 (4-79)
Supplement A

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

(INSTRUCTION: THIS IS AN OPTIONAL FORM WHICH CAN BE USED AS AN AID TO ORGANIZING DATA FOR THE PAR REPORT. IT NEED NOT BE RETAINED OR SUBMITTED.)

Project Title & Number: REVENUE GENERATION, 518-0036

Life of Project:
From FY 83 to FY 85
Total U.S. Funding: $1,000,000
Date Prepared: 6.13.83

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Program or Sector Goal: The broader objective to which this project contributes: (A-1)	Measures of Goal Achievement: (A-2)	(A-3)	Assumptions for achieving goal targets: (A-4)
Goal To strengthen GOE capacity to finance broad based development activities on a sustained basis.	1. Income and sales tax revenues increase from 30% of central government current revenues in 1982 to 35% by 1988. 2. Municipal own source revenues as a proportion of total municipal revenues (current and capital) increase from 20% in 1981 to 30% by 1988.	1. Ministry of Finance statistics. 2. Controller General Statistics.	-Ecuador's exportable oil surplus peaks in 1984 and declines through the rest of the 1980s. - World oil prices do not rise significantly in real terms through the 1980s. - Ecuador's access to external credit for public sector debt financing is limited through the 1980s. - GOE commitment to increasing internal revenues remains strong.

AID 1020-20 (5-70)
SUPPL. BUDGET 1

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project:
From FY 83 to FY 85
Total U.S. Funding $1,000,000 (G)
Date Prepared: 6.13.83

Project Title & Number: REVENUE GENERATION, 518-0036

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Purpose: (B-1)	Conditions that will indicate purpose has been achieved: End-of-Project status. (B-2)	(B-3)	Assumptions for achieving purpose: (B-4)
Purpose:	EOPS:		
To develop mechanisms for improved revenue generation and fiscal management at both central and municipal levels of the GOE	1. Central level a) Institutionalization within the Ministry of Finance of improved procedures for analyzing non-compliance among selected categories of taxpayers.	1.a) Reports of technical advisors.	- Ministry assigns adequate human and other resources to carry on the pilot programs beyond project termination. - Ministry fully accepts foreign technical advisors.
	b) New assessments of S/.315 million from non-complying taxpayers as a result of pilot revenue programs.	b) Reports of technical advisors. Ministry of Finance records.	- Technical advisors are able to design procedures appropriate to Ministry organization and to provide effective on-the-job training.
	2. Municipal level a) BEDE technical assistance unit functioning with a program which includes of a minimum two technical workshops per year and delivery of technical assistance to 12 secondary municipalities per year.	2.a) Reports of technical advisors.	- BEDE technical assistance unit continues to receive full support of BEDE management and adequate budget allocation. - Other municipal support organizations agree to coordinate efforts with BEDE on long term basis. - Municipalities follow up on pilot revenue projects with new assessments.
	b) Average increased assesments of: -50% for cadastres, or -20% for betterment levies, or -50% for users' fees in approximately 10 secondary municipalities, receiving technical assistance through BEDE.	b) Reports of technical advisors. BEDE records.	

42

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project: From FY 83 to FY 85
Total U.S. Funding $1,000,000
Date Prepared 6.13.83

Project Title & Number: REVENUE GENERATION, 518-0036

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Outputs: (C-1)	Magnitude of Outputs: (C-2)	(C-3)	Assumptions for achieving outputs: (C-4)
Outputs			
1. Central level			
a) Pilot programs to detect non-compliance among selected categories of taxpayers with high revenue potential.	1.a) Procedures developed and implemented, and Ministry working groups assigned to three program areas: tax filing compliance auditing, delinquent accounts.	1.a) Reports of technical advisors.	- Qualified technical advisors available in accordance with project implementation schedule. - Ministry assigns adequate human and other resources to support pilot activities.
b) More efficient documentation processing.	b) Increased number of processing functions performed in 3 pilot field offices.	b) Reports of technical advisors.	- Ministry committed to reorganization of tax administration operations.
c) Organizational study.	c) Study completed.	c) Submission of report to USAID and Ministry.	- Selected groups of Ministry employees can be made available for short term training without disrupting project pilot activities.
d) Short-term training of Ministry employees	d) 8 executive level employees given IRS orientation, 24 supervisory level employees given IRS middle-management training.	d) Certification from IRS that training successfully completed, training reports presented by trainees.	- IRS able to provide training courses failured to Ministry needs.
2. Municipal level			- BEDE is able to elicit satisfactory cooperation from other municipal support organizations for project activities.
a) Establishment of municipal data bank in BEDE.	2.a) Data bank stored on BEDE microcomputer. BEDE personnel trained in its use and performing analyses to support BEDE technical assistance unit.	2.a) Reports of technical advisors.	- Municipalities are receptive to BEDE assistance and assign adequate resources to support pilot activities.
b) Instructional manuals.	b) 5 manuals designed.	b,c) Reports of technical advisors. Examples of publications.	- Qualified U.S. training program identified.
c) Technical bulletins	c) 6 bulletins published and disseminated to municipalities.		

42

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Project Title & Number:

Life of Project:
From FY _____ to FY _____
Total U.S. Funding _____
Date Prepared: _____

PAGE 3

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Outputs: (C-1)	Magnitude of Outputs: (C-2)	(C-3)	Assumptions for achieving outputs: (C-4)
d) Technical workshops	d) One workshop conducted in approximately 9 regions across the country.	d) Reports of technical advisors. BEDE memoria of workshop proceedings.	
e) Pilot revenue projects in secondary municipalities.	e) A minimum of 2 pilot projects for cadastre improvement and 8 for other revenue generating mechanisms including betterment levies and users's fees.	e) Reports of technical advisors.	
f) Short term training for BEDE officials in municipal revenue generation.	f) A minimum of 2 members of BEDE's technical assistance unit trained.	f) Certification from U.S. training institution. Training reports presented by trainees.	

44

AID 1330-24 (10-79)
SUPPLEMENT 1

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Project Title & Number: REVENUE GENERATION, 518-0036

Life of Project:
From FY 83 to FY 85
Total U.S. Funding $1,000,000
Date Prepared: 7.5.83

PAGE 4

NARRATIVE SUMMARY Project Inputs: (D-1)	OBJECTIVELY VERIFIABLE INDICATORS Implementation Target (Type and Quantity) (D-2)		MEANS OF VERIFICATION (D-3)	IMPORTANT ASSUMPTIONS Assumptions for providing inputs: (D-4)
	($000)			
Inputs:	A.I.D. Grant	GOE		
1. Central level			- USAID Controller disbursement records. - GOE reports of counterpart contributions.	- A.I.D. funding available. - GOE cash counterpart and staff resources available.
a) Technical advisors	325	-		
b) Short term training	149	-		
c) Computer hardware/software	36	-		
d) Ministry Resources	-	350		
e) Contingencies	40	-		
SUBTOTAL	570	350		
2. Municipal level				
a) Technical advisors	256	9		
b) Short term training	10	-		
c) Equipment and materials	97	27		
d) Logistical support	7	9		
e) GOE personnel resources	-	80		
f) Contingencies	60	25		
SUBTOTAL	430	150		
PROJECT TOTAL	1,000	500		

REPUBLICA DEL ECUADOR
MINISTERIO DE FINANZAS

OFICIO No. 2975

Quito, a - 8 JUL. 1983

7 - 15 - 83

RECEIVED
BY
Date Initials

Señor
Orlando Llenza,
DIRECTOR DE LA MISION USAID EN ECUADOR
Ciudad.-

Señor Director:

El Ministerio de Finanzas y Crédito Público, en respuesta a la seria situación fiscal que el país atraviesa, y de acuerdo con los objetivos del actual Plan Nacional de Desarrollo, ha considerado necesario tomar medidas para incrementar a corto plazo las rentas fiscales, como uno de los medios para reducir el déficit del Presupuesto Nacional, asegurando al mismo tiempo los niveles adecuados de gastos a fin de mantener los proyectos y programas prioritarios de desarrollo que está llevando a cabo el Gobierno Nacional.

Entre las medidas más importantes es este sentido, están aquellas tendientes a reducir los niveles de incumplimiento en el pago de los Impuestos a la Renta y a las Transacciones Mercantiles, que en la actualidad producen mucho menos que lo que realmente deberían producir y que podrían contribuír significativamente al mejoramiento de la situación fiscal del Gobierno.

En base a estas consideraciones, el Ministerio de Finanzas y Crédito Público, con el apoyo de consultores en materia de Administración Tributaria obtenidos a través de la A.I.D. a principios de este año, ha elaborado un proyecto que busca establecer programas dirigidos a incrementar los ingresos fiscales, en el tiempo más corto posible, en las áreas anteriormente descritas, y que también ayude a fortalecer la capacidad del Ministerio, para expandir y mantener estos programas a un plazo más largo.

Los programas para mejorar los ingresos estarán dirigidos a las tres principales áreas de incumplimiento de pago de los Impuestos a la Renta y a las Transacciones Mercantiles: La falta de declaración de impuestos; la incorrecta presentación de declaraciones, y los pagos en mora. Los programas desarrollarán procedimientos y sistemas de información que permi-

...//..

REPUBLICA DEL ECUADOR
MINISTERIO DE FINANZAS

tan la identificación rápida y precisa de los casos de incumplimiento en estas áreas.

Los programas estarán dirigidos a categorías seleccionadas de contribuyentes de los cuales pueden esperarse los mayores ingresos por concepto de Impuestos a la Renta y a las Transacciones Mercantiles. Inicialmente, estos programas serán desarrollados y probados en las Jurisdicciones Tributarias más grandes del Ecuador (Por Ejemplo: Quito, Guayaquil, Cuenca). Los programas serán realizados por la Dirección General de Rentas, incluyendo las Delegaciones Generales y las Jefaturas Provinciales. El apoyo de la Dirección General de Organización y Sistemas será fundamental para proporcionar la información y análisis de datos necesarios para la ejecución exitosa de estos programas.

Adicionalmente, el proyecto contempla varias actividades tendientes a fortalecer la Dirección General de Rentas para llevar a cabo estos programas en la forma más óptima y eficiente y para mantenerlos y expandirlos en los años futuros. Estas actividades incluyen: La elaboración y establecimiento de los procedimientos más eficientes para el procesamiento de las declaraciones; un estudio especial tendiente a preparar recomendaciones para la mejor estructura organizacional del Ministerio en cuanto a las funciones de administración de impuestos se refiere; y capacitación a corto plazo en administración, manejo y técnicas tributarias para personal seleccionado del Ministerio.

Con estos antecedentes, el Ministerio de Finanzas y Crédito Público solicita de la Agencia para el Desarrollo Internacional, financiamiento mediante fondos no reembolsables por un valor aproximado de US 570.000 Dólares para la ejecución del proyecto descrito anteriormente. La participación nacional equivaldrá aproximadamente a US 350.000 Dólares, que consistirá de contribuciones en especie en la forma de recursos de personal, servicios de apoyo de computación y otros servicios provistos por el Ministerio. Los aportes A.I.D. y del Ministerio serán entregados en un período de quince meses.

Todas las actividades descritas anteriormente, requerirán del apoyo técnico de A.I.D. con el objeto de fortalecer la implementación del programa propuesto.

Deseo reiterarle el alto interés que el Ministerio de Finanzas y Crédito Público tiene por este importante programa y esperamos contar con la cooperación de A.I.D. para poder llevar

.../.../...

47

REPUBLICA DEL ECUADOR
MINISTERIO DE FINANZAS

a cabo las varias actividades en la oportunidad más cercana.

Atentamente,
DIOS, PATRIA Y LIBERTAD

Ing. Pedro Pinto Rubianes,
MINISTRO DE FINANZAS Y
CREDITO PUBLICO

48

banco de desarrollo del ecuador s.a.

OFICIO Nº BEDE-GG-83-1974

Quito, a 14 JUL 1983

Señor
Orlando Llenza
DIRECTOR DE LA
AGENCIA PARA EL DESARROLLO INTERNACIONAL
Ciudad.

Estimado señor Director:

El Banco de Desarrollo del Ecuador , consciente del papel que le corresponde en el alcance de los objetivos señalados por el Gobierno Nacional, y como parte de su plan de extender los beneficios del desarrollo hacia zonas distintas de los mayores centros urbanos, ha elaborado un programa específico de trabajo, que busca fortalecer la capacidad administrativa y financiera que actualmente tienen las Municipalidades, para llevar a cabo sus actividades prioritarias de desarrollo.

El BEDE, en cooperación con el FONAPRE y otros organismos nacionales, y con la asistencia de la A.I.D., ha adelantado ya algunas actividades, que constituyen una base firme para la ejecución del programa propuesto. Dentro de esa orientación, se realizaron nueve reuniones regionales que congregaron a dirigentes y técnicos de las Municipalidades, Consejos Provinciales y organismos de desarrollo regional, para analizar los problemas y necesidades de esas instituciones.

Por otra parte, se constituyó recientemente, dentro del BEDE, una unidad especial que tendrá como función fundamental canalizar la asistencia técnica y los programas de capacitación que se planea realizar, a objeto de contribuir a la solución de problemas y necesidades esenciales de las Municipalidades.

De esta manera, se espera complementar e intensificar los programas que lleva a cabo el BEDE actualmente, para financiar e impulsar la ejecución de obras de infraestructura municipal.

En los 12 a 15 meses venideros, se prevé que el BEDE auspiciará, conjuntamente con otras organizaciones apropiadas, varios tipos de actividades de apoyo a las Municipalidades. De modo especial

./.

Páez 655 y Ramírez Dávalos - Telfs. 551 770 - 551 870 - Casilla 373 - Cable BEDE ED 2655 - Quito Ecuador

banco de desarrollo del ecuador s.a.

2...

se ha pensado en concentrar la asistencia directa a un número inicialmente más bien reducido de Municipalidades.

Estas actividades de apoyo estarán dirigidas principalmente a obtener un mayor desarrollo de las áreas de administración financiera y especialmente a procurar el incremento de recaudaciones provenientes de fuentes locales de ingreso (por ejemplo, impuestos a la propiedad urbana y rural, contribución especial por mejoras), así como el avance en la planificación financiera y presupuestaria.

Para alcanzar estos objetivos, la nueva unidad de asistencia técnica del BEDE analizará los requerimientos de ciertas Municipalidades, y podrá, de este modo, planificar y precisar los tipos de actividades arriba descritos.

Esto redundará, por ejemplo, en el establecimiento de un banco de datos municipal, en la preparación de boletines técnicos y manuales de capacitación, y en la capacitación a corto plazo para el personal del BEDE.

Todas las actividades arriba descritas requerirán de la asistencia de asesores técnicos que trabajen directamente con el BEDE, para asegurar el éxito del programa propuesto.

Con estos antecedentes, el BEDE solicita a la Agencia para el Desarrollo Internacional un financiamiento, mediante fondos no reembolsables, por un valor aproximado de 430.000 dólares para la ejecución del proyecto descrito anteriormente. La participación nacional equivaldrá a aproximadamente 150.000 dólares, y consistirá en contribuciones en recursos de personal del BEDE y de otras organizaciones participantes, y también en materiales e instalaciones necesarios para llevar a cabo las diferentes actividades antes referidas. Los aportes serán entregados en un período de 15 meses.

Deseo reiterarle el alto interés que el BEDE tiene por este importante programa, y expresarle mi confianza de que el Banco podrá contar con la cooperación de A.I.D. para llevar a cabo las actividades que se han señalado en esta nota.

Atentamente,

Dr. Patricio Vivanco Riofrío
SUBGERENTE GENERAL, ENCARGADO
DE LA GERENCIA GENERAL.

Best Available Document

ACTION/INFO
AID-2

UNCLASSIFIED

TOR JAN 3 1983

ANNEX D
Page 1 of 2

REPLY DUE 4 4 83

NO REPLY NEEDED
REPLIED BY

P 310256Z DEC 82
FM SECSTATE WASHDC
TO AMEMBASSY QUITO PRIORITY 0075
BT
UNCLAS STATE 361099

AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: GUIDANCE CABLE - ECUADOR REVENUE GENERATION FOR DEVELOPMENT PID

1. AT A DAEC MEETING ON DECEMBER 21, 1982, THE SUBJECT PID WAS REVIEWED AND APPROVED. THE MISSION MAY PROCEED WITH INTENSIVE REVIEW, APPROVE THE PP AND AUTHORIZE THE PROJECT, TAKING INTO CONSIDERATION THE FOLLOWING GUIDANCE.

2. THE DAEC DISCUSSED GOVERNMENT OF ECUADOR (GOE) COMMITMENT TO TAX/CUSTOMS REFORM AND IMPROVED FISCAL MANAGEMENT, AT POTL CENTRAL AND MUNICIPAL LEVELS, AS A MAJOR AND DETERMINING FACTOR IN THE SUCCESS OF THIS PROJECT. THE PP SHOULD DISCUSS GOE POLITICAL WILL TO MAKE SIGNIFICANT CHANGES IN THESE AREAS AS A NECESSARY CONDITION FOR THE ADMINISTRATIVE AND TECHNICAL UPGRADING ACTIVITIES PROPOSED UNDER THIS PROJECT TO BE EFFECTIVE.

3. THE INTENSIVE REVIEW SHOULD FURTHER DEFINE THE SCOPE OF THE PROJECT AND CLARIFY THE OUTPUTS TO BE EXPECTED BY THE END OF THE TWO YEAR LIFE OF PROJECT (LOP). AS PRESENTED IN THE PID, THE MISSION INTENDS TO WORK WITH THE GOE ON A NUMBER OF FRONTS AND LEVELS WHICH, GIVEN THE LIMITED TIMING AND FUNDING PROPOSED FOR THE PROJECT, RAISES THE QUESTION OF WHETHER A.I.D. RESOURCES WILL BE SPREAD SO THIN AS TO HAVE A MINIMAL IMPACT ON ANY PROBLEM AREA. FOR EXAMPLE, THE PID STATES THAT THE URGENCY FOR THIS PROJECT AT THIS TIME IS TO INCREASE REVENUE GENERATION AND COLLECTION AS SOON AS POSSIBLE TO RESPOND TO THE INCREASINGLY UNMANAGEABLE PUBLIC SECTOR DEFICIT. THE PID ALSO STATES, BY THE END OF THE PROJECT, THE MISSION WILL HAVE PRODUCED A SET OF TESTED APPROACHES AND MECHANISMS TO IMPROVE REVENUE GENERATION TO DISCUSS WITH THE NEW ADMINISTRATION IN 1984. TO THE EXTENT CERTAIN ACTIVITIES HAVE THE OBJECTIVE OF INCREASING REVENUES IN THE NEAR TERM, THE PP SHOULD CONTAIN ESTIMATES OF IMPACT. TO THE EXTENT OTHER ACTIVITIES ARE OF A PILOT OR DEMONSTRATION NATURE, THE PROJECT ANALYSIS AND DESIGN SHOULD ADDRESS THE QUESTION OF REPLICATION. FOR EXAMPLE, WITH REGARD TO THE PILOT MUNICIPAL ACTIVITIES, THE LARGER, MORE CAPABLE MUNICIPALITIES MAY BE BETTER CANDIDATES IF REVENUE IMPACT IS SOUGHT IN THE NEAR TERM, BUT THIS APPROACH MAY NOT SERVE TO DEMONSTRATE WHAT COULD BE ACHIEVED IN THE SMALLER TOWNS THAT DO NOT HAVE A CADRE OF PERMANENT CAPABLE MUNICIPAL EMPLOYEES.

4. ALTHOUGH THE PID STATES THAT THE INTENSIVE REVIEW WILL EXPLORE VARIOUS NATIONAL LEVEL INSTITUTIONAL ARRANGEMENTS TO MOST EFFECTIVELY COORDINATE AND PROVIDE ASSISTANCE TO MUNICIPALITIES IN THEIR DEVELOPMENT EFFORTS, BASED UPON DISCUSSIONS IN THE PID AND THE DAEC, IT SEEMS AS THOUGH THE MISSION HAS DECIDED THAT THE ECUADOREAN DEVELOPMENT BANK (BEDE) IS THE MOST APPROPRIATE LEAD INSTITUTION. THE INTENSIVE REVIEW SHOULD EXAMINE INSTITUTIONAL ALTERNATIVES TO BEDE (SUCH

51

AS DINAC, FONAFRE) AND, IF CONFIRMED THAT BEDE IS THE BEST AGENCY TO ASSUME THIS ROLE, THE PP SHOULD DISCUSS WHY BEDE WAS CHOSEN AND CLARIFY THE ORGANIZATIONAL AND FUNCTIONAL RELATIONSHIPS AND COORDINATION ENVISAGED BETWEEN BEDE AND THESE OTHER AGENCIES. THE INTENSIVE REVIEW MAY INDICATE, FOR EXAMPLE, THAT BEDE MAY BE MOST SUITABLE WITH REGARD TO IMPROVED COLLECTION OF USER CHARGES ON PUBLIC INVESTMENTS, BUT THAT ANOTHER INSTITUTION WOULD BE MORE APPROPRIATE WITH REGARD TO PROPERTY OR OTHER TAX MATTERS.

5. THE PID INDICATES THAT A.I.D. ASSISTANCE IS CONTEMPLATED FOR ENHANCING GOE IMPLEMENTATION OF EXISTING CUSTOMS AND TAX LAWS. SINCE CERTAIN ASPECTS OF SUCH ASSISTANCE COULD CONFLICT WITH SECTION 660 OF THE FAA, THE BUREAU RECOMMENDS THAT THE MISSION CONSULT WITH THE RLA IN LIMA OR GC/LAC IF IT HAS ANY QUESTIONS

REGARDING THE LEGAL APPROPRIATENESS OF ANY PROJECT ACTIVITIES, PARTICULARLY IN THE AREA OF CUSTOMS REFORM. FYI: SECTION 660 PROHIBITS THE USE OF FAA FUNDS TO PROVIDE TRAINING OR ADVICE, OR TO PROVIDE ANY FINANCIAL SUPPORT, FOR POLICE, PRISONS, OR OTHER LAW ENFORCEMENT FORCES FOR ANY FOREIGN GOVERNMENT OR ANY PROGRAM OF INTERNAL INTELLIGENCE OR SURVEILLANCE ON BEHALF OF ANY FOREIGN GOVERNMENT. END. FYI.

6. THE PID STATES THAT, TO THE EXTENT APPROPRIATE, USAID WILL SEEK TO OBTAIN TECHNICAL ASSISTANCE THROUGH IQCS AND A.I.D. COOPERATIVE AGREEMENTS. A COOPERATIVE AGREEMENT IS NOT REPEAT NOT THE PROPER INSTRUMENT TO USE FOR PROCUREMENT OF SERVICES OF CONSULTANTS. THE APPROPRIATE INSTRUMENT FOR ACQUISITION OF SUCH SERVICES IS A CONTRACT (SEE AID HANDBOOK 1B, CHAPTER 25). MOREOVER, UNLESS NONCOMPETITIVE NEGOTIATION CAN BE JUSTIFIED IN ACCORDANCE WITH THE AIDPRS, COMPETITIVE PROCEDURES MUST BE FOLLOWED.

7. BUREAU REQUESTS TO BE INFORMED OF REVISIONS IN PP DEVELOPMENT SCHEDULE CURRENTLY ESTIMATING PROJECT AUTHORIZATION IN MAY 1983.

8. MISSION IS ENCOURAGED TO CONSULT AID/DIU FOR INFORMATION REGARDING PAST EXPERIENCES OF SIMILAR PROJECTS IN OTHER COUNTRIES. DAM
BT
#1099

Best Available Document

UNITED STATES I :RNATIONAL DEVELOPMENT COOPER ON AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

LAC/DR - IEE - 83 - 13

ENVIRONMENTAL THRESHOLD DECISION

Project Location	:	Ecuador
Project Title and Number	:	Revenue Generation for Development 518-0036
Funding	:	$675,000 Grant
Life of Project	:	FY 1983
IEE Prepared By	:	Randall W. Roeser, USAID/Quito
Recommended Threshold Decision	:	Negative Determination
Bureau Threshold Decision	:	Concurrence with recommendation
Action	:	Copy to Paul Fritz, USAID/Ecuador
	:	Copy to Peter Orr, LAC/DR
	:	Copy to Randall W. Roeser, USAID/Ecuador
	:	Copy to IEE file

James S. Hester Date 21 December 1982

James S. Hester
Chief Environmental Officer
Bureau for Latin America
and the Caribbean

INITIAL ENVIRONMENTAL EXAMINATION

Project Location:	Ecuador
Project Title:	Revenue Generation for Development (518-0036)
Funding:	FY 83: Grant $675,000 LOP: Same
IEE Prepared by:	Randall W. Roeser, Capital Development Officer. December 4, 1982
Recommended Threshold Decision:	The USAID/Ecuador Project Committee has undertaken a complete Initial Environmental Examination of the potential impacts of the proposed project and has arrived at a recommendation for a Negative Determination. (See Section entitled "Examination of Nature, Scope, and Magnitude of Environmental Impacts" and the "Threshold Decision Recommendations" Subsection thereunder.)
Mission Director's Concurrence:	John N. Sanzadilo Director USAID/Ecuador

EXAMINATION OF NATURE, SCOPE, AND MAGNITUDE OF ENVIRONMENTAL IMPACTS

Description of Project

The purpose of the project is to develop mechanisms for improved revenue generation and fiscal management at both central and municipal levels of the Government of Ecuador (GOE). These improvements will strengthen the capacity of the GOE to carry out important development programs on a sustained basis. They will also support a more active role for municipal governments in development planning and finance, thus ensuring a broad based and balanced pattern of development in Ecuador.

To achieve this purpose, the project will finance a number of technical assistance, training, and pilot activities with selected organizations at different levels of the public sector. For the most part, these activities will be of limited scope and designed to test various approaches to improving fiscal performance which could be later expanded upon. At the central government level, initial technical assistance will be provided to the Ministry of Finance to identify and address specific problems affecting income tax administration (e.g. billing and collections procedures, withholding, audits, record keeping). Similar assistance may be given in the area of customs administration.

With regard to local government fiscal performance, project activities will be carried out at two levels in a coordinated fashion. Technical assistance and selective training will be targeted to key national level organizations which provide financial or technical support to local governments. Of particular interest is the Ecuadorean Development Bank (BEDE), a major domestic source of public sector financing. BEDE seeks to complement its financing with technical assistance to help improve local government revenue and fiscal management systems. The project will help BEDE begin to develop this capacity through a small number of pilot financial and technical assistance packages to municipalities outside of Quito and Guayaquil. A.I.D.'s project assistance will be focused on the technical services component of these packages while BEDE will finance municipal infrastructure works as part of the pilot program. The specific locations and types of infrastructure works to be financed by BEDE cannot be identified at this time. In the past, BEDE financing to municipalities has been primarily for potable water, sewerage, electrification, and roads. Similar assistance and pilot programs may be carried out with other national level organizations though on a more limited scale than with BEDE. Pilot activities with these other organizations may involve municipal cadastres, planning and budgeting, and small scale neighborhood improvement works.

The project will also work directly with a small number of municipalities. This assistance will be designed to test approaches for strengthening municipal revenue generation and fiscal management systems. An important objective of this assistance is to develop within the municipalities the capacity and confidence to draw on the resources of the national level organizations and to complement them with local revenues for carrying out local and regional development programs. The project may also work with the Association of Municipalities to develop its capacity to serve as a liaison between the municipalities and the national level organizations to help ensure that the latter remain responsive to municipal needs.

Discussion of Environmental Impacts

A.I.D. funded inputs under the project will be limited to consultants, technical advisors, and training. This assistance will be directed at the design and implementation of improved revenue generation and fiscal management systems in the public sector. In and of themselves, these activities will have no significant physical environment impacts.

Any identifiable physical impacts related to the project are likely to occur at the municipal level. Some A.I.D. assistance may be linked to counterpart funded municipal infrastructure works funded by BEDE. Illustrative examples were given above. The specific infrastructure works will be identified during project implementation. As part of the project strategy of helping BEDE increase the development impact of its municipal investments, USAID will request that BEDE prepare an environmental assessment of each infrastructure work linked to the project, and will provide any needed assistance. Nevertheless, at this time there are reasons to presume that the adverse physical impacts of these works will be negligible. First, similar investments in the past have been of limited size, and have usually involved the extension of services to new sections of the municipality or the improvement of existing infrastructure. Second, all of the construction work will occur in areas that are already urbanized. In some cases (e.g., electrification which reduces fuelwood use), the physical impact may be positive.

The net socioeconomic impact of the project is expected to be favorable. All project activities, including the pilot programs, will affect urbanized groups that have to a large extent adopted or adapted to mainstream cultural practices. The pilot programs will often involve the extension of basic services which are highly valued by the low income beneficiaries and were probably among the attractions which drew rural migrants to the municipalities. Thus, the project is not expected to have an adverse effect on cultural traditions or values. On the other hand, the project will have substantial positive socioeconomic benefits. The poor in marginal areas of municipalities will receive various benefits from the extension of basic services under the pilot programs

(e.g., improved health, reduced time spent in domestic chores, opportunities to begin small enterprises). More generally, the municipal population will benefit from local governments which have a stronger financial and technical capacity to respond to local development needs. In the longer run, better services and more dynamic economies of the local level will help stem the flow of migrants to the major urban centers whose carrying capacity is already under strain.

Threshold Decision Recommendation

After analyzing the various areas of potential environmental impact, and taking into account the nature of the project, USAID concludes that in those areas where impact is expected under the project, such impact will either be neutral or will have a net beneficial effect on the environment. USAID therefore recommends a Negative Determination.

PROCUREMENT LIST

The following are the major commodities to be procured under the project and their estimated costs. It is expected that all of these commodities will be imported from the U.S.

1.	Stereo-compiler and automatic drafting board for photogrammetric compilation of rural cadastre maps - for DINAC	$ 80,000
2.	One microcomputer with minimum 64K RAM, 12-inch high resolution monitor, numeric keyboard, hard disk drive and expandable external memory, matrix printer, uninterruptable power supply, and software (data base management, statistical analysis, word processing spreadsheet, graphics) - for BEDE technical assistance unit	12,000
3.	Three microcomputers, each with minimum 64K and expandable RAM, 12-inch high resolution screen, numeric keypad, hard disk drive and expandable external memory, matrix printer, telecommunications port and serial card, uninterruptable power supply, and software (data base management, statistical analysis) - for the Ministry of Finance	36,000

BENEFIT/COST CALCULATIONS

A. Ministry of Finance Tax Administration

The revenue programs in the Ministry of Finance component of the project are expected to have a significant impact relative to current returns to income and sales taxes within the life of the project. Therefore, a simple calculation of benefits (increased revenues) is made for the first year of implementation only and compared with project costs. The assumptions and calculations for each of the three revenue programs are given below.

1. Returns Filing Compliance

Given:

(1) Filing data for the two major categories of taxpayers for 1979 (the most recent year with complete data)

Category	Pct. of Filers Taxable	Avg. Tax Paid
Renta Global	28%	s/ 25,000
Personas Jurídicas	62%	s/ 375,000

(2) Average production of an auditor is now s/ 1,700,000 per year

Assume:

(1) 23 auditors assigned to this program (half the number assigned to Ministry's current "canvass" program for tax filing compliance)

(2) Program fully implemented for 6 months under project

(3) 5 individual taxpayers (Renta Global) and 1 business (Persona Jurídica) can be contacted by an auditor in one day

(4) 50% of new assessments actually collected during project

Calculations:

	Renta Global	Personas Jurídicas
No. of auditors	21	2
Contacts per day	5	1
Working days	120	120
TOTAL CONTACTS	12,600	240
% of contacts taxable	28%	62%
Taxable contacts	3,528	149
Avg. assessment (s/)	25,000	375,000
GROSS ASSESSMENTS (s/)	88,200,000	55,875,000

GROSS PROGRAM ASSESSMENTS	s/ 144,075,000
Less Normal Audit Production	
23 x s/ 1,700,000 x 1/2 year	19,550,000
NET PROGRAM ASSESSMENTS	s/ 124,525,000
% of assessments collected	50%
TOTAL PROGRAM RETURNS	62,262,500

2. Tax Reporting Audit

Assume:

(1) 25 auditors asigned to program for 6 months during the project

(2) 8 audits per auditor per month

(3) New selective audits only half as productive as current comprehensive audits (unappealed yield of s/ 154,000 per case)

(4) 50% of new assessments actually collected during the project

Calculations:

GROSS ASSESSMENTS	
25 auditors x 6 mos. x 8 audits/mo.	
x (s/ 154,000 x 50%)	s/ 92,400,000
Less Normal Audit Production	
25 x s/ 1,700,000 x 1/2 year	21,250,000
NET PROGRAM ASSESSMENTS	s/ 71,150,000
% of assessments collected	50%
TOTAL PROGRAM RETURNS	35,575,000

3. Delinquent Accounts

Given:

(1) Current delinquent account inventory of s/ 6,959,000,000

(2) An estimated 50% of inventory is tax accounts

Assume:

(1) 50% of delinquent tax accounts are in appeals status and 25% are prescribed or otherwise old and uncollectible

(2) Program would be able to collect 25% of collectible amount during the project

Calculations:

Total accounts	s/ 6,959,000,000
Tax accounts (50% of total)	3,500,000,000
Collectible tax accounts (25%)	875,000,000
% of collectible accounts collected under program	25%
TOTAL PROGRAM RETURNS	s/ 218,750,000

4. Summary

Program	Net Return (s/ rounded)
Returns Filing Compliance	62,000,000
Tax Reporting Audit	35,000,000
Delinquent Accounts	218,000,000
TOTAL RETURNS (BENEFITS)	s/ 315,000,000
Conversion at s/80 = $1.00	$ 3,937,500
PROJECT COST	$ 920,000
BENEFIT/COST RATIO	4.3

The benefit/cost ratio is a conservative estimate for two reasons:

(1) The ratio only takes into account first year benefits (returns) whereas the pilot programs can be continued and expanded over future years at low marginal cost;

(2) The programs may be expected to have a favorable indirect impact on revenues; that is, if collections resulting from the programs are enforced, the incentives for voluntary taxpayer compliance will be increased.

B. Municipal Revenue Generation

The municipal component of the project will include a limited number of pilot revenue activities in a sample of secondary municipalities. The short term revenue impact of these activities relative to project costs is expected to be considerably less than that achieved in the Ministry of Finance component because of (1) the "start-up" costs of establishing institutional mechanisms in BEDE which will support the long term replication of the pilot activities, and (2) the limited revenue raising capacity of individual municipalities. For these reasons, a longer term financial analysis is warranted. A period of five years is selected. It is assumed for this analysis that three cadastre improvement pilots and four pilots each for betterment levies and users' fees will be implemented under the project. The assumptions and benefit/cost calculationa are given below.

1. Cadastre Improvement

Given (based on random sample of eight Sierra municipalities):

	Urban Area	Rural Area
Average population	34,000	52,000
Avg. property tax revenues (1980)	s/2,800,000	s/1,700,000
Avg. property tax per capita	s/ 84	s/ 32
Highest observed prop. tax p.c.	s/155	s/ 72

Assume:

(1) 3 cadastre pilots in Sierra

(2) All municipalities start at average property tax per capita.

(3) Pilot municipalities increase property tax collections by 50% of the difference between average and highest observed per capita revenues during first year. Attain highest observed level in second year and maintain that level.

(4) Property tax revenues would have remained the same in real terms without project intervention.

(5) Recurring annual costs of maintaining cadastre and administering collections in a given municipality:

(a)	Reconciliation of land transfers (deeds) and mapping	3 p/m
(b)	Surveying new parcels	2 p/m
(c)	Additional collections administration	2 p/m
(d)	Updating land valuations	3 p/m
	Total	10 p/m
	Cost per municipality at s/ 10,000 per person/month	s/ 100,000
	- U.S.$ equivalent (s/80=$1.00)	$ 1,250

Calculations:

	Years 1	Years 2-5
Urban Area		
Avg. p.c. rev. (s/)	120	155
Avg. p.c. increase (s/)	36	71
Avg. population	34,000	34,000
Avg. total increase (s/)	1,224,000	2,414,000
- For 3 municipalities	3,672,000	7,242,000
- U.S. $ (s/80=$1.00)	45,900	90,500
Rural Area		
Avg. p.c. rev. (s/)	52	72
Avg. p.c. increase (s/)	20	40
Avg. population	52,000	52,000
Avg. total increase (s/)	1,040,000	2,080,000
- For 3 municipalities	3,120,000	6,240,000
- U.S. $ (s/80=$1.00)	39,000	78,000

TOTAL NET REVENUE ($)	84,900	168,500
TOTAL RECURRING COSTS ($)	3,750	3,750

At a discount rate of 12%:

Net present value of revenues = $532,703
Net present value of recurring costs = $ 13,515

2. Betterment Levies

Given (based on sample of eight Sierra municipalities for 1980):

Average population	34,000
Average betterment levies	s/ 1,795,000
Average per capita betterment levies	s/ 52.8

Assume:

(1) Four pilot municipalities under project.

(2) 20% improvement in real terms over 1980 average per capita levies.

(3) Major taxable improvements (betterments) occur in a given municipality every other year.

(4) Annual recurring costs associated with new betterment levy program:

Calculation of levies	2 p/m
Additional collections administration	2 p/m
Total	4 p/m
Cost per municipality at s/ 10,000 per person/month	s/ 40,000
- U.S.$ equivalent (s/80=$1.00)	$ 500

Calculations:

	Years 1, 3, and 5
Average p.c. revenues (s/)	64
Average p.c. increase over 1980	11
Average municipal population	34,000
Average total increase (s/)	374,000
- for 4 municipalities (s/)	1,496,000
- converted to $ (s/80=$1.00)	18,700
Recurring costs for 4 municipalities ($)	2,000

Present value of benefits = $ 40,579
Present value of recurring costs = $ 4,340

3. Users' Fees

Given (based on estimates of USAID Sanitary Engineer for secondary municipality water services):

Average users' fee per household per month (s/)	20
Monthly household fee required to cover operation and maintenance of systems (s/)	100

Assume:

(1) Three pilot activities

(2) Household rate raised to s/30 in year 1, s/40 in year 2, and s/50 years 3-5

(3) Rates would not have changed in real terms otherwise

(4) 54 percent of households have water

(5) 5 persons/household

(6) Incremental annual recurring costs associated with new users' fee program:

Calculation of new rates	1 p/m
More active collections	2 p/m
TOTAL	3 p/m
Cost per municipality at s/ 10,000 per person/month	s/ 30,000
- U.S.$ equivalent (s/80=$1.00)	$ 375

Calculations:

	Years 1	2	3-5
Monthly household rate (s/)	30	40	50
Increase over current rate (s/)	10	20	30
Annual increase (s/)	120	240	360
Avg. no. of households per municipality	3,600	3,600	3,600
Avg. annual increase per municipality (s/)	432,000	864,000	1,296,000
- for 3 munic. (s/)	1,296,000	2,592,000	3,888,000
- converted (s/80=$1.00)	16,200	32,400	48,600
Recurring costs for 3 municipalities ($)	1,125	1,125	1,125

Present value of benefits = $ 98,737
Present value of recurring costs = $ 4,054

4. Summary

	Net Present Value (in $) of: Benefits	Recurring Costs
Cadastre Improvement	532,703	13,515
Betterment Levies	40,579	4,340
Users' Fees	98,737	4,054
Initial (project) costs		580,000
TOTAL	672,019	601,909
Benefit/cost ratio	1.12	

ANALYSIS OF MUNICIPAL REVENUE SITUATION

Excerpted from: "Ecuador: Analysis of Municipal Financial Status and Recommendations for Improvement", report prepared for USAID by James F. Hicks, Jr., Richard K. Harper, and Ronald W. Johnson of the Research Triangle Institute under Contract AID/SOD/PDC-C-0392, April 29, 1983.

1. Assessment of Municipal Financial Conditions

An earlier analysis of national level totals by David Greytak[1/]Ñ David Greytak, "Observation and Considerations of the Structure and Operation of the Ecuadorean Development Bank and Some Observations on Municipal Finances", prepared for USAID/Ecuador, February 25, 1983.Ñ noted that municipal revenues went from 2.5 billion sucres in 1975 to a little over 11 billion in 1981, an increase of 377 percent in current sucres, or a still staggering increase of 277 percent in constant sucres. Although those increases do include some at the local, own source level (23 percent), of far greater magnitude is the increase in central government transfers, nearly 67 percent.

The 11.3 billion sucre municipal revenue in 1981 can be broken out into three basic categories,[2/]Ñ Source: Contraloría General del Estado, 1982.Ñ distinguishing among own source, non-loan external transfers, and loans:

- Own source -- 20.6 percent
- Non-Loan External -- 53.1 percent
- Borrowing -- 26.3 percent.

If both loan and non-loan source revenues are combined, less that 21 percent of total municipal revenues in 1981 were generated from local sources. It should be noted, however, that future loan repayments of the 26 percent borrowing could come either fom own sources or non-loan external transfers. In either case, the current dependency of municipal governments on external sources is large and, from Greytak's analysis noted above, is increasing. Whether or not this dependency is a problem, of course, depends on several factors, including the continuing availability of central government revenues, the relative efficiency of national revenue collection versus local collection, and one's views on the behavioral virtues of collecting and spending at the same level of government. The asumed context for our analysis is a future decrease in the rate of increase of central government transfers, if not an actual reversal of the current trend. Thus, for our purposes, the decreasing amount of central government transfers available to local governments means either that future local service levels must <u>decrease</u>, in absolute terms or at least relative to current increases, or that future local revenues must <u>increase</u> if current local service levels are to be maintained or improved.

Examination of the expenditure side of municipal finances in 1981 reveals that only 9.3 billion sucres actually were spent, 2 billion less than revenues. Explanation for this difference points to two factors. First, according to the report of the Contraloría General del Estado (1982), the increases in total municipal revenues have been so rapid that not all municipalities have the capacity to utilize all available funds. Second, according to interviews with officials of the Contraloría, as well as with official from other Ministries, including BEDE, CONADE and FONAPRE, and with municipal officials, central government regulations may prevent effective expenditure in the year for which authorization already has been granted.

Of the 9.3 billion sucres actually spent in 1981 at the local level, the expenditure distribution by object[3/Ñ Source: Informe de la Contraloría General del Estado, 1982.Ñ] was as follows:

- Current Expenditures -- 30.4 percent
- Capital Expenditures -- 46.2 percent
- Debt Service -- 16.1 percent
- Other (including cash balance) -- 7.3 percent

This distribution indicates that there is a very heavy investment emphasis among municipalities. It may be argued that high investment represent sound social, political and economic decisions. However, current investments may be expected to generate future high debt service and operation and maintenance costs. These financial demands may be expected to produce serious financial management problems for municipalities if central government transfers cannot keep up their current pace or if local revenue sources cannot be strengthened.

If we make three policy assumptions, a flow of funds diagram may be developed, illustrating the current relationships among different sources of revenues and the potential uses of these revenues on the expenditure side. These assumptions are:

1. Own source funds should cover current operating expenses, including operation and maintenance of capital facilities, general municipal service provision, and debt service.

2. Borrowing should be used as a source of funds only for capital investments.

3. External, non-loan sources should be used for investment purposes rather than current expenditures.

Although these assumptions may be disputed, they represent the current, general position of the Government of Ecuador. Even the large flow of petroleum funds into the national treasury is not intended to be used as a subsidy for current municipal expenses. Of the assumptions, only the third varies substantially from country to country. That is, although it is not the current policy position in Ecuador, policy decisions based on the distribution of social welfare benefits, the relative tax collection efficiencies of different levels of government, and other arguments could justifiably support central government revenue transfer support of municipal current operating expenses. General Revenue Sharing in the United States, for example, is a non-loan central government transfer thay may be used either for capital investments or current operating expenses. In Ecuador, the formal policy is that central government transfers are to be used for investment type purposes. Informally, however, it is acknowledged that some funds may be used, and are, for non-investment type activities.

Given those assumptions. Exhibit 1.1 indicates a significant gap in 1981 at the national level between the expenditure requirements assumed to be met by municipal own source revenues and the actual current revenue available, a gap of 2.7 billion sucres (linkages represented by arrows lettered a).

EXHIBIT 1.1

FLOW OF FUNDS ANALYSIS OF MUNICIPAL REVENUES
AND EXPENDITURE PURPOSES: 1981 NATIONAL LEVEL

Revenues		Expenditures
Own Source	a	Current Expenses*
(2.3 billion)	a	(2.8 billion)
	a	Debt Service
		(1.5 billion)
		Other
Borrowing		(0.7 billion)
(3.0 billion)	b	
External, Non-Loan	c	Capital Investments
(6.0 billion)		(4.3. billion)

* includes operation and maintenance costs of previous investments.

Legend:
- a — use of current revenues to pay for policy-defined current expenses.
- b — restricted use of borrowing for capital investments only.
- c — policy-defined, intended use for non-loan transfers.

Similarly, represented by linkage b, there is a gap between amount borrowed and amount spent on capital investments of 1.3 billion. Linkage c represents the use of part of the available external, non-loan revenues to cover the gap (b) of 1.3 billion. However, an additional 4.7 billion in non-loan external revenue is available for investments. Of this, 2.7 billion goes to cover the current expense deficit, and 2.0 remains in the Central Bank, not drawn down by the municipalities for the reasons cited earlier.

Thus, of the 6.0 billion originally available from external non-loan sources for invesment, 22 percent was actually used in 1981 for investments, 45 percent was used to cover a current budget deficit, and the remaining 33 percent was not drawn upon at all.

In summary, municipalities are covering only 46 percent of the costs associated with current operations from current revenues, relying on central government, non-loan transfers for the balance of 54 percent. Should the availability of central government funds decrease, as expected, municipalities will be in an increasingly unsound financial position, especially in light of the continuing heavy investment expenditures (46 percent of total expenditures) which inevitably will produce additional future operations and maintenance and debt service costs.

2. Projections of Municipal Revenues Under Alternative Assumptions

2.1 Methodology

There are two basic alternative ways in which to project municipal revenues at the national level. First, historical, or time series, data on the various sources of municipal revenues may be analyzed. From this analysis, an econometric model may be estimated for projections, with municipal, endogenous variables and parameters adjusted to reflect future policy determinations, as well as certain exogenous socioeconomic variables (e.g., revenues of petroleum exports, rates of population and gross national product growth). Once the projection model is calibrated, independent estimates of the various sources of municipal revenues may be made, and municipal total revenues may be allocated to the various municipal expenditure categories, based on assumptions about local and national policy priorities and implementation instruments. This alternative methodology has the advantage of allowing independent estimates of each municipal revenue category. However, it requires a historical data base with a high degree of empirical rigor, and, equally as important, a sound capacity to predict accurately policy directions and certain exogenous variables such as population growth and distribution.

An alternative methodology for projecting municipal revenues is to begin the analysis with a projection of municipal expenditures. The expected expenditure level may be based on an estimation of what may reasonably be expected of municipal governments in terms of providing local services. Once the expected level, or levels, of future municipal expenditures is established, then the various sources of municipal revenues may be projected according to various assumptions about the revenue potential of each source. If the central focus of the analysis is on the national perspective of municipal revenues, this approach has the advantage of allowing the analysis to concentrate on alternative municipal revenue sources necessary to attain an expected level of effort in municipal provision of local services. Thus, this alternative is more normative in orientation, when compared to the first alternative, which emphasizes a deterministic approach to prediction.

For the purposes of this report, the second alternative is preferred for the following reasons:

-- The central focus of this study is on municipal financial management capacity rather than on historically based projections of municipal revenues. In other words, the primary concern is with "what may be", given changes in municipal financial management performance, rather than "what will be" based on past performance and expected exogenous changes.

-- An initial assumption of this study is that local dependence on central government non-loan transfers will decline over time. Thus, the methodology selected should concentrate not only on the question of what the alternative municipal revenue sources may be projected to be, but also on the normative question of how these alternative revenue sources may be improved in order to meet local service demand.

-- The last year for which consolidated municipal revenue and expenditure accounts are available at the national level is 1981. There are no comparable accounts readily available for former years. Thus, although an econometric approach to projecting municipal revenues to 1986 could be done, the impossibility of quickly obtaining a reliable data base for this purpose makes this approach beyond the scope of the present study. Furthermore, the chosen alternative presents the advantages noted above to recommend it.

The first step in implementing our selected methodology is to select an appropriate level of municipal expenditures in 1986. For this, we assume that, at a minimum, the level of municipal services provided in 1986 should be no less than that observed in 1981. If it is further assumed that there is a direct relationship between municipal services and total municipal revenues, then Exhibit 1.1 is a useful guide in establishing the minimally desirable municipal expenditure level for 1986. Exhibit 1.1 demonstrates that in the 1981 national aggregate, municipal revenues totaled 11.3 billion sucres,

compared to 9.3 billion sucres in total expenditures. The difference of 2 billion sucres may be attributed to the incapacity of the municipal administration to utilize fully all the potential revenues available to them, and/or to statutory obstacles.

As a minimum expenditure level necessary to maintain the current level of municipal services in 1986, therefore, we establish the value of 9.3 billion sucres in 1981 prices. It should be emphasized that the 9.3 billion figure is not a prediction; in fact, it is hopefully a pessimistic figure. Rather, within the methodological approach established, we are not so concerned with absolute levels of future expenditures as with what sources of revenue a given level of expenditure will be paid. The key question thus becomes what kind of revenue mix will be capable of producing this level of expenditures, given the assumption that the current proportion of total municipal revenues provided by central government non-loan transfers will decline over the projection period.

The basis of our revenue simulations for 1986 may be described by a series of simple equations.

Let TR = Total Municipal Revenues
OS = Municipal Own Source Revenues
B = Municipal Borrowing
and ENL = Municipal Revenues from External Non-Loan Sources;

Then: (1) $TR = OS + B + ENL$

(2) $ENL = eTR$, where e is a variable proportion of TR

and (3) $B = b(OS + ENL)$, assuming that municipal debt levels should be defined as a proportion, b, applied to the sum of OS and ENL.

For our simulation purposes, the key variables are the proportions e and b defined in equations (2) and (3). From the analysis presented above, the national municipal revenue accounts in 1981 presented the following values:

TR = Total Expenditures = 9.3 billion sucres, discounting the 2.0 billion sucres of available revenues not spent;

OS = 2.3 billion sucres;

B = 3.0 billion sucres;

ENL = 4.0 billion sucres, again discounting the 2.0 billion sucres of available revenues not spent.

Therefore:

e = ENL/TR = 0.43 and
b = B/(OS + ENL) = 0.48

In 1981, the proportion of external non-loan revenues to total revenues was 43 percent, and the proportion of borrowing to the sum of own source and external non-loan revenues was 48 percent. Both figures may be considered high: the first because of the policy assumption that external non-loans will decrease over the projection period; the second because of limited municipal debt capacity, particularly with the perspective of decreasing external non-loan revenues. Therefore, for our simulations the following values for e and b are established:

e = 0.43; 0.30; 0.20; 0.10; 0.00; and

b = 0.48; 0.40; 0.30; 0.20.

In summary, our 1986 simulations are based on total municipal revenues (equals total municipal expenditures) of 9.3 billion sucres at 1981 prices; the proportion of external non-loan revenues to total revenues varying between 0.43 and 0.00; and the proportion of borrowing to the sum of municipal own sources and external non-loan revenues varying between 0.48 and 0.20. From Equations (1) to (3) above, it may be noted that with TR fixed, assigning simulated values to e and b makes it possible to solve for all the other variables in the equations.

2.2. Simulation Results

Table 2.1 presents the results of the simulation, with 20 combinations of municipal borrowing rates, b, and the rate of external non-loan transfers, e. In this table, the focus is on the municipal own source revenues necessary to respond to the diferent cvombinations of the tro rates, in order to maintain the assumed municipal service level represented by 9.3 billion sucres.

The first column of Table 2.1 presents the different values of the borrowing rate. In the second column, the five alternative transfer rates are presented for each of the four borrowing rates. The own source impact of departing from the 1981 situation (first row of the table) is presented in the third column. For example, if the transfer rate decreases from 0.43 to 0.2, with the 1981 borrowing rate remaining unchanged at 0.48, the own source revenues must increase from 2.3 to 4.4 billion sucres, an increase of 91 percent. With borrowing and transfer rates each equal to 0.2, 5.9 billion sucres in own source funds will be necessary to maintain 1981 service levels. Finally, if transfers are eliminated, own source revenues must rise to 6.2 billion sucres if the borrowing rate remains at 0.48, and to 7.8 billion sucres if the borrowing rate falls to 0.2.

TABLE 2.1
Simulation of Municipal Own Source Revenue Needs Given Different Rates of Borrowing and External Non-Loan Transfers

Borrowing Rate (b)	Transfer Rate (e)	Own Source Revenues Billions of Sucres
.48	.43	2.3
.48	.30	3.5
.48	.20	4.4
.48	.10	5.4
.48	.00	6.2
.40	.43	2.6
.40	.30	3.8
.40	.20	4.8
.40	.10	5.7
.40	.00	6.6
.30	.43	3.2
.30	.30	4.4
.30	.20	5.3
.30	.10	6.2
.30	.00	7.2
.20	.43	3.8
.20	.30	5.0
.20	.20	5.9
.20	.10	6.8
.20	.00	7.8

2.3 Municipal Financial Management Implications

In Table 2.2, the simulation results of Table 2.1 are presented in descending order of external non-loan transfers. Note that the sum of the three revenue sources must equal 9.3 billion sucres. When there are equal values of transfers, this demonstrates the trade-offs available to municipalities between increasing debt and increasing own source revenues.

The first row of Table 2.2 presents the 1981 profile of municipal revenues. Moving down the transfer column demonstrates the high sensitivity of own source and borrowing revenues to this external revenue. If transfers decrease from 4.0 to 3.9 billion sucres with a borrowing level of 1.6 billion, then own source revenues must increase to 3.8 billion sucres, an increase of 65 percent over the 1981 amount.

If the 1981 borrowing amount of 3.0 billion sucres remains constant, then the simulation shows four combinations of transfer and own source revenues, as presented in Table 2.3.

In summary, municipalities will face difficult trade-offs if external non-loan transfers decrease as expected. If, for example, the 1981 rate of borrowing is maintained, municipalities will need to increase their own source revenues by approximately 50 percent if the proportion of total revenues supplied by external non-loan transfers drops to 0.30. This implies that the debt capacity of municipalities will have to be much more carefully managed than in the past.

TABLE 2.2
Simulations of Borrowing and Municipal Own Source Revenue Requirements for Different Levels of External Non-Loan Transfers
Billions of 1981 Sucres

External Non-Loan Transfers	Borrowing	Own Source
4.0	3.0	2.3
4.0	2.7	2.6
3.9	2.2	3.2
3.9	1.6	3.8
3.7	2.2	4.4
2.8	3.0	3.5
2.7	1.6	5.0
2.7	2.7	3.9
1.9	3.0	4.4
1.8	2.7	4.8
1.8	2.2	5.3
1.8	1.6	5.9
0.9	2.7	5.7
0.9	2.2	6.2
0.9	1.6	6.8
0.9	3,0	5.4
0.1	3.0	6.2
0.0	2.7	6.6
0.0	2.1	7.2
0.0	1.6	7.8

TABLE 3.3
Trade-Offs Between External Non-Loan Transfers and Own Source Revenues, Given a Level of Borrowing
Billions of 1981 Sucres

Borrowing	Transfers	Own Source	Percent Increase in Own Source from 1981
3.0	2.8	3.5	52
3.0	1.9	4.4	91
3.0	0.9	5.4	134
3.0	0.1	6.2	170

COUNTRY CHECKLIST

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FAA Sec. 481. Has it been determined that the Government of the recipient country has failed to take adequate steps to prevent narcotic drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully?	It has not been so determined. The GOE has an active narcotics program with USG support.
2. FAA Sec. 620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) the debt is not denied or contested by such government?	No such case is known.
3. FAA Sec. 620(e)(1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?	No.

4.	FAA Sec. 532(c), 620(a), 620(f), 620D; FY 1982 Appropriation Act Secs. 512 and 513. Is recipient country a communist country? Will assistance be provided to Angola, Cambodia, Cuba, Laos, Vietnam, Syria, Libya, Iraq, or South Yemen? Will assistance be provided to Afghanistan or Mozambique without a waiver?	No.
5.	ISDCA of 1981 Secs. 724, 727, 728 and 730. For specific restrictions on assistance to Nicaragua, see Sec. 724 of the ISDCA of 1981. For specific restrictions on assistance to El Salvador, see Secs. 727, 728 and 730 of the ISDCA of 1981.	N/A
6.	FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action of U.S. property?	No.
7.	FAA Sec. 620(l). Has the country failed to enter into an agreement with OPIC?	Yes.
8.	FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters?	In accordance with the Administrator's taking into consideration memo dated January 31, 1983 there have been no such seizures by Ecuador.
	(b) If so, has any deduction required by the Fishermen's Protective Act been made?	No.

9. FAA Sec. 620(q); FY 1982 Appropriation Act Sec. 517. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any AID loan to the country?	No.
(b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the appropriation bill appropriates funds?	No.
10. FAA Sec. 620(s). If contemplated assistance is development loan or from Economic Support Fund, has the Administrator taken into account the amount of foreign exchange or other resources which the country has spent on military equipment? (Reference may be made to the annual "Taking into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)	Yes. In accordance with the Administrator's taking into consideration memo dated January 31, 1983, these factors have been taken into account.
11. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?	No.

12. FAA Sec. 620(u). What is the payment status of the country's obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget? (Reference may be made to the Taking into Consideration memo.)	Payment status is current.
13. FAA Sec. 620A; FY 1982 Appropriation Act Sec 520. Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism? Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed a war crime?	No.
14. FAA Sec. 666. Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?	No.
15. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards? Has transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device, after August 3, 1977? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.)	No.

16. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Session of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the Taking into Consideration memo.)	Yes. Yes. In accordance with the Administrator's taking into consideration memo dated January 31, 1983 these factors have been taken into account.
17. ISDCA of 1981 Sec. 721. See special requirements for assistance to Haiti.	N/A.
18. Further Continuing Appropriations Act, 1983, Sec. 133. Notwithstanding any other provision of this joint resolution, none of the funds appropriated under Section 101(B) of this joint resolution may be available for any country during any 3-month period beginning the certification of the President of the Congress that such country is not taking adequate steps to cooperate with the United States to prevent narcotic drugs and other controlled substances (as listed in the schedules in Section 202 of the Comprehensive Drug Abuse and Prevention Control Act of 1971, 21 U.S.C. (812) which are produced, processed, or transported in such country from entering the United States unlawfully.	The President has not issued such a certification for Ecuador.

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria.

a. FAA Sec. 116. Has the Department of State determined that his government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?	The Department of State has not determined that Ecuador is a violator of human rights.

2. Economic Support Fund Country Criteria.

a. FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest?	N/A.
b. ISDCA of 1981, Sec. 725(b). If ESF is to be furnished to Argentina, has the President certified that (1) the Govt. of Argentina has made significant progress in human rights; and (2) that the provision of such assistance is in the national interests of the U.S.?	N/A.

c. ISDCA of 1981, Sec. 726(b). If ESF assistance is to be furnished to Chile, has the President certified that (1) the Govt. of Chile has made significant progress in human rights; (b) it is in the national interest of the U.S.; and (3) the Govt. of Chile is not aiding international terrorism and has taken steps to bring to justice those indicted in connection with the murder of Orlando Letelier?	N/A.

PROJECT CHECKLIST

A. GENERAL CRITERIA FOR PROJECT

1. FY 1982 Appropriation Act Sec. 523; FAA Sec. 634A; Sec. 653(b).

   (a) Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project; (b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than $1 million over that amount)?

   a. The Project was described on a Planned Project Summary Sheet in the FY 1984 Congressional Presentation. Formal notification will occur through an Activity Data Sheet; obligation of funding is contingent upon Congressional concurrence.

   b. Yes.

2. FAA Sec. 611(a)(1). Prior to obligation in excess of $100,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonable firm estimate of the cost to the U.S. of the assistance?

   a. A financial plan is included in the PP.

   b. Reasonably firm estimates of costs are presented in the PP.

3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   No such action is required.

4. FAA Sec. 611(b); FY 1982 Appropriation Act Sec. 501. If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973?

   N/A.

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?	N/A.
6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.	No. The project is designed to address Ecuador's fiscal situation based on detailed analyses of specific institutional constraints in the Ministry of Finance and Municipalities.
7. FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.	The project purpose is not directed to any of these areas.
8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).	The project could indirectly encourage U.S. private investment in Ecuador by improving internal revenue generation and thereby reducing the need to contract external debt to finance public sector deficits. A reduced extend debt would, in turn, provide greater incentives to foreign investment. Also, the project will finance technical services provided by private U.S. consultants.

9. FAA Sec. 612(b), 636(h); FY 1982 Appropriation Act Sec. 507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.	Host country contributions, including in-kind support, are estimated at 32 percent of total project costs.
10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	No.
11. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?	Yes.
12. FY 1982 Appropriation Act. Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?	N/A.
13. FAA 118(c) and (d). Does the project comply with the environmental procedures set forth in AID Regulation 16? Does the project or program take into consideration the problem of the destruction of tropical forests?	Yes. An Initial Environmental Examination was performed as part of the PID. The IAC Environmental officer issued a negative threshold decision.

14. FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)?

N/A.

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FAA Sec. 102(b), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

(a) The project will help spread benefits to the poor on a wide, sustained basis by developing mechanisms for strengthening the financial capacity of secondary municipalities. This capacity will support the decentralization of investments to areas which have traditionally been largely isolated from the development process in Ecuador. Municipalities will also be in a stronger financial position to pay the recurring costs associated with these investments and thus ensure that the benefits are sustained.
(b) By strengthening municipal revenue generation capacity, the project will contribute toward stronger, more autonomous local government in Ecuador.
(c) The project is designed to increase the capacity of Ecuadorean government to mobilize domestic resources, an essential condition for self-help developments.
(d) A project of this nature cannot be targeted at women or any social group in particular. It is assumed that the increased revenues will be used for priority investments and the support of important development programs which do benefit women.
(e) Through short term training activities and technical assistance, the project will promote the interchange of ideas and knowledge regarding tax administration and municipal development in Latin America.

19

b. FAA Sec. 103, 103A, 104, 105, 106. Does the project fit the criteria for the type of funds (functional account) being used?	Yes. Consistent with Sec. 105, the project is intended to strengthen public administration in Ecuador, specifically in the area of revenue generation and fiscal management. Particularly at the local level, the project will improve the capacity of government organizations to finance and administer development programs that will more effectively involve the poor.
c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?	Although the project does not involve productive technologies, it does seek to promote the use of simple, low cost methods for improving revenue administration. These methods are appropriate to the legal, organizational, and human resource context of revenue generation in Ecuador.
d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the cost of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?	Yes.
e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"? (M.O. 1232.1 defined a capital project as "the construction", expansion, equipping or alteration of a physical facility or facilities financed by AID dollar assistance of not less than $100,000, including related advisory, managerial and training services, and not undertaken as part of a project of a predominantly technical assistance character.	No.

f. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?	Yes. The project will contribute to the mobilization of domestic resources which will support the development of the country's physical and human infrastructure which, in turn, is necessary for sustained economic growth.
g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intelectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.	The project responds to the serious fiscal needs of Ecuador and seeks to provide solutions which are consistent with the capacities of the public sector implementing organizations. The project will provide technical assistance and training to develop institutional capacity of central and municipal levels of government. At the municipal level, in particular, the project will demonstrate mechanisms for increasing financial autonomy and thus promote more active, responsive local government.
2. Development Assistance Project Criteria (Loans Only)	
a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan, at a reasonable rate of interest.	N/A.
b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan?	N/A.
c. ISDCA of 1981, Sec. 724(c) and (d). If for Nicaragua, does the loan agreement require that the funds be used to the maximum extent possible for the private sector? Does the project provide for monitoring under FAA Sec. 624(g)?	N/A.

3. Project Criteria Solely for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic or political stability? To the extent possible, does it reflect the policy directions of FAA Section 102?	N/A.
b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities?	N/A.
c. FAA Sec. 534. Will ESF funds be used to finance the construction of the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such use of funds is indispensable to nonproliferation objectives?	N/A.
d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?	N/A.

STANDARD ITEM LIST

A. Procurement

1. FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?	It is expected that technical services will be provided by U.S. individuals and/or small firms. Commodities will be procured in accordance with AID procedure which encourage small business participation.
2. FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or under delegation from him?	Yes.
3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?	Ecuador does not discriminate against U.S. marine insurance companies.
4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If off-shore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not resonably be procured in U.S.)	N/A.
5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of countries otherwise elegible under Code 941, but which have attained a competitive capability in international markets in one of these areas?	No.

92

6. FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at lest 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent that such vessels are available at fair and reasonable rates.?	No.
7. FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?	It is expected that a large share of the U.S. technical services financed under the project will be provided by U.S. private individuals and/or small firms. To the extent possible, however, the project will make use of tax administration advisors from the U.S. Internal Revenue Service which is particularly suited to the needs of this project. The IRS maintains a special international technical assistance unit apart from its domestic operations which provides training and other services not competitive with private enterprises.
8. International Air Transport. Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?	Yes, the Project Agreement will so state.
9. FY 1982 Appropriation Act Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?	Yes, direct contracts entered into by A.I.D. under this project will contain such a provision.

B. Construction

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services to be used? — N/A.

2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? — N/A.

3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million? — N/A.

C. Other Restrictions

1. FAA Sec. 122(b). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? — N/A.

2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an intenational organization, does Comptroller General have audit rights? — N/A.

3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? — Yes.

4. Will arrangements preclude use of financing: — Yes, for all items.

25

a. FAA Sec. 104(f); FY 1982 Appropriation Act. Sec. 525: (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion?

b. FAA Sec. 620(g). To compensate owners for expropriated nationalized property?

c. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?

d. FAA Sec. 662. For CIA activities?

e. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?

f. FY 1982 Appropriation Act, Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for military personnel?

g. FY 1982 Appropriation Act, Sec. 505. To pay U.N. assessments arrearages or dues?

h. FY 1982 Appropriation Act, Sec. 506. To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)?

i. FY 1982 Appropriation Act, Sec. 510. To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields?

j. FY 1982 Appropriation Act, Sec. 511. Will assistance be provided for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights.?

k. FY 1982 Appropriation Act, Sec. 515. To be used for publicity or propaganda purposes within U.S. not authorized by Congress?