PD-ABB-291 68445

V-1 - A.I.D. EVALUATION SUMMARY PART I

(BEFORE FILLING OUT THIS FORM, READ THE ATTACHED INSTRUCTIONS)

IDENTIFICATION DATA

A. REPORTING A.I.D. UNIT: USAID/Ecuador (Mission or AID/W Office) (ES# PES-EC-008)

B. WAS EVALUATION SCHEDULED IN CURRENT FY ANNUAL EVALUATION PLAN? yes ☐ slipped ☒ ad hoc ☐
Eval. Plan Submission Date: FY 89 Q 4

C. EVALUATION TIMING
interim ☐ final ☒ ex post ☐ other ☐

D. ACTIVITY OR ACTIVITIES EVALUATED (List the following information for project(s) or program(s) evaluated; if not applicable, list title and date of the evaluation report)

Project #	Project/Program Title (or title & date of evaluation report)	First PROAG or equivalent (FY)	Most recent PACD (mo/yr)	Planned LOP Cost ('000)	Amount Obligated to Date ('000)
518-0042	Fiscal Administration Development Project	1985	3/90	7,050	7,050

ACTIONS

E. ACTION DECISIONS APPROVED BY MISSION OR AID/W OFFICE DIRECTOR

Action(s) Required	Name of officer responsible for Action	Date Action to be Completed
I. Review IDB agreement to determine overlap with what MOF wants AID to do.	EOrtiz	Oct. 1989
II. Receive MOF proposal for project amendment.	EOrtiz	Nov. 1988
III. Decide on PACD extension on basis of MOF proposal.	Mission	Dec. 1989
IV. Complete economic analysis of new tax law.	EOrtiz/BArellano	Dec. 1989
V. If positive, prepare PPS and hold Mission review of PPS. Sign Project Agreement Amendment.	EOrtiz/SMeyer	Dec. 1989

F. Evaluation/Audit Report Actions

A final project evaluation was conducted on August 1989. Its major findings and recommendations include:

(Attach extra sheet if necessary)

APPROVALS

F. DATE OF MISSION OR AID/W OFFICE REVIEW OF EVALUATION: mo 08 day 20 yr 89

G. APPROVALS OF EVALUATION SUMMARY AND ACTION DECISIONS:

	Project/Program Officer	Representative of Borrower/Grantee	Evaluation Officer	Mission or AID/W Office Director
Signature				
Typed Name	Eduardo Ortiz	Juan Acosta	Guido Páez	Charles E. Costello
Date:	8/15/90			5/2/1?

Clearance: Dereck Singer ____ Patricio Maldonado ____

ABSTRACT

H. EVALUATION ABSTRACT (do not exceed the space provided)

The Project goal is to strengthen the Government of Ecuador's (GOE's) capacity to finance equitable development on a sustained basis. The project purpose is to increase Central Government fiscal revenues and to strengthen the fiscal revenue administration capacity of the Central Government.

The objective of this evaluation was to measure achievement of the major project objective, to assess how the project fits in the context of the current GOE fiscal strategy and overall Mission strategy and to identify areas of potential Mission support if the project is to be continued, at no additional cost, beyond the new PACD of December 31, 1989.

3. Findings and Conclusions:

1. The tax administration reform (Law 006 - 12/88) does not negate any of the major elements of the DGR reorganization plan.
2. Overall, the reform is remarkably on the right track in both areas of policy and tax administration.
3. Before committing itself to further funding, USAID should examine carefully administrative aspects of the new reform, emphasizing cost effectiveness and long-term commitment on the part of the GOE.
4. It is evident that the GOE has a continuing need for outside consultants and will be receptive to offers of such from USAID.
5. The administrative changes which are being implemented as a result of Law 006, reduce the importance of the area offices as collection centers and will require a rethinking of the computerization system.
6. New legislation to go into effect in 1990 will further refine some operating aspects of the tax reform changes.
7. Progress to date on mechanization has been "uncertain".

Recommendations:

1. There is a need to rethink the focus of the project and to concentrate on specific areas which are crucial to the success of current tax reforms.
2. The ongoing tax reform in Ecuador is deserving of all the help the Mission can provide.
3. The Mission should ask the Minister of Finance to provide a new proposal which details how the Fiscal Administration project can be integrated in a supportive role of the tax reform effort initiated in December 1988.
4. USAID should work with the MOF to establish priorities for its assistance to the DGR aimed at focusing primarily on making the new reform effective.
5. The evaluators recommend the earliest possible involvement of the Departamento de Programación y Control in conjunction with a senior-level systems analyst in planning for changes in tax administration.

COSTS

I. EVALUATION COSTS

1. Evaluation Team

Name	Affiliation	Contract Number OR TDY Person Days	Contract Cost OR TDY Cost (US$)	Source of Funds
Patrick F Morris Jorge Martínez David Greytak Bernabé Monsalvo	Development Associates Inc.	PDC-5317-I-00-8127-00	$54,290.=	Grant Project Funds

2. Mission/Office Professional Staff Person-Days (estimate) 30 days 1 person full time

3. Borrower/Grantee Professional Staff Person-Days (estimate) 77 day 4 people-full tim

A.I.D. EVALUATION SUMMARY PART II

J. SUMMARY OF EVALUATION FINDINGS, CONCLUSIONS AND RECOMMENDATIONS (Try not to exceed the 3 pages provided)
Address the following items:

- Purpose of activity(ies) evaluated
- Purpose of evaluation and Methodology used
- Findings and conclusions (relate to questions)
- Principal recommendations
- Lessons learned

Mission or Office: USAID/Ecuador   Date this summary prepared: 08-07-90

Title and Date of Full Evaluation Report: Evaluation on Fiscal Administration Development Project 08/89.

1. Purpose of the Project:
To increase central government fiscal revenues, especially from income and sales taxes. The sub-purpose of the project is to strenghthen the institutional structure within the General Directorate of Revenues (DGR) of the Ministry of Finance (MOF) for the purpose of improving revenue administration. This is to be accomplished through two project components: improved revenue administration and organizational improvements.

2. Purpose of the Evaluation and Methodology Used:
The primary sources of information for the final evaluation were interviews and documents. One of the advantages the team had was that two of th team members hade done the mid-term evaluation on this project and a third member had worked on a preliminary study related to the project. Assignments were made to team members to address the specific issues raised in the Scope of Work. Documents were collected and the evaluation report was developed and circulated for comments and clearance. Some meetings were held with the USAID Director and staff to indicate the report's direction.

3. Findings and Conclusions:
1. The tax administration reform (Law 006 - 12/88) and those which are to be proposed for 1990 do not negate any of the major elements of the DGR reorganization plan.
2. There are problems confronting both the implementing of tax reform and the reorganization of the DGR as a professional internal revenue service.
3. The "old" programs procedures and organizational relationships introduced under this project are still in incipient stages of institutionalization and the "new" programs of integrated personnel system, manuals and regulations have not been introduced at the operating level yet.
4. The space necessary to accommodate DGR reorganization "is said" to be available. Reorganizati-- is in its initial phase and needs to continue.
5. Project funded training had a positive impact on current performance of the DGR staff in the collections area and maybe in computer operations/programming.
6. The administrative changes which are being implemented as a result of Law 006, reduce the importance of the area offices as collection centers and will require a rethinking of the computerization system. The reorganization of DGR is as relevant today as it was four of five years ago.
7. With the exception of collections, the project has made no progress with the plans developed four years ago.
8. The brief overview of the extent and nature of the tax policy reforms contemplated by the GOE, clearly shows that the reform is both deep and generally well thought out. However, the speed of the process has sacrified adequate background research on the impact of the proposed changes in revenue yields, distribution of tax burdens, and economic efficiently.
9. Overall, the reform is remarkably on the right track in both areas of policy and tax administration. Comparing the proposed tax reforms against the list of desirable goals of any tax system, the evaluators conclude that the new taxes will generally represent a significant improvement over existing taxes and they will also be, generally, easier to administer.

b'

10 .Higher level MOF officials recognize the need for USAID assistance and it appears that they would welcome it. It is evident that the GOE has a continuing need for outside consultants and will be receptive tooffers of such from USAID. If there appears to have been some reluctance in this regard during the past months, it can be attributed, in part, to the lack of confidence the MOF has had in the DGR and the project contractor OMNIMAX.
11. The current project has the potential to play an important role in the present tax reform effort. However, before committing itself to further funding, USAID should examine carefully administrative aspects of the new reform, emphasizing, cost effectiveness and long-term commitment on the part of the GOE.
12. USAID will have to further analyze how it wants to invest its limited resources in this venture, establishing priorities in order to obtain optimum results.
13. Progress to date on mechanization has been "uncertain'
14. It is very difficult to evaluate <u>real</u> GDR management capabilities in such a short time. The evaluators impression is that, under the guidance of a competent senior-level system analyst, management and personnel could be brought together to work synergistically to get out of a fire-fighting mode.
15. With regards to the system documentation, this is almost non-existant as no "feasibility study" or design reviews were held. Test documentation and methodology used was not available.
16. A central filing system for media and documents is a must. The programming department needs to be more functional in lighting, space, furniture and quiet.
17. The hardware and the software are appropriate for the applications presently in use to the requirements of the tax reform. Some backup equipment would be advisable.
18. The NCR Tower Hardwaare is more than adequate to process a growing work load during a normal 8-hour shift. The possibility of a second 8-hour shift is always open, but at this time is not required. The physical electrical and environmental installation seems adequate at both sites.
19. Without any kind of in-depth testing of personnel, it is very hard to determine capabilities (levels and abilities) of the programmers. Software purchased is being utilized fully, therefore the inference is that the level of understanding is high. However, no technical library exists for consultation of detailed topics. English proficiency should be required at least at the technical reading level of programmers, system engineers and analysts both to be more productive at work and to qualify for further training in the U.S. as part of the project.
20. Applications need to be reviewed to decide whether computer hardware in all regional and area offices should be installed or not. It should be considered that applications that were started añnd later stopped will need to be re-evaluated under the light of the tax reforms and the reorganization of the DGR, for possible development of rejection. The "Sales Tax Processing System" needs to be put on line as soon as all applicable software is updated and tested
21. New legislation to go into effect in 1990 will further refine some operating aspects of the tax reform changes. Computer systems existing today are expected to keep pace if early notice is given to the system departments.

4. <u>Recommendations</u>:
   1. The role of the area offices as collection agents should decline with the full implementation of reform. Emphasis at this level should refocused on the other important functions they are charged with.
   2. The DGR and MOF policy group should come to agreement of the definition of responsibilities. Particularly imprtant areas are control of the largest taxpayers, tax collection by Jefaturas and financial and logistical support of DGR operation most particularly field operations. Technical assistance in the establishment of the "Estimation Objetive Global" is required and its data processing needs to be designed. The long range goals and objectives of the DGR should be set out so that current audit and data processing activities can be prioritized.
   3. The DGR should be encouraged to continue with its reorganization plan and its integrated personnel system pilot project. It needs to develop a plan for its audit and control activities as part of an integrated system. It needs the input of an outside advisor to describe the

operations of a modern internal revenue service and to assist in the developing of a prioritization of activities.

4. Future training plans should be closely related to on-going project progress and specific requirements of existing project needs.
5. With the exception of collections, the project has failed to make any rpogress with the plans developed four years ago. Consequently, there is a need to rethink the focus of the project, and the strategy should be to concentrate on specific areas which will prove crucial to the success of current tax reforms.
6. The ongoing tax reform in Ecuador is deserving of all the help the Mission can provide. USAID missions in many countries, specially in Latin America spend years to get to the point where the GOE is at the present time. The Mission should take advantage of this opportunity and jump on the band-wagon.
7. Rather than waiting to see if the present reform measures fall short, USAID should encourage the MOF to submit a proposal which identifies the nature and type of technical expertise required.
8. The Mission should ask the Minister of Finance to provide a new proposal (of a modification paper) which details how the Fiscal Administration project can be integrated in a supportive role of the tax reform effort initiated in December 1988 and still in progress. All parties involved, Minister Gallardo, his advisor Sandoval, the Subsecretary Acosta, and the Omnimax team, seem to have agreed to the value of such a proposal. It is important that the proposal paper originate in the office of the Minister so as to avoid the continuation of parallel tracks by the Minister's advisor and the Subsecretary of Rentas.
9. USAID should work with the MOF to establish priorities for its assistance to the DGR aimed at focusing primarily of making the new reform effective.
10. Hire a Senior System Analyst to create the Functional System Specifications. It is also important to monitor the reorganization process to streamline functions and assign resources to functions already defined.
11. Provide qualified, Spanish-speaking instructors to cover topics as data base selection; trade-off and capabilities of various Unix or Xenix available packages; advanced system analysis topics; how to choose computer equipment, capacities, configurations, options, peripherals, availability of manufacturers in Ecuador; system documentation techniques; coding, design and testing of applications.
12. DGR needs a new building with ample space to allocate individual partitioned workstations to each programmer, system analyst or engineer. A central library area for documents, spedifications, media, system manuals, operator's handbooks and trade magazines should be provided.
13. Study the possibility of acquiring a low-speed laser printer and one or two "Ribbon Re-inking Machines" with appropriate adaptors for the Word Processors along with adequate number of toner cassettes in order to insure print quality. Also, serious considerations should be given to another NCR Tower System to be used for software development. It is imperative to have an inventory of the existing equipment.
14. Plan now to add a "Programming, Testing and Debugging" system soon so that a production systems is not subject to the extraneous influences.
15. Independent testing of technical topics of the people involved cap perhaps be done as a pre-requisite to further training. In line with this, qualified Spanish-speaking instructors should address data base selection, advanced system snalysis and the establishment of a technical library in order to upgrade the Department skill set.
16. As the new law seeks not to create new taxes but to increase the collection of existing taxes the processing of taxes must keep pace with the objectives of the new law. The evaluators recommend the earliest possible involvement of the Departamento the Programación y Control in conjunction with a senior-level systems analyst in planning for changes in tax administration..

5 Lessons Learned:

When a project loses or appears to lose the high-level support which it had when it was initiated, the USAID should undertake a major review to decide whether the project should proceed or be cancelled. Temporizing too often leads to unproductive wheel spinning and ultimate waste.

SUMMARY (continued)

ATTACHMENTS

K. ATTACHMENTS (List attachments submitted with this Evaluation Summary; always attach copy of full evaluation report, even if one was submitted earlier)

- Final Evaluation Report (Fiscal Administration Development Project)
- Letter of Omnimax with comments on the final evaluation report.
- MOF proposal for extending project PACD.

MISSION COMMENTS ON FULL REPORT

L. COMMENTS BY MISSION, AID/W OFFICE AND BORROWER/GRANTEE

USAID.- The Mission considered that the final evaluation recommendations were crucial for the extension of the project.

The fiscal evaluation findings showed the need of a project amendment based on the new tax reform undertaken by GOE.

The Ministry of Finance has agreed that the present project (as it was originally designed) should be closed out, and that it should be amended to focus on the new tax reform measures. Within this context, the GOE will present a proposal for new project activities beyond the current PACD. Such activities would be financed with funds still available from the present project.

XD-ABB-841-A
68446

FINAL REPORT

on the

"FISCAL ADMINISTRATION DEVELOPMENT PROJECT"

Contract No. PDC-5317-I-00-8127-00
Work Order No. 9

Submitted To:

USAID/ECUADOR

By:

DEVELOPMENT ASSOCIATES, INC.
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Arlington, Virginia 22204

DEVELOPMENT ALTERNATIVES, INC.
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Washington, D.C. 20001

August 1989

TABLE OF CONTENTS

TABLE OF CONTENTS (Cont.)

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GLOSSARY

FREQUENTLY USED TERMS AND ABBREVIATIONS

MOF:	Ministry of Finance
Sub-Secretary de Rentas:	Under Secretary of Internal Revenues, MOF
DGR:	Directory General of Revenue
Renta:	Income Tax
Transacciones Mercantiles:	Sales Tax
RUC:	Master Register of Taxpayers
DOS:	Direccion Organizacion y Sistemas, Office of Organization and Systems (has mainframe computer)
Codigo Tributario:	Tax Code and Regulations
Titulos de Credito	Notice of Amount of Tax Owed
Agentes Tributarios:	Professional Collection Corps (Collection Agents)
Retenciones:	Withholdings
Retenciones en la Fuente:	Withholdings
IESS:	Ecuadorian Institute of Social Security
IDB:	Inter-American Development Bank
IBRD:	World Bank
ILDIS:	Instituto Latino Americano de Investigaciones Sociales (Latin American Institute of Social Research)
PP:	Project Paper
Regional Delegations:	Regional Offices
Jefaturas:	Area Offices
Estimacion Objectivas Global:	Estimation of Income by Trade of Profession
Informacion Cruzada:	Cross Referencing Information

INTRODUCTION

:cause of the history of this project, the USAID decided to go beyond the usual ıd-of-project format in formulating the Scope of Work for this evaluation. It not ıly asked for the usual end-of-project logical framework analysis, but posed an :tensive and comprehensive list of issues and questions about the present and ıture consequences of extending or not the project beyond its termination date.

ıis had two major consequences in terms of the way the evaluators organized their ›rk and the format and content of this final report. In order to be responsive to ıe Scope of Work throughout, within the limited time provided for the evaluation, : was decided that (1) the logical framework analysis would have to be of a ımmary nature recording project status rather than providing the extensive and ıalytical treatment that was given to this same project in the mid-term valuation, and that (2) the evaluation be as responsive as possible to the ndividual issues and questions raised in the Scope of Work. It is the responses o the questions in the Scope of Work that contains the analytical discussion which ormally would have been included in the logical framework analysis.

hus, this report is divided into two parts, (1) logical framework analysis summary nd (2) major issues section. The format for each is different, Part One esponding to the log frame requirements, Part Two providing specific answers to he questions raised.

'hose who read the report from cover to cover will find that there is a certain ımount of repetition as one moves from one issue to another. This was inevitable ›ecause many of the issues and questions raised in the Scope of Work addressed the ;ame problem from different angles and because most of the problems addressed are .nter-related. In addition, some of the questions raised covered the same ground ıs the log-frame summary.

Ve could have resolved this problem, to some extent, by referring back and forth, ›etween sections of the report, but the overlap between issues was so extensive that our discussion of individual issues would have been fractured and fragmented and would not have been fully responsive to the individual issues as they were raised in the Scope of Work. We therefore opted to address each issue fully even though this meant that the report as a whole might be viewed as repetitious.

The final result is that many of the issues can be treated almost as separate independent sections. This has certain advantages, since the report can be divided up and the sections will be self-contained. The major disadvantage is that as a whole the report is much less concise and focused than it would have been had we done a straight-forward, end-of-project log-frame evaluation.

Patrick Morris, Team Leader
Jorge Martinez
David Greytak
Bernabe Monsalvo

EXECUTIVE SUMMARY

The time frame of this project coincided generally with the four-year term of the government which came to power in August 1984. It was negotiated with the new government and began in August 1985. While the project was under a number of serious constraints, since it did not contemplate changes in the tax law, which had serious deficiencies, it was, nevertheless, a well-conceived, comprehensive and well-planned, if overly-ambitious, tax administration reform initiative. It appeared to have the full support of the Minister of Finance (MOF) and the Government of Ecuador (GOE). The background and qualifications of the contractor, OMNIMAX, appeared to be ideal to provide technical assistance to assist the GOE in transforming the Directory General of Revenue (DGR) into a modern tax administration agency.

Within eight months, however, the project ran into a serious problem of wavering MOF support which was to plague it throughout the four-year period of the Febres Cordero administration. The reorganization of the Direccion General de Rentas, which was central to the project, was held up for one year before finally being approved by the MOF, which put project implementation a year behind schedule.

When that problem was resolved, the GOE refused to provide duty-free customs clearance for equipment brought in under the project so that the other central project-element — computerization of tax collections, control and follow-up — was delayed indefinitely. Although both the USAID and the Contractor worked diligently to obtain a satisfactory resolution to this problem, it persisted until the change of government in August 1988.

In spite of these problems, the contractor provided technical assistance and tried to achieve at least some of the project goals and objectives. The DGR, working with the contractor, achieved some success in improving the collections system and in taking the first steps to separate policy from operational functions and to decentralize the system. However, it did not achieve most of the project goals set for it. The greatest failures were in auditing and in systems and processing. This was due to internal resistance to change within the DGR itself, lack of leadership and competence at the sub-director level of DGR, deficient technical assistance from the contractor and waning commitment for the project on the part of the MOF.

The new government, which came in August 1988, was committed to fundamental tax reform and began to take action immediately upon assuming office. It not only promulgated a new tax law and initiated a lightening-like program of procedural changes, it also addressed some of the project's long-standing problems. Within six weeks it administratively resolved the duty-free customs clearance for project equipment and promptly honored a project obligation to put 20 collection agents on the DGR payroll who were being temporarily carried with project funds. Later, in May 1989, the law was changed to accommodate duty-free entry of project equipment.

The team found that the new tax law 006 and the pending legislation for fundamental tax reform are sound and forward-looking, that the new tax laws will represent a significant improvement over the previous law, and they will be easier to administer. In general, the reform is on the right track in both areas of policy and tax administration.

However, if these reforms are to succeed there is a need for an efficient and institutionally strong tax administration organization. There is no alternative to the DGR. It must be strengthened and reoriented to make the reform effective. In spite of the very limited progress achieved under the present project, it has moved the DGR in the right direction. Continued USAID assistance to the DGR could be critical in making the new tax reform effective.

If the USAID is interested in continuing to provide assistance in the tax area, it would be advisable to close out the present project and to amend it with a new project design which focuses primarily on the new tax reform measures. While many of the activities going on under the present project are necessary whether there is tax reform or not and could be so justified, it is important to relate future activities to current tax reform, taking into account the role other donors may play and prioritizing the activities in which USAID will assist.

SUMMARY OF RECOMMENDATIONS

Here we present a summary of our recommendations in order to facilitate access by interested parties to the major suggestions of the evaluation team. The section and subsection numbers and headings to be found at the left side of the page refer to the specific sections of the full report in which the matter is discussed. Anyone desiring a fuller treatment of a specific topic can thereby more easily access relevant material.

PART ONE

II. Project Sub-purpose:

"Strengthen the Institutional Basis for Improved Fiscal Revenue Administration by the Central Government."

Recommendation:

In view of the positive steps taken by the GOE since August 1988, and its evident commitment to tax reform and improved tax administration, USAID should give serious consideration to utilizing the funding still available under this project to support the tax reform initiative of the present government. If the tax reform is to succeed, it will need a strong and efficient DGR. USAID assistance in this area could be critical to its success.

The USAID should inform the GOE that the present project agreement expires December 31, 1989, and that in order for USAID to continue providing assistance in tax administration beyond that date, it is necessary that the GOE submit a proposal for assistance which describes the new tax laws which are being put into effect, the administrative requirements of the DGR under the new laws, and the role that USAID and other donors are expected to play. It is understood on the part of the GOE that only those funds originally obligated for this project will be available under a revised project.

PART TWO

I.B. Constraints

"Major On-going problems and constraints to the proper functioning of these changes (i.e., DGR reorganization M.A.s 664, 267 Tax Administration Reforms, Ley 006)."

Recommendation:

The DGR and MOG policy should come to agreement on the definition of responsibilities. Particularly important areas are control of the largest taxpayers, tax collection by Jefaturas and financial and logistical support of DGR operation most particularly field operations. In this regard full implementation of bank collections in place of the Jefaturas should be encouraged. Technical assistance in the establishment of the "Estimacion Objetiva Global" is required and its data processing needs to be designed. The long range goals and objectives of the DGR should be set out so that current audit and data processing activities can be prioritized.

D. Institutionalization of Recent Changes:

"Additional process and procedures required to fully institutionalize recent functional and organizational changes."

Recommendation:

The DGR should be encouraged to continue with its reorganization plan and its integrated personnel system pilot project. It needs to develop a conception of, and plan for its audit and control activities as part of an integrated system. It needs the input of an outside advisor to describe the operations of a modern internal revenue service and to assist in the prioritization of activities.

E. Impact of Training:

"The impact of project-funded training on current performance of DGR staff."

Recommendation:

Future training plans should be closely related to on-going project progress and the specific requirements of existing project needs.

II.A. Nature and Extent of the Tax Reforms:

"The nature and extent of the MOF Tax Reform program, identifying those elements that constitute reforms and those that are merely reordering or simplification of current legislation."

Recommendation:

The ongoing tax reform in Ecuador is deserving of all the help the Mission can provide. The direction of the reform is the desirable one. USAID missions in many countries, especially in Latin America spend years to get to the point where the GOE is at the present time. The Mission should take advantage of this opportunity and jump on the band-wagon.

B. Relevance of the Present Project for the Tax Reform:

"The implications, if any, of the forms for the current project, and the potential role of the project in this changing environment over the short and medium term."

Recommendation:

The Mission should ask the Minister of Finance to provide a new proposal (or a modification paper) which details how the Fiscal Administration project can be integrated in a supportive role of the tax reform effort initiated in December 1988 and still in progress. All parties involved, Minister Gallardo, his advisor Sandoval, the Sub-secretary Acosta, and the Omnimax team, seem to have agreed to the value of such a proposal. It is important that the proposal paper originate in the office of the Minister so as to avoid the continuation of parallel tracks by the Minister's advisor, Mr. Sandoval, and the Sub-secretary of Rentas, Mr. Acosta.

F. Institutional Constraints:

"Major institutional constraints to effective implementation of the fiscal reform package within the DGR, and whether these can be addressed under the project as designed."

Recommendation:

USAID should work with the MOF to establish priorities for its assistance to the DGR aimed at focusing primarily on making the new reform effective.

III.A. Progress to Date:

"Progress to date on mechanization, both at the regional level and as it relates to the collection system through the private banks."

Recommendations:

1) The whole cycle of validation needs to be implemented if the transcription efforts by the banks are to be useful to the DGR. The equipment in place will support this new application.

2) The data collected, i.e., RUC, name and address of the taxpayer, profession, etc. needs to be collected in a central Taxpayer Data Base, perhaps in the mainframe at the DOS. The information collected can be used to determine if a taxpayer using the Cedula has a valid RUC issued or not. The longer time goes by, the more out of date the information collected becomes.

3) As the question has been raised whether the reception of tapes in Guayaquil is a good idea, a decision should be made as to whether the Guayaquil reception center will continue. Once the decision is reached, it is important that resources and personnel be allocated so as to make reception effective.

B. GDR Management Capability:

"Real capability of GDR management and personnel to successfully carry out the processes and procedures necessary for effective mechanization."

Recommendations:

1) Hire a Senior System Analyst with responsibilities to create the Functional System Specifications outlining the whole cycle of data processing until the data becomes information.

2) Monitor the reorganization process to streamline functions and assign resources to the functions already defined.

C. Systems Documentation:

"Effectiveness of systems documentation and designs utilized and training provided in programming and processing."

Recommendations:

1) Provide qualified, Spanish-speaking instructors to cover the following topics:

   a) Data base selection, trade-off and capabilities of various Unix or Xenix available packages such as "Unify," "Oracle," "Foxbase+," "Informix," "Accel" and others.

   b) Advanced System Analysis topics, with emphasis in teleprocessing and transaction based systems.

   c) How to choose computer equipment, capacities, configurations, options, peripherals, availability of manufacturers in Ecuador.

   d) Unix advanced techniques in shell programming, "C+" programming. Performance tuning and available tools.

2) System documentation techniques are also required to be successful in future projects.

3) In future implementation the advisors should not be involved intimately with coding, design and testing of applications. Advisors should "advise" 80% or more of the time and "do" 20% or less of the time.

D. Logistical Support:

"Logistical support provided by GDR, e.g., space, installations, furniture, supplies, etc., for correct use of equipment already purchased."

Recommendations:

1) DGR needs a new building with ample space to allocate individual partitioned workstations to each programmer, system analyst or engineer. A central library area for documents, specifications, media, system manuals, operator's handbooks and trade magazines should be provided.

2) If possible new more functional furniture should be acquired where the desk area has enough room for a couple of open books, a listing and a terminal or monitor. Enough monitor and keyboard extension cables should be purchased so that the CPU's do not occupy all of the desktop.

3) Curtains to shield sunlight or at least subdue it should also be procured.

E. Hardware and Software Utilization:

"Appropriateness and utilization of the hardware and software installed to the requirements of the new tax reform."

Recommendations:

1) Study the possibility of acquiring a low-speed (8 to 10 PPM) laser printer for the Word Processors along with adequate number of toner cassettes in order to insure print quality.

2) As extra applications, i.e., "Sales Tax Processing" or "Titulos de Credito," are added to the NCR Tower System. Serious considerations should be given to another NCR Tower System to be used for software development.

3) An inventory of the existing equipment detailing at the very minimum, location, type, application, operation system type and revision, utilities type and revision, data base type and revision, peripherals installed, printers, disk capacities, etc. To deploy resources effectively.

4) Purchase one or two "Ribbon Re-inking Machines" with appropriate adaptors to reink the ribbons in use at DGR, such as NCR 0101 for the 400 LPM NCR printers, Epson 5000 line printers, Epson FX-1050 and IBM Proprinter XL24. The low cost of these machines will more than pay for themselves in a couple of weeks.

F. Organization Considerations

"Organization considerations such as hours of processing per day, week or month; different applications and shifts, etc.."

Recommendations.

1) Plan now to add a "Programming, testing and debugging" system very soon so that a production systems is not subject to the influence of extraneous code, practices and people.

G. Programmers' Capabilities

"Levels of programmer's understanding of, and ability to utilize software purchased."

Recommendations:

1) Independent testing of technical topics of the people involved can perhaps be done as a pre-requisite to further training. A workbook could be developed for in-home or correspondence training on Unix, Xenix, "Unify," "Informix," etc., by qualified Spanish-speaking instructors.

2) Establish minimum level of knowledge, i.e., a baseline, by position and function. This is better handled as a "Classification of Personnel" project for compensation and staffing purposes.

3) Establish a technical library as soon as budget and space permits to support the computer department.

I. Flexibility of current mechanization

"Degree to which current mechanization is sufficiently flexible to include processes, procedures, and modifications under Tax Reform legislation to go into effect in 1990."

Recommendations:

1) As the new law seeks not to create new taxes but to increase the collection of existing taxes, the processing of taxes must keep pace with the objectives of the new law. So, we recommend the earliest possible involvement of the Departmento de Programacion y Control in conjunction with a senior-level systems analyst in planning for changes in tax administration.

2) Assess what changes might be required to the two functioning systems at DGR: "Cashier System" and "Bank tape processing system." Proceed to develop schedules, tasks and personnel assignment using some sort of Project Management software such as "Timeline" or "Harvard Project Management." PERT Charts would also suffice if employed correctly.

J. Operations, System and Software

Recommendations:

These recommendations may be found in Part Two, Section III, Mechanization Process.

IV. Technical Assistance:

A. Technical Assistance by Project Component:

"Assess the technical assistance provided in each project component."

Recommendations:

1) The reporting system for contractors on project progress should be revised so that the USAID has on-going information on individual technicians' performance and effectiveness.

2) The USAID clearance system for approving contract technicians should be reviewed and possibly tightened. Future contracts should give USAID full authority to monitor on-going performance of individual technicians and to recommend replacements where necessary.

3) It is difficult to obtain top quality technicians under any system, a replacement of the OMNIMAX contract might not yield any better results. Thus, a strict limitation on long-term positions, greater use of local hire talent and a closer screening of all candidates for technical positions might be a wiser course to follow.

B. Constraints to Performance

"Major constraints to effective performance of the Contractor."

Lessons Learned:

1) When a project loses or appears to lose the high-level support which it had when it was initiated, the USAID should undertake a major review to decide whether the project should proceed or be cancelled. Temporizing too often leads to unproductive wheel spinning and ultimate waste.

D. Critical Areas for Technical Assistance Support through December 1989

"Identification of critical areas in which technical assistance is needed through the proposed new PACD (December 1989)."

Recommendations:

1) The USAID should request the DGR and the Contractor to review the 1989 Strategy Statement and came up with a list of priorities aimed specifically at furthering the new tax reform effort. Each activity proposed should be justified on the basis of the new priorities and the tax reform requirements.

2) The USAID should consider bringing in short-term consultants to help the MOF and the DGR prepare a new proposal and for the follow-up work on project design.

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PART ONE

LOG FRAME ANALYSIS

Achievement of Major Objectives

PART ONE

LOG FRAME ANALYSIS

Achievement of Major Project Objectives

I. PROJECT GOAL AND PURPOSE

"Increase Central Government Fiscal Revenues, Especially from Income And Sales Taxes."

Target:

The major indicator for measuring the achievement of this goal was a "net increase in non-petroleum (principally income and sales) tax revenues of S/. 25 billion over the 4 1/2 year life of the project (above and beyond what would have been expected in the absence of the project.)"

Project Achievement as of June 30, 1989

This indicator for measuring project progress has lost whatever relevance it might have had originally because of weaknesses in the original projections and because of confusion or differences of opinion in how the calculations were to be made. This is discussed in detail in the mid-term evaluation, so will not be repeated here. While it is technically possible to manipulate revenue data and calculate the approximate increase in revenues "above and beyond what would have been expected in absence of the project," the time involved in such an operation would not be justified in the context of its diminished value as an indicator of project progress.

Nevertheless, the measurement of increases in tax revenue does continue to have same utility in providing a general framework of project activity. Thus, the January 1989 monthly report of Omnimax International indicates that "the cumulative adjusted net additional revenues at the end of 1988 were S/.35.5 billion or S/. 10 billion over the goal of S/. 25 billion increase projected over the life of the project. This figure was based on Central Bank computations which deflate for current inflation and includes natural growth in the economy and other adjustments in sales tax figures.

Therefore in general terms, without subjecting the figures to formulas which could approximate the increase in revenues "above and beyond what could have been expected in the absence of the project" the quantitative goal of increasing revenues by S/. 25 billion over the life of the project was exceeded by the end of 1988.

The raw figures for revenue collection without adjusting for inflation are as follows:

	Revenue Collection (000 sucres)	% of Increase	% of Inflation
1984	S/. 32,895,279.8		
1985	49,114,589.5	49.3	28
1986	83,346,419.1	69.7	23
1987	109,938,020.6	31.9	29.5
1988	167,600,000.0	52.5	58.2

I. PROJECT SUB-PURPOSE

"Strengthen the Institutional Basis for Improved Fiscal Revenue Administration by the Central Government."

A. Revenue Administration

1. Improved Collection System

Target and Outputs:

- Collections Unit in DGR functioning efficiently to maintain value of delinquent accounts of not more than 10% of annual tax receipts.
- Professional corps of 35 persons established in year 2.
- Thirty-five technicians trained by year 3.
- Improved collection procedure and managerial functions fully instituted by year 5.

Project Achievements as of June 30, 1989

As noted in the mid-term evaluation this has been a particularly successful activity which has had a significant operational impact and has demonstrated the wisdom of separating the audit functions from the collection functions. The original project output target of having 35 collection agents by the end of the second year and have all of them trained by the end of the third year has been exceeded on both counts, with 50 agents having been trained and hired at the time of the mid-term evaluation. Subsequently in 1987, 20 additional agents who had been trained earlier, were hired by the DGR. USAID agreed to fund these positions from the project up to August 31, 1988 at which time they were to be financed by funds from the MOF. In November 1988, the new government honored this commitment, creating 20 new positions and including funds in DGR budget to cover them. Since then 110 additional employees have been transferred from other sections of the DGR to be trained in collections procedures and compliance activity and assigned as agents. Thus, the Collections Unit presently has a corps of 180 collection agents.

The upward trend in the collection of delinquent accounts, noted in the mid-term evaluation and attributed in part to the initiation of the collection agent system, has continued with revenues from this source rising from S/. 815.8 million in 1987 to S/. 1,078.6 million in 1988 and 51.800.1 million for the first five months of 1989. However, these increases have largely been offset by rising inflation.

The target of reducing the total delinquent accounts to not more than 10% was finally achieved in 1988. The downward trend noted in the mid-term evaluation from 18% 1985 to 14% in 1986 continued in 1987 to 12.4%, and in 1988 to 7.12%, thus meeting the target.

Delinquent accounts as % of total collections:

1984 - 18%
1985 - 18%
1986 - 14% (increase in sales tax)
1987 - 12.4%
1988 - 7.12%
1989

This is the single most successful element of this project. It has not only contributed to increased collections, but is recognized as an important institutional reform which has improved GDR's effectiveness. The fact that the number of collection agents has far exceeded the number originally planned is testimony to top management's faith in the usefulness of this unit. Also, it is significant that the number of delinquent accounts decreased steadily from year-to-year and that by December 1988, the target of 10% or less was finally reached.

2. Improved Return Filing Compliance System

Target and Outputs:

Tax filing compliance function is clearly defined within DGR organizational structure and is operating effectively to identify non-filers. The number of global income tax and sales tax filers increased by 50% and 100% respectively, from initiation of project.

- Professional Corps of 35 persons established in year 2.
- Thirty-five technicians trained by year 3.
- New programs and managerial functions fully instituted by year 4.

Project Achievements as of June 30, 1989

As part of the reorganization undertaken in decree 664 of September 1986, the tax-filing compliance function was clearly defined within the DGR organizational structure under the Subdirecciçn General de Control Tributario. The Departamento de Normas y Tecnicas of this Sudireccion had produced four manuals at the time of the mid-term evaluation to define functions and procedures. However, programs to identify non-filers of income tax at that time were judged to be narrow in scope and produced disappointing results.

The September 1987 semi-annual report of the Contractor, OMNIMAX, recognized that although considerable effort had been made to identify non-filers, estimated at about 50%, there was no workable master file to identify delinquents in sales tax and income tax withholding. It promised a full-scale effort to develop a system to identify non-filers even if other goals of this project had to be deferred.

However, in spite of this resolve, progress continued to be slow. The previous government failed to approve the use of the collection manual for delinquent accounts which had been completed earlier and the effort to update the master file was producing no visible results. It was not until the middle of 1988 that a computer program to identify non-filers was developed. Key to this was the control of tax returns received. This was accomplished only in the Guayaquil region. However reciprocal control in Quito headquarters had not been achieved and installation of the procedure in the four other regions was lagging. The DGR and OMNIMAX are now taking steps to reactivate the program focusing it on non-filers and withholding agents under the provisions of the new law 006.

As the project ends, the targets of increasing the number of sales and income tax filers by 50% and 100% were not even close to being realized. Sales tax filings increased by 37.4% in 1987 but decreased to only 7.9% over the base year in 1988. Income tax filing which had increased 5% from 1984 to 1985 were also running behind at only a 2% increase by 1987. Figures for 1988 were not available. It should be noted, however, that the achievement of this target has become confused because of legal dispositions which eliminated the filing obligation for those in the lower income brackets, estimated at 25% of all the returns filed in 1984.

Thus, what the mid-term evaluation had judged as a well-planned program which offered great hope for increased revenues has had little forward movement. In addition, the project paper had mentioned a parallel effort for delinquent returns of the withholding tax, this element was never activated. Perhaps this will now move ahead under the new DGR-OMNIMAX initiative mentioned above.

While the number of collection agents trained and hired exceeded the original project targets (see 1. above), the new programs and managerial functions that were expected to be fully instituted by year 4 of the project are still in their initial stages of organization.

Hence it must be judged that this project element only partially achieved its objectives.

3. Improved Audit System

Target and Outputs:

Audit function operating more efficiently with number of audits increased by 100% from initiation of project and unappealed assessment per year increases from approximately S/. 2 million in 1983 to S/. 4 million.

- Selective office audit functions initiated by year 3.
- 100 technicians trained in audit procedures by year 4.
- Improved audit procedures and managerial functions fully initiated by year 5.

Project Achievements as of June 30, 1989

The mid-term evaluation identified an improved audit function as critical to the success of the project and documented in detail the shortcomings and lack of progress in this area between 1985-1987. In spite of the fact that the contractor had a full-time audit advisor for most of the life of the project and several additional short-term advisors during the last two years, the deficiencies noted earlier have not been changed materially. The situation became even more critical in December 1988 when the contract audit advisor was made Chief of Party for Omnimax and could not dedicate full-time to audit problems.

The progress noted in the mid-term evaluation with regard to the increase in audit coverage in 1986 which gave hope to eventually meeting the project target of 100% increase in audits, unfortunately did not continue into 1987 and 1988. In fact, 1986 appears to be a peak year with 5974 audits having been made compared to 3445 in 1984. Since then, the totals have continued to decline to 4704 in 1987 and 4378 in 1988. In addition, the average number of monthly audits for 1986 through 1988 decline from 414.7 to 364.8. This trend continued into 1989 with the average of the first two months at 317. The DGR points out that part of the reason for this decrease was that in 1987 15% of the auditors were suspended and have not been completely replaced because of legal problems.

The second part of this target of increasing unappealed assessments per year from S/. 2 million to 4 million was judged by the mid-term evaluation to be ineffective for monitoring progress and suggested it be changed since no record was kept of cases that were appealed, thus invalidating the target. However, the planning department of the DGR has now begun keeping records and figures indicate that for 1988, the amount in unappealed assessments in constant 1984 sucres was S/. 3,213 million, an increase of 61% over the base year.

The selective office audit function, which has the general support of the DGR management and which has the potential for quintupling the number of audits done annually was scheduled to be operational by the end of 1987. While plans were made for a pilot program in Guayaquil, it was not initiated because of space and staffing problem. Since then, there has been no action to institute this program.

The problems in the audit function discussed in detail in the mid-term evaluation of internal management control, quality control, the developing of selection and classification procedures persist. The only area in which this project element has achieved or exceeded targets is in training where 237 auditors had received at least 40 hours of instruction by October 1988.

In summary, this project element has not achieved its major target nor most of its output goals.

B. Organizational Improvements

1. Reorganization of DGR

Targets and Outputs:

DGR functioning under new organization with clearly defined functions and lines of authority, separation of management from operations, and greater decentralization of operations.

- Reorganization Plan approved in year 1.
- New Organizational Structure in place by end of year 3.
- Sixty executives and managers trained in country by year 2.
- 110 managers given advanced U.S. training by year 4.

Project Achievements as of June 30, 1989

The reorganization of the Direccion General de Rentas (DGR) is the core element in this project. The primary objectives of the reorganization were to (1) separate operational and line functions from policy and management functions and (2) decentralize operations in five regional offices.

The reorganization in turn, was premised on the full computerization of the tax administration system. Initial delays at the beginning of the project in approving the reorganization by the MOF for over a year, reported in the mid-term evaluation, set the entire project back and signaled the beginning of a trend in waning government support for the project.

Nevertheless, once the reorganization decree was issued in October 1986, hope was revived and the project took on a new life, produced tangible results in increased collections and institutional improvements, gave promise that lost time could be made up and that most project objectives could be achieved within the original time frame. The DGR immediately began installing the reorganization structure throughout the country. The mid-term evaluation, while noting many deficiencies, reflected this as well as the higher expectations for the project. However, since the reorganization was tied in so closely with equipping the entire system with computers, further delays were experienced when the GOE failed to facilitate customs clearance for equipment ordered under the project. This problem persisted through October 1988, when the newly elected Government, installed in August 1988, finally resolved the problem within a few days of being advised of it. However, by that date, so much time had been lost that it was evident that the project could not possibly achieve its original goals within the remaining months of the project agreement.

While the contractor and the DGR management continued to slowly implement the reorganization plan, the new Government, through the Ministry of Finances undertook a lightening-like program of tax law reform utilizing short-term technical assistance from Colombia, Spain and the Inter American Bank. The DGR, for its part began to revise the reorganization plan to correct problems it was encountering as it went forward and also to anticipate the changes in tax administration that the new laws would require using an organizational development model of broad participation which produced ministerial accords 267 and 299 in June 1989. In terms of administration, the new law which became effective January 1, 1989, had a major impact upon the way collections were made, substituting, to a large extent, the area offices, being set up under the reorganization plan, for collections from voluntary declarations being handled through commercial banks.

Thus, the original reorganization plan was overtaken, at least in part, by unexpected developments in the tax law and by revision in the plan itself initiated in the DGR. Also, because a large part of the computer equipment had still not been ordered, the reorganization could be only partially implemented, the old institutional structure and the new organizational changes existed simultaneously.

The newly revised organizational plan (267 and 299), which has the full support of the MOF, has just been approved and published. This latest revision is not likely to cause major disruptions since it embraces a good part of the original reorganization and corrects, refines, elaborates on and completes much of it. It does, nevertheless, recentralize the legal functions creating a large new Sub-directorate of Legal Affairs with the purpose of encouraging uniformity and consistency in the legal determinations made on tax appeals and in the application of the new law.

As a result of all of these developments, the reorganization plan, as contemplated in the project agreement, has not been fully implemented as the project comes to an end. However, it has achieved limited institutional success in having established the concept of decentralization to regional offices and separating operational and policy functions and it has accelerated by at least 10% the time it takes to answer taxpayer appeals. However, even under the most favorable circumstances, it will be at least two years before a completely reformed administrative structure can be in place.

With regard to training, as in other project elements the goals were reached. The output goals for training, 60 managers by year 2 was exceeded with 34 managers participating in seminars in improvement, 22 managers and analysts trained in O and M., and 35 first time supervisors trained in a 50 hour management course. Also, to meet the goal of 100 managers trained in the U.S. by year 4, 52 mid-level managers were trained at a 4 week INTAX seminars and 32 were trained in CIAT in Panama.

2. Restructured Processing System

Targets and Outputs:

A manual and automated processing system is functioning which integrates the processing of individual accounts with a master tax file without backlogs and which provides operating data on a timely basis.

- Integrated master file processing system in DOS completed by end of year 4.
- Thirty technicians trained by year 4.

Project Achievement as of June 30, 1989

This element is central to the project. It is intimately related to the reorganization and descentralization of the DGR. They are mutually dependant on each other and must proceed at approximately the same pace in order for the project to achieve its major goals. Unfortunately, both of these elements are significantly behind schedule. Both were victims of waning GOE support for the project and internal DGR resistance to change until the change of government in August 1988.

Major obstacles which slowed down installing an automated processing system were identical to those discussed above under reorganization. First, an eighteen month delay occured at the beginning of the project when the GOE did not approve the DGR reorganization plan and the USAID held up all procurement actions under the project. Once the reorganization was approved, further delays were encountered when the GOE failed to facilitate customs clearance for equipment ordered under the project. Once again the USAID held up procurement until a solution was found. By the time the new government took office in August 1988 and promptly resolved the problem, the project had only one year to go. The computerization element by then was at least two years behind schedule and the USAID decided to await the end of project evaluation in July 1989, prior to making a decision on the procurement of valuable computer equipment.

In the meantime, the DGR reorganization plan was being slowly implemented, but was seriously limited by the lack of the computers upon which the decentralization of the system had been premised. Limited amount of computer equipment was procured for the central office and to establish two agent cashier offices in Cuenca and Quito. USAID did collaborate with the new government in limited emergency order of computer equipment to help the initial implementation of the new tax reform law 006 to become effective Jan. 1989.

The contractor provided technical assistance in this area during the entire life of the project and in frustration erroneously assumed operational responsibilities to try to move this element forward even with the limited amount of equipment procured. Computer operators and computer programmers were hired and trained to form the operating core of the new system. Unfortunately, serious differences between the contract computer advisors and some managerial members of he DGR staff complicated and made more difficult the implementation of even the limited computer system program being pursued.

As a result of these factors, the computerization of the regional offices was not achieved. Limited computer equipment was procured and is in operation in Quito and Guayaquil. Agents Cashier Offices were established and are functioning in Quito and Cuenca. However, in spite of four years of technical assistance there is no integrated master file system in the DOS and there is no one in the DGR at present with the technical and organizational knowledge to direct a nationwide program for equipping and operating a decentralized computer system of tax collection, control and data management.

The recent changes prompted by the new tax reform legislation have made part of the planned agent cashier computer system redundant to automated bank collections and has introduced new computer functions of reception and control of bank data which will be a new DGR responsibility.

In summary, the goals and targets established for this element were not achieved. The new system introduced by the new reform law partially invalidates the original computer system plan. If the USAID decides to renew or extend this project, a new computer system plan must be worked out with the GOE.

3. Professional Inspection Service

Target and Outputs:

Inspection service performing internal, professional quality audits on a regular, programmed basis, with information being used as management tool by DGR.

- Unit established and staff of about 20 in place in year 2.
- Programs and Procedures instituted in year 3.

Project Achievement as of June 30, 1989

As reported in the mid-term evaluation this unit was established in March 1987. It has been fully operational since January 1988 and has been receiving technical assistance from the contractor to upgrade its personnel and to further define its functions. A procedural manual was produced and is in use. The work plan and internal audit plans that it has prepared have received full support from top management of the DGR and it has proceeded systematically with a training program for its personnel.

Before the change of Government in August 1988, the Unit had conducted a number of internal investigations which required disciplinary action on the part of the DGR and the MOF which were not acted upon. With a new Director of the DGR this attitude has changed dramatically. Cases of internal fraud and embezzlement are being vigorously prosecuted. A recent case in Guayaquil discovered by the Inspection Service involving officials of the Provincial Collections Office of Guayas and private bank employees is being pursued through the Courts. Fifteen suspects have been jailed and the DGR is pressing for full restitution of funds from the bank.

Another indication of top MOF, DGR support for this unit is the recent organizational revision in the DGR in which the Inspection Service was expanded to include two separate offices, one for administrative control and another for internal security. Under the new reorganization decree, its name has been changed to the Department of Internal Inspection.

4. Public Relations Program

Targets and Outputs:

An ongoing public relations program functioning in the DGR to encourage taxpayer compliance through various forms of media messages.

- Unit established in DGR for developing instructional materials and publications.
- Effective media techniques tested and identified by year 3.

Project Achievement as of June 30, 1989

This element has always occupied a low priority in the reorganization plan and in the view of the contractor. Even though the Department of Information was established in 1987 and is functioning, it has not achieved the role foreseen for it in the project paper of developing a public relations program, capable of changing taxpayer attitudes toward tax programs.

In addition, most of the public relations for tax matters has been traditionally performed by the Ministry of Finance. This has been especially so since the Government began to promote its new tax reform legislation in November of 1988. The MOF Public Relations Department greatly expanded its budget and personnel to carry on a nationwide public education campaign to familiarize the public with the new law and the simplifications in the tax returns. It has carried this program into 1989 preparing for the next phase of the reform and the submission of additional legislation to Congress at the end of July.

Under the circumstances, it appears that the DGR Office of Information is destined to play a limited and fairly technical role introducing information on changes in tax return requirements for the public, etc. It will never meet the objective outlined for it in the project paper.

5. Studies

Target and Outputs:

By the end of year 2, a study of a revised revenue code and procedural tax laws completed and approved by Minister of finance.

- Revenue Sensitivity Analysis to be completed in year 1.
- Revenue Sharing analysis to be completed in year 1.
- Design of Improved Customs Revenue Collections System completed in year 1.

Project Achievements as of June 30, 1989

The mid-term evaluation gave a complete report on these studies which will not be repeated here. Also Part II of this report (II B) provides an update and additional information which would be redundant to repeat here. One comment worth adding, however, is that these studies continue to have relevance and have been used at various times by succeeding Ministers of Finance. The present government has consulted them in preparing its new tax reform package and the World Bank has used the Revenue Sharing Analysis in its design of a new municipal development loan. In the end, they may prove to be one of the most cost-effective investments the USAID has made in tax reform.

C. Summary of Project Progress

The time frame of this project coincided generally with the four-year term of the new government which came to power in August 1984. Even before the government assumed power, preliminary conversations were initiated with the USAID preparatory to entering into subsequent detailed discussion out of which the project agreement grew. The Minister of Finance designate personally participated in these discussions. The new Government was interested in increasing revenues from non-petroleum sources so that public sector investment needs could be met. This was to be accomplished primarily through strengthened tax administration, expanding the tax roles and improving taxpayer compliance. The USAID had just completed three pilot programs with the GOE in (1) returns filing compliance, (2) delinquent accounts and (3) tax auditing which had had positive results and which offered promise for much greater returns within a more comprehensive program of tax administration reform.

While the project was under a number of serious constraints since it did not contemplate changes in the tax law, which had some serious deficiencies, it was nevertheless a well-conceived, comprehensive and well-planned tax administration reform initiative that appeared to have full support of the Ministry of Finance and the GOE. In spite of this auspicious beginning, the project soon ran into serious difficulties which raised questions about the GOE's commitment to the project. First the plan for the reorganization of the Direcciçn General de Rentas (DGR) was held up for more than a year before being approved. Then, after it was approved and the project began to make progress, the GOE refused to allow equipment ordered for the project to enter the country duty-free. Under the circumstances USAID restricted procurement until the issue was resolved.

At the same time, within the DGR, the reorganization plan, which was being slowly implemented, was meeting passive resistance from vested bureaucratic interests. The Contractor providing technical assistance to the project, anxious to demonstrate progress, erroneously began to assume operational responsibility in some areas (especially in computerization of the tax system) which generated resentment and eventually weakened these project elements. Lacking strong leadership from the top and strong support from the Ministry of Finance, the project languished until the Government changed.

The new government, dedicated to fundamental tax reform, took an immediate interest in the project and took speedy action on a number of problems which the USAID had identified, in an issues paper, as critical if the project were to continue. The most troublesome, the lack of duty-free customs clearance for project equipment, was addressed and resolved in six weeks, with the Sub-secretary of Rentas in the Ministry of Finance taking personal responsibility for the decision. This administrative action on the part of the MOF was followed up by a change in legislation which became law in May 1989. This has been beneficial not only for the Tax Administration project, but other USAID projects, as well, which had similar problems.

It took equally decisive steps to create positions and budget for 20 additional collection agents in the DGR which were being payed for out of project funds but which the previous government had pledged to put on DGR roles, and had delayed to do for over a year.

In addition, the Director General of Rentas established regular weekly meetings to follow project progress, to be advised of problems and to take the indicated actions. He also initiated periodic meetings, at least one a month with the Sub-secretary of Rentas to keep him advised on the project.

This renewed interest at the highest levels of the GOE made it possible for the DGR to undertake a new restructuring initiative which would correct, refine and elaborate on the original reorganization plan. This culminated in the new ministerial accords 267 and 299, which have just been approved and published and gives further impetus to a reorganized and reformed DGR.

Inevitably, this renewed interest on the part of the GOE in the project focused attention on the contractor OMNIMAX. There had been a serious erosion of confidence by the government in the contractor. The OMNIMAX Chief of Party had requested in May 1988 to be allowed to depart prior to completing his two-year contract. The new Director General of Rentas was anxious for him to leave and for a replacement who spoke Spanish to be named. Subsequently, two computer technical advisors were asked to leave.

Since the project, at this point, had less than a year to go, the USAID decided to extend it, but for only six months, to December 1989, and to await the end-of project evaluation before deciding whether to proceed further.

<u>Conclusion</u>

As this log-frame analysis indicates the project, as it reaches its termination date, has achieved very few of its original objective. While many of the objectives continue to be valid and should be pursued, the context within which they were originally conceived has changed radically.

The actions taken by the new government, combined with the legal reforms it promulgated in Law 006 and is promoting in the new legislation it expects will become law in November of this year, are indicative of a serious and sustained interest on the part of the GOE in tax reform and to an effective and efficient revenue collection agency to carry it out. While it will require continuous active support over an extended period from the Minister of Finance in order to make that a reality, the GOE action to date demonstrates a renewed commitment to the goals of tax administration reform which had been lacking under the previous government and which deserves recognition by the USAID.

If it is decided that the project objectives are worth pursuing, this should be done within the context of a completely new proposal and plan. The resources available from USAID are less than those in the original project, and implementation priorities have also changed as a result of recent GOE actions to change the tax law. Under the circumstance, it is fitting that a project negotiated with the previous government be brought to an end and that a new project reflecting present realities be negotiated with the government now in power.

It is important to underline in this regard that the reforms contained in 006 and those projected for November 1989, require an efficient and institutionally strong DGR. Without it the reforms are destined to fail.

Recommendation:

In view of the positive steps taken by the GOE since August 1988, and its evident commitment to tax reform and improved tax administration, USAID should give serious consideration to utilizing the funding still available under this project to support the tax reform initiative of the present government. If the tax reform is to succeed, it will need a strong and efficient DGR. USAID assistance in this area could be critical to its success.

The USAID should inform the GOE that the present project agreement expires December 31, 1989 and that in order for USAID to continue providing assistance in tax administration beyond that date, it is necessary that the GOE submit a proposal for assistance which describes the new tax laws which are being put into effect, the administrative requirements of the

DGR under the new laws and the role that USAID and other donors are expected to play. It is understood on the part of the GOE that only those funds originally obligated for this project will be available under a revised project. A GOE proposal can serve as the basis for a new project design and agreement. Ideally, this new project plan should be completed before the end of September.

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PART TWO

SCOPE OF WORK

Major Issues

PART TWO

SCOPE OF WORK

Major Issues

I. TAX ADMINISTRATION

A. Appropriateness of New Organization

"Appropriateness of the proposed reorganization of GDR (modified Acuerdo 664) with respect to the recent tax administration reforms."

Finding:

The reorganization of DGR set out in Ministerial Accord 664, modified by Ministerial Accord 267 and in a subsequent update which is now pending approval is certainly appropriate and with additional refinements perhaps necessary for successful realization of the tax Administration Reforms set out in Law 006.

Discussion:

The basic purpose of the reorganization of the DGR envisioned in the Project Paper was the separation of management and operation tasks and activities, the definition of functional areas of responsibility and authority including the rationalization of staffing patterns, the development of planning and administration capacities, and the decentralization of processing operations.

It was anticipated that these activities would be carried out in two phases, the first involved with strengthening operations, management and control at the central level and the second concerned with decentralization. Internal inspection service and public relations were to be developed as part of phase one and decentralization of processing operations were to be installed as part of phase two. Activities were to have been carried out simultaneously.

The design of the reorganization was originally contained in M.A. No. 664 of September 1986, modification of the design was approved by M.A. 267, of June 16, 1989, which also called for further elaboration and additional changes in the reorganization design.

The components of 664 and 267 have been integrated in a document which provides greater definition of functions and responsibilities, this is now in the approval process and has proceed to the ministrial level. These latest modifications, developed after 006 (December 1989), were designed to be consistent with the new administration reforms.

Both the general design and most of specific elements of the reorganized DGR administrative structure as contained in the modified plan yet to be approved are appropriate to the recent tax administration reforms. Some important modifications (see below) to the original designs (664 and 267) were undertaken at the request of the Director General and Sub-secretary of Rentas. This provides one clear indication of high level support for the objectives of this activity.

The new administration design provides for a separate legal department (M.A. 292), the movement of the data processing and sales tax sections from the direct control of the Director General and their reorganization as operational units under sub-directors. These and other realignments are designed to both separate management from operations and to place strategic operation (those in the legal department) under the direct control of a single sub-director.

Various elements of the second phase of the reorganization plan under 664 Project — the implementation of decentralization — have been included in the new administrative reforms.

In large measure, the functions and operations of the Jefaturas (areas offices) and their agencies as they exist and as set out in the reorganization will be important to the implementation of the new administrative reform at least in the next year during the transition to implementation of the new reform.

Originally the reorganization plan envisioned a wide range of activities in the regional delegations (regional offices) and their Jefaturas within them. During the course of the project several steps were taken to equip and prepare personnel in the decentralized offices. These efforts envisioned a wide range of activities, i.e., collections, audit, pursuit of delinquents, RUC updating, identification of non-filers both the income and sales taxes. To this end equipment has been installed in some regional delegations and the cashiers system is set up and operating in Quito, and Cuenca. With the new reform, the collection function of the Jefaturas is to be undertaken by the banks. However, it is the case that at least during this year of transition, many tax payers (about 50%) continue to make tax payment at the Jefatura. Thus, the activities of the areas offices will continue during this year as they were envisioned prior to substituting bank collections. Beyond the transitional year, it is probable that the collection function will be required in at least some outlying Jefaturas where the banks are not conveniently located. With full implementation of the tax administration reform, the decentralized cashiers system — Jefatura collection of taxes — will be unnecessary. But the area offices will continue to operate, performing all the functions envisioned in 664, except collections, after the full implementation of 006.

The initiation of bank collection of taxes required that DGR set up a system for receiving and processing tapes from the banks (and from the decentralized agencies which continue to collect taxes). This has been accomplished. However, the program to verify the information on the tape as well as bank programs to enter the data are not yet developed and operational. In this regard, the data processing in DGR takes on <u>greater importance</u> as a result of the administration reforms (006).

Conclusion:

The recent tax administration reform (006) and those which are to be proposed for next year do not negate any of the major elements of the DGR reorganization plan. Given that some of the reforms — withholding and estimation of income by trade or profession — are major and that the procedure by which they are being implemented are new, it can be expected that there will be many calls for administrative and legal interpretations. If these actions are to be handled effectively and insulated from the influence of those in contact with tax payers, then it is important that a strong centralized legal department be established as envisioned in the modified plan as an independent section responsible to the Director General de Rentas.

The role of the area offices as collection agents should decline with the full implementation of reform. Emphasis at this level should be refocused on the other important functions they are charged with.

B. Constraints

"Major on-going problems and constraints to the proper functioning of these changes (i.e., DGR reorganization M.A.'s 664, 267 Tax Administration Reforms, Ley 006)."

Findings:

There are problems and constraints, some long standing and other created by DRG Reorganization and tax reform which are serious impediments to the realization of the objective of reorganization and reform. Some action which can alleviate these circumstances are being taken. Other actions to clarify responsibilities and provide support will be necessary. A broader understanding of tax administration and its component activities is needed so that priorities can be established.

Discussion:

Prior to the initiation of the present Fiscal Administration Development Project, the DGR had developed by adding and grafting operations and activities to an organizational structure which was established and defined at a time when the demands and the scope of activities required from an internal revenue service were much less complex. The project paper noted that there was a foundation for change in the managerial capacity within DGR. The institutional strengthening and reorganization activities of this project constituted an ambitious program whose success depended on a complex set of factors including strengthening ties with and dependence on other governmental units, most importantly within the Ministry of Finance. A view currently espoused by some is that the DGR is a step child of the MOF. In many ways it has been so treated and, in many ways it has acted the part.

The intent of the reorganization plan was to rationalize activities giving clearer definition to responsibilities while moving management and mangers above the level of day-to-day operations. That is, the reorganization is designed to modernize the DGR structure. But the conception of even the most recent plan is building blocks and not of the building. Thus, the DGR even as restructured will suffer for a lack of an overall concept of what a modern internal revenue service is or should be. Lacking the strength of identity it has not been able to command the respect and support of other governmental units. Within this context the technical assistance and reorganization programs of this project planted DGR's feet at ground level. Since then it has been an upward push against the inertia of entrenched self-interest without much of a lift from above. Nowhere is this more clearly revealed than in the turf fights which grew out of the MOF tax administration reform initiative.

Without a strong self-image it is difficult to set forth and enforce priorities to attract and retain high quality personnel, and to negotiate areas of responsibilities with other units of government. While reorganization and the training of staff are necessary for the modernization and professionalization of the DGR, this alone cannot provide the strength of a professional image flowing from top to bottom.

The difficulties both of self image and of internal control have been exacerbated by a number of factors. Important among these have been: (1) insufficient space and the fragmentation of activities among four physical locations; (2) the lack of an internal budget; (3) the absence of an organized personnel system; and (4) professional rather than political criteria in the selection of leadership at the higher levels.

Solution to the problems associated with these four factors may not resolve all the DGR problems, nor may it guarantee the successful implementation of the Tax Administration Reforms. However there can be little doubt that improvement in these four areas should move the DGR closer to the professional organization that an internal revenue service should be.

The DGR has completed a study which indicates that an additional 5000 m^2 are required to minimally accommodate the reorganization. In part, this requirement is the result of crowding due to past addition of activities and employees. In part, it is required to accommodate expanded computerized operations, the reorganized and expanded legal office and the division of the control and inspections office into two units.

Over a period of three years, the DGR presented to the MOF five proposals identifying specific location and necessary actions. Response to these has been characterized as slow and without support. All were turned down. The urgency of this matter was emphasized by USAID in the issues paper it prepared in June 1988. Perhaps as a response to prospective termination of funding, the MOF has just this week indicated that this issue has been resolved and that space will be available for reorganization and relocation as soon as next month. This may be evidence that the present leadership in DGR and MOF share both the desire for a more professional organization and the view that reorganization is a necessary step thereto.

A number of facts indicate that higher officials are sincerely interested in the upgrading and professionalization of the DGR. The Minister of Finance has been a driving force behind the reform of the tax structure. His statements in interviews indicate that he understands that successful tax reform requires effective tax administration. The Sub-secretary de Rentas is a previous director of the DGR. He is actively pushing tax reform and forcefully has stated that the completion of the present project activities is essential to the success of the new tax reform.

Finally the current director of the DGR has acted quickly in response to the official publication of the DGR reorganization plan, i.e., upon official publication of M.A. 267 he met with his sub-secretaries and has planned reassignments. This action appears to be consistent with his expressed interest in the professionalization of the DGR.

The DGR is the largest operating unit within the Ministry of Finance, yet it has no operative plan or budget. Thus it lacks the base for evaluating the efficiency of the operation of its units. More importantly, as the allocations of the overall resources assigned to the DGR is governed by what Department heads and sub-director have been able to negotiate in the past, they represent bargaining skills and political clout rather than a consistent ordering of priorities. Until some more formalized accounting and fund allocation procedures are initiated, it will be difficult to ensure that the resources are channeled to where they can best serve the DGR's goals. The DGR indicates that the development of its Budget has begun. The plan is to have a budget prepared in March 1990 for fiscal year 1991. The objective of this exercise, to achieve greater financial independence, will require negotiations with the Sub-secretary of Rentas. It may be that these negotiations will be the bellwether of higher level support for an independent revenue service.

Improvements in resource allocation alone will not solve the DGR's problems. As will be noted in several places below, many of the operation problems that have plagued the DGR are the result of too few resources. Certainly if the MOF Tax Administration reform package is as successful as has been stated - an estimated 100% increase income tax revenues in 1989 of which 74 percent had been realized by May 30th. Additional funds could be alloted to the DGR.

Within the DGR, as in other parts of the government, personnel administration has developed without any systematic planning. In the absence of such a system, career paths and criteria for advancement are undefined. The importance of experience, training and productivity are uncertainties: and the rewards for upgrading of skills unknown. These conditions cannot foster institutional attachment nor professional upgrading.

The DGR initiated steps toward the development of an integrated personnel system with a survey of its personnel. The word is that participation was greeted by employees with enthusiasm, virtually all participated. Building on this, the OMNIMAX team has developed the basics for the what they term an integrated personnel pilot project. This is being reviewed with the GOE Civil Service Department for further refinement. There is concern within the OMNIMAX team that this project will fall short of its potential simply because of a lack of experience and expertise in this area within the GOE. This is an area where technical assistance would be very useful.

Professionalism in a non-policy, operating agency at the upper levels of management is crucial. While it is unlikely that the Director of DGR would be a career civil service position, it should be expected that the appointee bring to the position honesty, professionalism, management skill, and dedication to improvement. Perhaps of equal importance is stability a this level.

DGR history at the sub-director level has been varied. Turf protection appears to be a force, and maintenance of control an objective. Most Sub-directors are carry overs from pre-reorganization days. While this is consistent with career civil service classification, they were appointed to service the system as it was, and their interest and qualifications may not coincide with what is desirable after reorganization.

The initiation of Tax Reform Program (006) created certain problems which have the potential to forestall the realization of the program's goals.

The relationship between the tax reform policy makers in the MOF and their consultants with the implementation, agency (DGR including OMNIMAX) is strained. As a consequence tax reform measures have been and are being developed without understanding of the capacity to administer or enforce them. This is most obvious in the problem the banks are having in complying with their responsibilities as collection agents. It is also evident in the conflict over the role of Jefaturas as collections agents. The strained relation also has complicated the interaction between DGR data processing and DOS activities. As a result, even the most elemental activities e.g. RUC updates and bank tape verification are not being pursued effectively.

The tax reform has thrust responsibilities on the regional delegations. Compounding the problem is the fact that the lines of responsibility within DGR have not been fully worked out because reorganization is just beginning. As a result, regional delegations do not receive the needed guidance and support from central DGR sub-directors. The current DGR director has initiated meetings with the sub-directors to explain reorganization. This could be significant in two respects. First, to establish reorganization as DGR policy. Second, lines of responsibility and range of activities can be more clearly defined.

A number of specific problems confront DGR reorganization/tax reform. Some important specific problems are due to the strained relations between DGR and the MOF policy group. Of particular importance are:

- The future of the cashier system.
- The role of Jefaturas as collection agents.
- The bank tape processing in Guayaquil.
- The responsibility for processing and audit of the largest tax payers.

There are some important problems which grow out of the tax reform, i.e.:

- Implementation of the "Estimacion Objectiva Global."
- Audit and control of "retenciones en la fuente."
- Audit and control of individual taxpayer.

- The capacity of bank to comply with their responsibility to accurately record tax collections on tape.

- The capacity in DGR to verify the accuracy of bank tapes.

A third set of problems are of longer standing. They are related to:

- The concept and purpose of a general taxpayer file (e.g., RUC).

- The concept and purpose of the "informacion cruzada" file.

- The ability of DGR to process tax files on a timely basis.

- The support that DOS provides DGR in programming and processing tax information.

With regards to the first set of issues, the cashier system and Jefaturas as collections agents are functions which could and should disappear with full implementation of the bank collection system. The Guayaquil operation for processing bank tapes, while sensible in terms of facilitating data collection and transfer of data to a master file, will continue to function inefficiently until DGR in Quito provides clear specification of operations and procedures and sufficient budgetary support.

The location of responsibility for the largest tax payers is an issue between DGR and the MOF policy group. One point raised by an OMNIMAX advisor is that it amounts to putting of essentially line operations — tax payer control — in the hands of policy makers. Public Administration principals argue against such a move. However, if as is often inferred, the DGR does not operate effectively, then it may be reasonable to place control on one of the nation's major sources of revenues in an environment not tainted by questionable behavior.

With regard to the problems directly produced by the tax reform, most could be achieved with experience and technical assistance. Facilitating the operation of the "Estimacion Global" may be one of the more difficult tasks because there is little experience to draw on. The meetings with the first two groups — mechanics and taxi drivers has gone well. But these are viewed within the DGR as the easiest. Other professions and trades are considered to be more difficult. Effective means of dealing with the more difficult groups have not yet been developed. A knowledge and understanding of the Spanish experience would be useful as a means of identifying procedures and pitfalls.

The other problems, at least as they are related to the existing situations, relate to programming and processing rather than computer capacity. They could be overcome with technical assistance and additional resources. Among the third set of problems, those related to the tax payer file and the "information cruzada" are viewed as major activities. In fact the development of a master tax file in the DOS was programmed as one of the major outputs of the Fiscal Administration Development project. That this has not been produced is indicative of the difficulties of the interinstitutional cooperation particularly when objectives are not shared.

Of greater import to the objective of reorganization and tax reform, the construction, use and value of these systems is not well understood. Moreover, the emphasis on them is misplaced since neither the difficulties in processing the basic information on the tax forms have yet been overcome, nor has the purpose and function of the processing system been thought through.

<u>Conclusion</u>:

Serious problems confront both the implementing of tax reform and the reorganization of the DGR as a professional internal revenue service. Negotiations among conflicting parties, technical assistance in specific areas and the development of a broader view of the DGR and the objective of its functions to facilitate the ordering of priorities are prerequisites to progress.

<u>Recommendation</u>:

The DGR and MOF policy group should come to agreement on the definition of responsibilities. Particularly important areas are control of the largest taxpayers, tax collection by Jefaturas and financial and logistical support of DGR operation most particularly field operations. In this regard full implementation of banks collections in place of the Jefaturas should be encouraged. Technical assistance in the establishment of the "Estimacion Objetiva Global" is required and its data processing needs to be designed. The long range goals and objectives of the DGR should be set out so that current audit and data processing activities can be prioritized.

C. Institutionalization of Programs

"The degree to which new programs (e.g., integrated personnel system) procedures (e.g., manuals, regulations) and organizational relationships have been institutionalized."

Findings:

The "old" programs, procedures and organizational relationships introduced under this project are still in incipient stages of institutionalization. The "new" programs of integrated personnel system, manuals and regulations have not even been introduced at the operating level yet.

Discussion:

The institutionalization of programs, procedures and institutional relationships planned for in this project are, for the most part, still in an incipient stage. The two program elements which were to make the greatest contribution to this institutionalization process — reorganization of the DGR and computerization — are still a long way from being complete. The most that can be said as regards institutionalization is that the project was successful in establishing certain basic concepts such as separating policy and operational functions and decentralizing operations. It was also successful in starting the process of institutionalizing them. The programs, procedures and organizational relationships have only just begun and are being changed to adapt to present realities.

The new programs, such as an integrated personnel system and the manuals and regulations growing out of DGR's changing responsibilities under the new reform program, are too recent to have yet been fully vetted at the working level. Only after this process takes place can an estimate be made about their possible incorporation into the system and their eventual institutionalization. It may be significant that these new programs, manuals and regulations are the product of a rather broad and comprehensive writing and review process requiring significant participation from both management and operational employees. This may auger well for their eventual adoption and institutionalization.

With regard to organizational relationships, there are rivalries and conflict between the MOF and the DGR which in the past have slowed down the institutionalization of the reorganization reforms (see B. above). Unless there is determined leadership in both MOF and DGR and an agreement on reform objectives, these rivalries could again become an obstacle to the eventual institutionalization of the new programs and procedures.

D. <u>Institutionalization of Recent Changes</u>

"Additional process and procedures required to fully institutionalize recent functional and organizational changes."

<u>Findings</u>:

Plans for DGR reorganization (267) have been approved and announced officially. Some steps have been taken to implement the previous plan (664) and the Director of the DGR has initiated implementation meetings with his sub-directors. The space necessary to accommodate DGR reorganization is said to be available.

The first phase of the development of the integrated personnel system is complete. Plans for subsequent phases are being developed with the "Direccion Nacional de Personal." New activities will be required to complete the design of this system.

The process and procedure required to support tax administration reform are yet to be fully designed although preliminary actions have been started. Effective implementation of process and procedures necessary to support recent reorganization and tax changes need to be reevaluated in light of the impending MOF tax reform of 1988/90. Audit and control activities as part of an overall strategy are not well understood, the DGR has not developed a strategy which articulates the relation between its audit and control activities, thus it cannot order priorities.

Discussion:

Full implementation of DGR reorganization requires a number of activities. A document which elaborates and modifies the functions and responsibilities delineated in the officially announced reorganization plan (267) has already been completed and is being reviewed within the MOF. Its approval and implementation should be pursued. The assignment of space and relocation of activities will have to be undertaken when the promised new building becomes available. When complete the integrated personnel system will have to be implemented. Prior to that, however, a set of activities related to the development of the personnel system will have to be undertaken. More specifically, procedures to determine job requirements, employee selection and promotion procedures, pay structure etc. will have to be undertaken. The DGR has a contract with the National Personnel Organization. However, their experience in this area is limited and certainly not closely related to tax administration.

With the exceptions noted elsewhere, the process and procedure recently initiated by the DGR are appropriate components of effective tax administration. At this point in time, they are characterized by three major deficiencies: (1) they are incomplete; (2) some of the more important (the cashiers system and Jefatura collection) were designed to support functions whose importance may (and should) decline; and (3) the processing of tax information lacks the coherence of purposeful design.

The processing of taxpayer information is currently carried out as separate sets of activities and the prime objective is to record the data. As a result each of the specific activities is carried out independently with little effort to ensure that the information will be compatible with the overall design of an ongoing system of tax collection, audit and control. This is most obvious in the plans for the RUC, the envisioned program of "informacion cruzada," the current processing of bank tapes and the decentralized processing of tax information. The urgency of the need to record information, insufficient resources and difficulties in coordination between DGR and DOS are the reasons given for the lack of coordination. However, the problem is more basic. There is no sense of a system, thus the execution of an exisiting or suggested component activity becomes the objective with the collection and recording of data the first order of business. Thus, updating the RUC is planned and IBRD support is to be provided for an "informacion cruzada" project. Both these are designed to test and verify tax return information. At the same time DOS continues to record tax records but they are years behind. In addition, a new system for auditing "retenciones en la fuente" must be developed. "Estimacion Effectiva Global" will also be adding to the list of potential tax payers. The relation between these has not been spelled out because of the overall objective has not been defined and as a result the purpose of each activity in relations to the objective cannot be stated.

The DGR is about to receive modest support from the IBRD & IDB to pursue some of these activities. The support was sought (and given) on the basis of ad-hoc articulation of needs rather than as part of a well thought out plan of operations.

<u>Conclusion</u>:

The DGR has made some strides towards reorganization and absorption of new responsibilities. Reorganization is in its initial phase. This process needs to continue. To serve the tax administration reform new processes have been initiated, e.g., "estimacion objectiva global" and others are contemplated, (e.g., "informacion cruzada"). However, the approach is piecemeal. The DGR needs to think through its objectives in the area of audit and control, it needs to develop an understanding of the relations between its activities and to set priorities in relation to its overall objectives.

Recommendation:

The DGR should be encouraged to continue with its reorganization plan and its integrated personnel system pilot project. It needs to develop a conception of, and plan for its audit and control activities as part of an integrated system. It needs the input of an outside advisor to describe the operations of a modern internal revenue service and to assist in the prioritization of activities.

E. Impact of Training

"The impact of project-funded training on current performance of DGR staff."

Findings:

Project-funded training had a positive impact on current performance of the DGR staff in the collections area of the project and probably in computer operations and programming. It had little or no effect in management and audit because of other problems in these areas.

Discussion:

To do this subject justice, a much more in-depth effort than that undertaken in this evaluation would be required. In fact, the contractor as part of its implementation strategy should be continually evaluating the relationship between the training being given and its impact on the project. This evaluation should be routinely passed on to the USAID for its information and comments. Thus, for our part, because of time constraints, we must limit our remarks to a number of generalizations which we hope address the underlying concerns which prompted the question.

Superficially, at least, training has been one of the major accomplishments of this project. In almost every category the output targets have been achieved. In fact, it appears that training for much of the project took on a life of its own and operated on automatic pilot. The project output targets were religiously observed and reported on and in most categories were exceeded. By the end of 1988, 237 auditors had been trained, far exceeding the goal of 100 established for the project. One hundred sixty managers had been trained, passing the goal of 110. Collection agents, computer technicians and computer programmers also met the training goals. New training programs were regularly produced and implemented with almost clockwork regularity. While much of the project languished, the training programs went on.

In many ways, training is the easiest part of any project to implement. The Contractor or technician has control of practically every element necessary to produce and carry out the designated training. Thus, it can and does proceed, while other project elements meet obstacles that slow or stop their progress. As a result, the relationship between training and other project elements can get out of kilter as well as sync. This is what happened in this project.

Project progress reports are repleat with comments about the apparent disparity between the number of people receiving management training and the lack of application of good management principles within DGR. The criticism was particularly directed at the key top-management level of sub-director. Obviously, at this level, training was having little or no impact on improving the performance of management staff.

Another problem was being experienced in audit, where the number of auditors trained continued to increase and the number of audits per auditors and overall audits continued to decrease. Only among Collection agents and computer technicians did there seem to be a correlation between the progress of the project and the training being provided.

Training is usually an auxillary rather than a leading element in achieving project objectives. It may be essential to project success, but it cannot substitute for other necessary factors. There seems to be some suggestion in the project progress reports from OMNIMAX that training and training alone could improve management performance within the DGR, when it is obvious (as discussed in other sections of this report) that the management problems were related to built in resistance to reforms, vested interest in the status quo and probably incompetence among top management personnel. Evidently instead of recognizing this, OMNIMAX continued to promote management training programs and to exceed project targets in this area.

In auditing, it appears that emphasis was put on training to the exclusion of everything else. Pilot efforts in field audit survey and office audits were abandoned, but the training program increased, perhaps because this was the only area over which the technician had relative control, or maybe because he had competence only in this area.

The best balance between training and project accomplishment is in collections, where the program proved itself at an early stage and continued to expand. The training in the beginning was modest, only sufficient to orient the new collection agents. Later, follow up courses were given to strengthen their performance. It should be noted that all of this training was done in-country and was mostly on-the-job training.

Conclusion:

It is important to maintain a balance between training and other elements of project progress. When training gets too far ahead of the total project, adjustments should be made to make sure that the training continues to be relevant. It could be argued that since nothing significant was happening in the audit area, audit training should have been curtailed or stopped. In management, training was not a substitute for overcoming more basic problems.

Recommendations:

Future training plans should be closely related to on-going project progress and the specific requirements of exisiting project needs.

F. Relationship Between Original Project and Current Reorganizations

"The relationship between original project components and DGR reorganization and administration reforms, those elements that are obsolete, and those that remain of critical importance to the current MOF fiscal strategy"

Finding:

The administrative changes which are being implemented as a result of Law 006 reduce the importance of the area offices as collection centers and will require a rethinking of the computerization system. Data processing activities identified in the PP such as development of a master file continue to be pertinent. Other project activities while of continuing importance, such as a comprehensive audit program, will perforce have to be given lower priority, in order to concentrate on making the reform effective. Other activities such as improved filing compliance takes on even more importance because of the potential for abuse in the new system.

Discussion:

The project paper identifies five major project components:

1) Revenue Administration
2) Organizational Improvements
3) Studies
4) General Advisory Support
5) Monitoring and Evaluation

1) Revenue Administration

This component of the project consists of three major parts: a) Improved Collection System; b) Improved Returns Filing Compliance System; and c) Improved Audit. In all three areas the major activities identified in the PP were focused on technical assistance. There has been some success in many of these activities.

a) Improved Collections: The MOF reform has appointed the banks as the major collections agents. As a result the cashiers system which had been developed by the project has importance primarily as a transitory collections mechanism. If and when the bank collection system become comprehensively functional — planned for tax year 1990-91 — the cashier system will be unnecessary and the role of the Jefaturas in tax administration altered. It can be anticipated that activities at this level will be predominantly directed towards non-filers and identification of delinquents. However, the possibility that the Jefaturas in outlying isolated areas will continue collection activities beyond the transition period should be evaluated. If they are to continue collection activity training and assistance for them may be appropriate but this should be a minor activity provided by the DGR.

b) Improved Filing Compliance: In general the activities under this component are consistent with current MOF strategy. However as a result of the 006 reform, two types of activities become more important, the first has to do with the "Estimation of Income by Trade or Profession." This involves the cooperation of professional organizations, mercantile associations and the like in the determination of their taxable income and amounts of taxes due. This method is somewhat unique, having been employed only for a short period in Spain. The DGR has initiated its first efforts in this system with the Mechanics associations.

The person in charge of this activity, while pleased with the cooperation, has indicated a complete lack of information about these activities. Here is an area where assistance could be of prime benefit.

c) Improved Audit System: The audit activity, in particular that of the income tax returns, has taken the initial steps along the line described in the project paper. However, as a result of the 006 reform, tax payers are no longer required to provide the annexes (backup information to the new tax form). Unless this decision is reversed, the possibilities for office audits has been drastically reduced. An office audit program would require that the tax payer bring his document to the office. While it would be desirable to continue activities to reinforce and upgrade this function, it may have to be given a lower priority until the collection and compliance system are functioning properly.

One activity which has been discussed by the project personnel but which was not included in the project paper is a program of "cross-referencing information." The idea is to use third party information to audit returns, that is, a compilation of personnel service contracts, building permits, import/export bill contracts, cadasters and other source could be used to determine incomes payed to tax-payers. It is interesting to note that employees withholding statements would be very appropriate information for this purpose but it is seldom mentioned. There can be little doubt that a cross referencing program would help in the detection of non filers as well as in the detection of underreporting. However, currently there is little expertise in DGR in the operation of such a programs. <u>If such a program is to proceed, it should be preceeded by an evaluation</u> and supported by technical assistance.

Within the new MOF strategy, retentions related to both income and the sales tax are to play a more important role. Company audits to insure both the appropriate withholdings and the full reporting should become a more important activity. In this regard an increase in the number and training of field auditors would be desirable. Office audits could be a more efficient way to perform a large part of this activity, however such a program would require a change in the MOF strategy. That is tax payers would have to remit the annexes which contain the basic information on income exemptions etc. The DGR is not staffed to undertake a serious office audit program, however, such a program which could greatly increase the number of audits performed annually should be considered in the future.

2) Organizational Improvements

There are four elements to this component. Progress of varying degrees has been made on each of the first four. The nature of the fifth has been modified but as such it remain a potentially valuable activity.

a) Restructuring of the DGR: The original reorganization plan under this project was approved in 1986. The DGR has been slowly implementing it since. Recently, an elaborated and revised reorganization plan was approved (# 267) and published in the official registrar the week of 7/3/89. While waiting approval the reorganization plan was further refined and responsibilities have been more clearly articulated in a document which has proceeded through channels to the point of awaiting final ministerial approval. As modification to the original reorganization plan this latest, represents a substantial improvement, particularly the concentration of legal activities in a separate subdirection and the separation of inspection service as a department. However, the original reorganization plans have never become fully functional. Thus, in a real sense, the reorganization has just begun.

b. Restructured Processing System: This part of the project foresaw the development of an integrated decentralized processing system, the automotization of DGR operations and improved management and technical capabilities.

Several major steps have been taken towards the realization of these objectives. As a result of the 006 reform the need for decentralized collection capacity identified in the PP is now much less. The other decentralized activities associated with processing remain. However, decentralized collection activity albeit through the banks remain. This has created a need for systems and programming activities in the DGR Data Processing Center in place of some similar activities and equipment programmed for the regional delegations and/or Jefaturas. Thus while of a different focus, strengthening decentralized processing is of prime importance to the current MOF fiscal strategy.

The role of DGR data processing vis-a-vis DOS has been a matter of discussion and uncertainty. At an early point in the development of the MOF strategy it appeared that DOS would play the predominant role, however, the DGR has been established as the bank tape reception center. Still the relative roles of DOS and DGR in the processing of tax data remain in question. In interviews, the Minister of Finance, his Fiscal Advisor and the Sub-secretary of Rentas all reiterated the importance of DGR processing. However, it appears that the MOF strategy has DOS in charge of the files for the 600-700 largest tax payers. In recognition of the fact that DOS does not have manpower and expertise sufficient for a major undertaking, it has also been indicated that DOS would have to borrow these from DGR.

Thus, it appears that in any case, support for an improved programming and processing capacity in DGR is consistent with the MOF strategy. However, given the uncertainty which has grown up around data processing, a clear specification of the roles of DGR and DOS should be a prerequisite to any substitution of new activities in this area.

c) Professional Inspection Service: The major intent of the activities identified in this area in the PP was to separate Inspection operations from audit, separate management from operations activities and expand the number of qualified personnel. As a result of DGR reorganization and project technical assistance, substantial progress has been achieved in this area. Improved operations in this area will enhance the realization of the MOF strategy.

d) Public Relations Program: Under this heading the PP contemplated the establishment of a Department of Information and Technical Publication and the development of a public relations campaign. The structure, responsibilities and activities of such a department have been developed and included in the DGR reorganization plan. Beyond this, there has virtually no activity to develop or disseminate information or to initiate a public relations market strategy, in fact the MOF has a program to market its new tax reform. While it has not been investigated, even casual observations of the public media (T.V., newspaper, etc.) suggests its nature and breath. Still, there is a need to develop a program which explains both the rational and process of the restructured tax system.

Development of taxpayers information office in DGR while not absolete is not crucial to MOF strategy.

3) Studies

This is is complete in so far as the studies which AID is responsible for (see II.B below). Studies for which DGR had been responsible have been undertaken by the special assistant to the Minister of Finance and the Subsecretaria de Rentas. Regretfully these have been classified as "Reservado" and were not provided for review by the team. As noted in the section on Studies (II.B), the methods and most of the findings of the AID financed studies remain relevant.

Judging from descriptions of the MOF Studies, they are quite pertinent to the anticipated tax reform program. However, descriptions by MOF personnel and other information we have about them suggest that they are primarily conceptual analysis of potential reform measures and contain limited estimation of the effects of tax changes on tax payers of specific types and levels of income.

Implementation of tax reform on such a limited analytical base is risky. Similar efforts undertaken elsewhere (e.g., Guatemala in the mid 1980's) had such poor results that a major tax revision project ($ 9 million) is about to be initiated. The MOF proposed tax reform program no doubt would benefit from additional analytical (empirical) studies of the potential impacts of alternative reform proposals.

4) General Advisory Support

This component of the project retains its critical importance even in the context of current MOF fiscal strategy. Advisors and consultants in support of the major project components will be required during the final stages of the project although the emphasis may have to be altered. These considerations are, in fact, part of this evaluation. At present it would appear that systems and data processing expertise is of the first order of importance. This is to facilitate the data processing necessary to support the new collection system. Some expertise in the system design and processing of third party information for the "Informacion Cruzada" program is also necessary.

An area in which the project could provide advisory support is that of background analysis and impact studies of the proposed reforms. This however, would depend on a willingness of higher level MOF people involved in the formulation and design of fiscal strategy to recognize the need for such assistance.

5) Monitoring and Evaluation

This element calls for the establishment and regular meeting of a coordinating committee in DGR which includes AID participation. Regular meetings of this component and formal AID participation has never been achieved. During the last year of the project the activities of such a committee have been informally undertaken by the OMNIMAX Chief Advisor, the MOF project coordinator and an Ecuadorian who has been hired as a consultant by OMNIMAX. For the most part, liaison has improved as a result of the activities of this group. However this group has not been included among those producing major policy initiatives. This is problematic on two counts (1) that it indicates that major policy initiatives are being developed with little consideration for the capacity to administer tax reforms, and (2) it reflects a lack of confidence by the MOF in the DGR and in the OMNIMAX advisors.

The PP also calls for periodic progress reports to AID. The record shows that these were provided generally on schedule. The informative content of these reports were variable with some recent decline. Ultimately it is not at all clear that there was any consistent pattern of response or evaluation of the content or follow-up to the monthly and semiannual reports. It should be noted that AID did provide a quite comprehensive issue paper during the last year of the project. This was well done and served to crystalize concerns and provide some directions.

The evaluation component calls for a formative evaluation in the third year of the project and at end of the project review. The latter is now in process. The former was completed on schedule. There is no evidence that the mid-term evaluation was used as a management tool to follow-up with the contractor and the DGR on its recommendations nor is there a record of any formal response by the contractor to the evaluation. Given the limited progress since the mid-term evaluation, most of its recommendations remain applicable.

Conclusions:

Plans for the reorganization of DGR along functional lines have been completed and all that remains to be done is the full implementation of those plans. The reorganization of DGR is as relevant today as it was four or five years ago. The area of the project that has become more absolete is that of computerization and mechanization of Jefatura tax collections. The plans for a cashier system country-wide have been displaced by the use of the commercial banking system. The project plans for the functional areas of collections, filing, and auditing have not become absolete. These are functions that any tax enforcement agency should always develop and perfect. However, the reality is that with the exception of collections, the project has failed to make any progress with the plans developed four years ago. Consequently, there is a need to rethink the focus of the project. The strategy should be to concentrate on specific areas which will prove crucial to the success of the tax reforms currently under way. These areas include, reading and validation of data tapes sent by commercial banks, implementation of "estimacion objetiva global" and "estimacion objetiva individual," control and audit of withholding agents and supervision of the "regimen de equivalencia" on "Transacciones Mercantiles." The DGR still badly needs general programs to control non-filers and stop-filers. It also needs to develop effective programs for office and field audits. However, we are pessimistic about the possibility of making real progress in these two areas in the next 12 or 16 months.

G. Compatibility of Tax Reform and Administrative Changes with Mission Objectives

"The degree to which all the administrative changes of tax reform program implemented by GOE relate to Mission Objecti[illegible] [illegible]conomic stabilization)."

Findings:

Although it is too early to tell what the long term impact of the administrative changes introduced by LAW 006 (December 1988) will be, so far, non-petroleum tax revenue collections are up. If after allowing for inflation GOE tax revenues are increased in 1989 and subsequent years, this will allow, but not necessarily cause, a decrease in GOE's budget deficit, which is a key component of the GOE's (and USAID's) economic stabilization objective.

Discussion:

The Borja administration introduced a bold and far-reaching tax administration package in December 1988. The "Ley 006 de Control Tributario y Financiero" introduced a tax amnesty in January 1989 condoning 80 percent (60 percent for payments made between March 28 and May 10, 1989) of all fines and interests on many past due tax obligations. Law 006 also (1) widened the use of withholding ("retenciones") at the source for other types of labor income, professional fees, and interests, dividends and other financial payments, (2) introduced a new (in Ecuador) tax assessment procedure for income taxes and "Transacciones Mercantiles," the "estimacion objetiva global, (3) institutionalized payment and initial data processing of tax obligations through private commercial banks, (4) simplified the tax return forms for income and "Transacciones Mercantiles," shortening their length and dropping all annexes, and (5) simplified the tax law and returns of the "Timbres Fiscales" tax.

Many of the measures introduced in Law 006 should help to streamline tax collection procedures and potentially increase tax revenues from present taxes or the new taxes to be introduced late in 1989. The tax amnesty is a one shot deal, however, and the evidence from other countries which have undertaken this type of measure does not clearly indicate that tax revenues are increased on a permanent basis. With the tax amnesty, some individuals wishing to clear their tax status will make use of the favorable conditions offered to do so. This will increase revenues in the short run. These are, in general, revenues that otherwise may never have been collected. In the longer run, however, these net increases in revenues may be lost due to the wrong message the tax amnesty sends to both previously compliant and non-compliant taxpayers. The expectation that other tax amnesties may be offered in the future will reduce the overall level of tax compliance and therefore tax revenues. From January to May 1989, the tax amnesty in Ecuador is thought to have yielded approximately S/. 10 billion by official estimates even though only S/. 5.6 billion have been verified so far. Because data recording for the amnesty seems to have tagged only past due "titulos of credito," unofficial estimates at DGR put the revenue impact of the amnesty at twice the S/. 10 billion estimated to be collected. This latter figure would represent around 7.5 percent of total non-petroleum tax revenues projected in the 1989 Budget. Whether this will be a permanent increase in tax revenues remains to be seen. Other things being equal, i.e., without stricter tax enforcement measures, a backlash to the amnesty should be expected in the form of poorer tax compliance in future years.

The widening of withholdings to other sources of income should result in increased tax compliance and revenues. These are measures which have been received with marked taxpayer opposition in other countries. Surprisingly, this does not seem to have ben the case in Ecuador. <u>One caveat is that the increase in compliance and revenues may be decreased if withholding agents realize that the tax authorities lack adequate resources and</u>

control. Withholding agents may now substitute their own evasion for the withheld taxpayers' past evasion. This is definitely an area in which the GOE needs technical assistance. There is no quantitative evidence of the impact of this measure so far, but the expanded tax withholding should already be at work and reflected in collection figures for the last few months.

The "estimacion objetiva global" assessment technique if properly implemented should become an effective tool of tax enforcement. Essentially this assessment procedure negotiates a tax base for income and "Transacciones Mercantiles" taxes with groups or association of professionals and single firms via joint committees of tax officials and taxpayers. These categories of taxpayers are traditionally known to include a large number of non-filers and income under-reporters. Using the "estimacion objetiva global" brings non-filers into the tax net and can increase collections from those that are already filing. The technique works by putting peer pressure and inducing self-enforcement within the group of taxpayers. Later on, as the tax administration apparatus of the country matures, taxpayers subject to "estimacion objetiva global" can be "graduated" into direct self-assessment procedures. The MOF jumped into this area, like almost all those in Law 006, without any previous notice to the DGR and without a minimum of adequate preparation. Unlike the case of "re :nciones." however, results from the "estimacion objetiva global" is not likely to yield results without heavy resource involvement from the DGR. So far, only two joint committee meetings involving the mechanics association and cab drivers of Pichincha have been held. Several other joint committees are planned.

Personnel at DGR have not been trained in the technique and little background work is being done previous to the meetings. As a consequence the discussions are held around final tax liabilities rather than as originally intended on tax base. The "estimacion objetiva global" has yet to yield an increase in revenues. Without a vigorous training program at DGR on how to conduct background research, lead negotiations, etc., we fear this administrative innovation will yield no practical results. This is another area in dire need of technical assistance.

The institutionalization of tax payments through the commercial banking system has now reached 50 percent of all declarations. The plan is to reach the 100 percent figure within the next year. With proper control and supervision this is a preferred collection system to the old one which used DGR Jefaturas. Because of the wide-spread corruption in the Jefaturas, making use of the banks could also lead to increased collections. The new system is also simpler than the planned cashier system under the tax administration Project, and in the long run should also be cheaper and more reliable. The cost to the MOF in terms of foregone interest on deposits now cashed in by banks should be reduced in the future. An added advantage of the new collection system is that banks are also doing the initial data processing of the tax returns. The MOF and DGR so far are only performing very basic processing of the magnetic tapes received from the banks and plans for the validation of the data are still very limited. These issues are discussed in III below. Complete implementation, control and validation of the banking collection system should become a priority area in the Mission's technical assistance program.

Present plans of the MOF involve the DOS for the input of declaration accepted in Jefaturas in magnetic tapes in a format identical to that used by the banks. The DOS will also do a very limited data validation for the tapes received from commercial banks. Some concerns have been raised about the transfer of data control from DGR, to the DOS. We do not believe these concerns are well founded. There is a good chance that DOS role will be temporary, but even if it were not, this may not be all that bad because of DGR's past and present inability to carry out any kind of systematized program. It should also be remembered that the DGR is overseen by the Subsecretario de Rentas who sits outside DGR in the MOF. The innovation of collections through the banking system are very likely already reflected in the Tax revenue figures for the first 6 months of 1989.

The simplification of tax forms for income tax and Transacciones Mercantiles was forced by the decision to process returns through commercial banks and it is not expected to have any direct impact on revenues. Present tax laws are extremely complex and this complexity was reflected in long, cumbersome and many times confusing tax forms. Ordinarily the simplification of tax reforms is preceded by tax reform. When (and if) the new tax laws are introduced in late 1989, the tax forms for income and Transacciones Mercantiles will be changed again. The changes in the "Timbre" tax undertaken in Law 006 went beyond cosmetic aspects. The "Timbre" tax is an old colonial inheritance and over the years became a nuisance tax. Law 006 significantly simplified the structure of the tax. It would be preferable to entirely abolish the "Timbre" tax in the near future.

The emphasis on simplification in Law 006 also led to questionable measures. In particular taxpayers subject to income tax withholding with only labor income were exempted from filing a return with the DGR. This move definitely simplifies paper work for DGR but it also is likely to encourage less compliance by both taxpayers and their employers as withholding agents. Another undesirable measure with possibly worse consequences on overall compliance, was the elimination of the annexes in the corporate income tax returns. An explanation of these two moves may have been political so as to fend off opposition to other measures in Law 006. Universal filing for all taxpayers and use of annexes for corporations are both features of a well administered tax systems. These procedures which have been eliminated in Law 006, must make a come back in Ecuador sometime in the future.

How do the administrative reforms of Law 006 relate to Mission objectives for economic stabilization in Ecuador? Economic stabilization requires a reduction of the inflation rate back to the single digit range, a reduction in the unemployment rate, and regaining equilibrium in the balance of payments. These accomplishments would be the stage for a renewal of real economic growth in Ecuadorian economy. The economic disequilibria and imbalances besetting the economy of Ecuador at the present time have multiple causes. Some of them, such as the 1987 earthquake and low prices for petroleum products in international markets, have been entirely out of the control of the GOE. However, GOE's fiscal, monetary, exchange rate, and resource allocation policies such as price controls, all have had a significant role on the present state of economic conditions.

In particular sustained budget deficits by the central government financed by direct borrowing from the central bank have resulted in marked increases in the money supply and the price level in the recent past. While the Borja administration has been quite successful so far in containing the growth in the money supply, it has had less success controlling the budget deficit. Being unable to borrow abroad, the present course for fiscal policy will only be tenable through either cuts in public expenditures (including price subsides) and/or increases in tax revenues. It is in this macroeconomic context that one should evaluate the administrative tax reforms in Law 006. The Borja administration, under pressure, designed an innovative and practical package of tax administration measures with the objective of increasing tax (non-petroleum) revenues. Although higher tax revenues will not necessarily cut the central government budget deficit, they could, if accompanied by expenditure control polices.

Overall the record from January 1989 to May 1989 has been good although quite uneven. The numbers also look less impressive when inflation over the period is taken into account. Several of the 1989 first six months, the annualized inflation rate in Ecuador was above 80 percent. Total non-petroleum tax collections from January to May 1989 amount to S/. 132.4 billion. This figure represents around 30 percent of total collections during 1988. Even after taking into account an inflation rate as high as 80 percent for the entire five months from January to May, real tax collections are up between 6 and 10 percent. This is a good performance, especially in an inflationary economy and with weak tax administration. The performance by individual taxes has been uneven. For example, collections in income tax during the first five months of 1989 are already 19 percent higher than for the entire 1988. For the same period sales tax (Transacciones Mercantiles) collections are at 66 percent of total collections for 1988. Although this is a good performance, it is clearly less impressive than for income tax and less impressive than the annual increase in sales taxes in previous years. For the timbres tax, which was reformed in December 1988, tax collections for the first few months of 1989 represent only 37 percent of total collections for 1988. This is a clear case in point of what can happen after tax reform. It reinforces the importance of studies which research the yield and incidence of the different tax alternatives being considered. On the other hand, the specific tax on "bebidas gaseosas" has already yielded in the first five months of the year, 126 percent of the collections for the entire year of 1988. This tax is a good example of how effective targeted audit programs can be in raising revenues.

<u>Conclusions</u>:

The analysis of the individual tax administration measures introduced in Law 006 in December 1988 and the tax revenues reported so far by the Subsecretaria de Rentas tell a good story. There is little doubt that the result of the December 1988 measures support the GOE objectives on economic stabilization, which is also a USAID objective.

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II. POLICY REFORM

A. Nature and Extent of the Tax Reforms

"The nature and extent of the MOF Tax Reform program, identifying those elements that constitute reforms and those that are merely reordering or simplification of current legislation."

Findings:

The Tax Reform Legislation of December 24, 1988 (Registro Official No. 97) No. 006 "Ley de Control Tributario y Financiero" contains 9 sections, 84 articles and covers 25 pages.

For want of a better terminology the basic reforms can be classed as administrative, legal and structural.

The major administrative reforms are:

1. Retenciones en la Fuente: In a rough sense the intention is to give the responsibility for tax withholding to all sources from which income is derived. Thus in addition to employer withholding on employee wages and salaries, there is to be withholding by companies related to income earned by these who provide them goods and services, by banks on interest, etc.

2. Reporting: Tax returns are simplified to a one page summary statement of income, deduction, exceptions, credits, withholdings and some calculations. The annexes which identify the sources for the above, some basic calculation, etc., no longer have to be filed with the tax return.

3. Tax Filing and Collection Agents: Tax filing and tax payment are to be made at banks' offices rather than at DGR agencies.

The legal reforms are:

1. The interest rates and fines applied to past due taxes and delinquencies are substantially increased.

2. The level of income which must be earned to be subject to taxation has been increased to S/. 570.000.

3. The calculation of taxable base and tax due for independent professionals and small business (empresariales) is to be obtained by the "Estimacion Objectiva Global." Professional organizations are to be formed which along with representatives of the MOF will determine the amounts of income and sales tax they owe the government.

The Structural Reforms are:

1. Elimination of 38 of the 48 stamp taxes and fees.

2. The addition of an 8% surcharge to fund the "Fondo de Salvamento del Patrimonio Cultural." Taxpayers in Guayaquil and Portoviejo are exempt because of preexisting similar surcharge. These funds are to be returned to provincial governments.

3. An extension in the definition of one municipal tax i.e. from 1.5 mil on liquid capital (capital en giro) to 1.5 on total capital (activos totales).

4. Permission for municipalities to reassess properties when the assessed value is partial, mistaken or deficient.

In addition to the structural changes identified above, the MOF has indicated that it plans to introduce other major changes. Documents related to these are "Reservado." However it was announced recently at a seminar in Guayaquil that the following significant changes are planned:

1. Reduction in income tax rates and reduction in the number of tax brackets: three or four rate bracket with maximum marginal rate of 25-30%.

2. Substitution of credits for deductions and exemptions.

3. Revision of tax subsides for investment.

4. The expansion of the income tax base to include bonuses and the like.

5. The introduction of an automatic inflation adjustment in the calculation of depreciation. (At this point a similar adjustment is not planned for the individual income tax.)

6. Eliminate the double taxation of corporate profits.

7. A public enterprise pricing policy of self-financing for both national and municipal public enterprises.

8. Revision in the taxation of the repatriated profits of foreign enterprises.

9. Complete reform and simplification of import taxes.

Elsewhere it has been indicated that consideration has been given to the introduction of a national property tax.

Discussion:

The MOF is in the midst of an ambitious tax policy and tax administration reform. Law 006 of December 1988 was, for all practical purposes, only a tax administration package. The only tax partially reformed by Law 006 was "Timbres." The changes, in Law 006, to the other taxes were made only to accommodate and legalize new approaches in the administration of these taxes. Since the beginning of 1989, the MOF through the Permanent Committee for Tax Reform has been planning a tax policy reform. From documents we read and interviews we had, this appears to be a quite comprehensive policy reform. The MOF plans to have the policy proposals out for public review and discussion by July 31 and their final versions approved by Congress before the end of the year. Although the MOF is faced with a tight schedule, considering the performance over the last 10 months, there is a good chance the schedule will be met.

The proposed reforms will affect all present taxes and are guided by the overall objectives of simplification and consolidation. There are proposals also to introduce new taxes on donations and inheritances. The only areas of fiscal policy and administration of the central government not to be affected by the Reform are customs, budgeting and public enterprises. However, Minister Gallardo has expressed a desire to reform the tariff and customs administration in the near future. The Reform apparently will not deal either with municipal and regional public finance issues. Although less important in size, the local public finances are also very much in need of reform. For the purpose of discussion we will distinguish 3 areas or groups of taxes: (1) direct taxes which include personal and corporate income taxes, and the newly proposed taxes on the transmission of wealth, (2) indirect taxes including an expanded Transacciones Mercantiles and specific taxes on alcoholic beverages and tobacco, and (3) petroleum levies.

The proposed changes to the personal income tax follow patterns suggested by modern theory and applied in recent reforms in the developed and developing world. The tax base would be widened through the elimination of numerous exemptions and deductions at the same time that the tax rates are both lowered and significantly cut in number. The only allowed deductions would be the personal and family deduction all specified in sucres. Strictly speaking, these allowances would be in the form of credits (which are substracted from taxes owed) rather than deductions (which are substracted from the tax base before computing the tax). The only difference between credits and deductions is that with a progressive tax rate schedule credits have a more neutral impact on individuals than deductions.

There is also a somewhat vague proposal for allowing a 10 percent credit on savings or investments of individuals over the year. For tax rates, the proposal, which is very likely to change, is for 3 brackets with no zero or exempt income bracket. The first bracket for incomes up to S/. 1.5 million would be taxed at 15 percent, the second bracket with incomes up to S/. 6.0 million could be taxed at 20 percent, and incomes above S/ 6.0 million would be taxed at 25 percent. This proposed schedule is unlikely to be approved into law as is. Congress is likely to try to increase the appearance of progressivity by enlarging the number of rates and brackets.

In the present proposals, the elimination of zero-rate bracket takes away flexibility from the tax so as to affect the level of progressivity with a small number of brackets. But in general the proposed rates are a good compromise, effectively making the income tax a proportional tax (at a rate of 15 percent) for 80 or 85 percent of taxpayers.

The reform proposals for the new income tax, build on and expand the administrative reforms, introduced by Law 006 in December 1988. This is one area of the proposal with potential problems. Withholding for those with wages and salary income only will be at 15 percent. None of these taxpayers would be required to file a return. This leaves the door open, for example, to multiple use of personal and family deductions or credits for those with more than one employer. Previous research indicates that this is a wide-spread phenomenon in Ecuador.

Withholdings for fees paid to professionals will play the role of an estimated tax and sometimes a minimum tax. Besides the "estimacion objetiva global," the policy proposals also make reference to an "estimacion objetiva individual." The proposals also refer to "simplified" versus "complete" tax returns. All these areas will require a fast response from the DGR. But so far, no discussions have been held between the Reform Committee and the operational ranks of DGR. The proposals are also short of concrete recommendations on controversial areas such as capital gains, how to deal with inflation (for rate brackets and credits and deductions), or how to integrate the personal income tax with the corporate income tax to deal with the issue of double taxation of dividends. Nevertheless, the discussion of these topics in the proposals is knowledgeable. Reasonable compromises should be reached in these gray areas.

The proposals for the corporate income tax are for a lower single proportional rate of 25 percent, the introduction of a minimum tax, and the elimination of all sorts of deductions and special treatments, which in the past had significantly reduced the tax base. Instead of the deductions, the new proposal would exempt reinvested profits, introduce a credit for share holders of 6 percent of distributed profits, and give companies a 10 percent tax credit on investment financed with borrowed capital. While exemption for reinvested profits seems too generous, the other two measures are commonly used in other countries.

The most controversial aspect of the reform proposal is the introduction of a new tax on donations and inheritances. This tax is a complement to the income tax so as to tax all types of accruals to an individual's net worth. With some deductions or credits, especially in the case of close relatives, the proposed tax would have a progressive rate (identical to that of the income tax). The rate would be 15 percent for total received donations and inheritances between zero and S/. 30 million. The rate goes up to 20 percent for a tax base of up to S/. 120 million, and to 25 percent for larger tax bases. We believe that there is very little chance that this proposed tax will survive in the final version of the reform tax bill.

In the area of indirect taxes, the reform proposals would eliminate a large number of special sales taxes on goods and services incorporating them into an expanded tax on "Transacciones Mercantiles." Specific taxes on alcoholic beverages an tobacco products will be kept under a unified "specific" tax levied, as it is now, at the point of production. The Transacciones Mercantiles tax would keep its value-added tax nature, allowing credits for the taxes levied on intermediate inputs and outputs. It would have two rates, one of 10 percent, which is the rate used at the present time, falling on most goods and services. A higher rate of 20 or 25 percent would fall on a list of luxury goods. A number of necessities still would remain exempt. The proposal adds a few new services to this category.

Imports will continue to be subject to the Transacciones Mercantiles tax at the point of entry in the country. The proposals recommend granting special regimes to agriculture, financial institutions and travel agencies. These special regimes are also common in other countries. The proposals also suggest replicating the Transacciones Mercantiles tax for other transactions among individuals ("Transacciones Civiles") such as the buying and selling of real estate, used automobiles, etc. Because the newly proposed Transacciones Mercantiles tax is both broader and more complex, there is a danger of making it more difficult to enforce.

Besides the direct assessment in "estimacion objetiva global," the proposals recommend using a "regimen de equivalencia" for small retailers subject to the "Transacciones Mercantiles" tax. Under this regimen small retailers would pay 15 percent rather than 10 percent to wholesalers who should remit payments to DGR. Retailers could then still charge customers the 10 percent for "Transacciones Mercantiles" tax but they would be able to keep these revenues for themselves. The "regimen de equivalencia" is obviously another area where improved administration efforts will be crucial.

The proposal for petroleum taxes is to reduce the large number of levies existing today to two main taxes. The first would fall on production as a "regalia." This would allow the GOE to share in the income of the oil producing companies. The second levy would fall on the domestic consumption of petroleum products.

Obviously, the current administration has in mind major and significant, structured reforms. Coupled with the administrative and structural reform of 006, implementation of just some of what is likely to be considered would constitute a fundamental change in the structure of taxation. In general the existing and potential reforms appear to be directed towards three objectives - simplification, privatization (retentions en la fuente and estimacion objectiva global) and revenue increase via reduction in evasion and corruption.

In general, the direction of changes in the tax structure are consistent with contemporary view of the efficiency of a tax system. However, the achievement of whatever efficiency there may be in a tax structure is dependent on its effective application. Given the lack of experience with "Withholding" the "Estimation of Income by Trade or Profession," the bank collection of tax payments, and the need to develop the procedures and processes to monitor these activities, the efficiency with which the new tax structure will operate must be seriously questioned. Without continued progress in areas of tax collection and tax enforcement, a new more efficient tax structure may operate no more efficiently than the old system.

<u>Conclusion</u>:

This brief overview of the extent and nature of the tax policy reforms presently being contemplated by the GOE clearly shows that the reform is both deep an generally well thought out. It is indeed surprising that in the short period of time available to the MOF the proposals are so far along. However, the speed of the process has sacrified adequate background research on the impact of the proposed changes in revenue yields, distribution of tax burdens, and economic efficiently. Although some time for public reaction to the reform proposals have been set aside, it would have been made more effective to have worked with the public from the beginning in the form of a blue ribbon commission, composed of representative individuals from all socio-economic and political strata.

There is likely to be shock caused by the proposals when they are presented to the public and there will be limited background work and intellectual authority to defend them. Another possible roadblock to the reform will be the opposition in Congress, within the administration, and in the street to the elimination of many special taxes that in the past were earmarked to particular agencies or activities.

Recommendation:

The ongoing tax reform in Ecuador is deserving of all the help the Mission can provide. The direction of the reform is the desirable one. USAID missions in many countries, specially in Latin America spend years to get to the point where the GOE is at the present time. The Mission should take advantage of this opportunity and jump on the band-wagon.

B. Concordance of Resea. . Findings and GOE Reform

"The degree to which the findings of the research financed under the project, in the area of tax Reform, are in agreement with the reform being proposed by MOF."

Finding:

The studies financed by the project including, many of the findings recommendations, remain pertinent to the proposed tax reform.

Discussion:

The Project Paper called for four types of studies:

1. Revised Procedural Laws and Regulations. A comprehensive study of the Revenue Code and the procedural aspects of substantive tax laws and regulations.

2. Tax Revenue Sensitivity Analysis: A study of relationship between changes in the income tax structure and Central Government revenues

3. Revenue Sharing Study: Studies of the rational for FONAPAR's allocations, the efficiency of its organization and operations, its impact on municipal development and revenue generation capacity and intermediate term revenue prospects.

4. Design of Improved Customs Collection System: A thorough Study of GOE Customs leading to recommendations for improved organization and control systems.

The first of these studies was to be undertaken by a work group composed of DGR officials. It is noted in the mid-term evaluation that the DGR had not and did not intend to undertake the assigned studies. In fact, nothing related to these studies was done until the new government took office (see below).

Studies in the other three areas were undertaken through the Local Revenue Administration Project of the Metropolitan Studies Program of Syracuse University. These studies produced five reports, two related to income taxation, two related to FONAPAR and one on customs.

One Study "The Income Tax in Selected Latin American and Caribbean Nations: A Cross National comparison with Special Reference to the Case of Ecuador" concluded that the GOE neither relies heavily on taxes nor does it impose heavy tax burdens on the people. Further the study indicated that taxation is not particularly centralized and that in relation to similar countries, Ecuador has underutilized income taxes. In this regard, the study revealed that Ecuador, like other natural resource rich countries, tax the exploitation and exportation of their resources to an extent which allows relatively limited utilization of other taxes. This study indicates that an expansion of income taxation in Ecuador would be consistent with the general pattern of taxation in countries of similar size and income.

The study "Sensitivity Analysis and Evaluation of the Ecuadorian Personal Income tax" analyzed the revenue and equity implication of changing the structure of the personal income tax. The major findings were:

- The income tax structure is excessively complicated and tax evasion is rampant.
- The large number of deductions and exemptions greatly reduce revenue proceeds and as they are taken advantage of by high income groups primarily they tend to make the system regressive.
- Elimination of the proportional component of the income tax would be of most benefit to middle and high income groups.
- Intentional computation errors, multiple filing, under reporting of income and non-filing generate high revenue loss.
- Unless accompanied by strong efforts to overcome all types of tax evasion, reduction of marginal tax rate will produce large revenue loss unless accompanied by significant broadening of the tax base.

These findings remain pertinent to current reform thinking. First they indicate that rather substantial broadening of the tax base would be required to offset reductions in the tax rates. One way to broaden the tax base would be reduce the number of deductions and exemptions. The study indicates that such a step both would enhance the progressitivy of the system and by simplifying tax calculations reduce the possibility of evasion via intentional errors.

Another way to broaden the tax base would be to integrate into the system all who should pay taxes and insure that all taxable income is properly reported. These objectives, of course, are part of what guide the current DGR Fiscal Administration Development Project the GOE Administrative reform package 006 and the anticipated package of tax reform measures. The findings of this study indicate that unless reform efforts include strong tax enforcement, the simplification and rate reductions envisioned in the rax reform may well reduce the revenue potential of increase taxation.

Perhaps of greater import, the study demonstrates that alternative changes in the tax structure can have substantially different effects on the amount of tax revenues and on the equity of the tax system. In this regard the methodology employed in the study is of potentially substantial practical importance to the development of a tax reform package. Methods and techniques like those employed in this study provide the means of calculating the costs and benefits of changes in tax structures. Calculations of this type can provide substance to augment and identify unintended and/or undesirable implications of proposals which on the surface appear wholly beneficial. In fact, this data from this study provided the analytical bases for one of the presentations (see Cagigal, Documents Consulted Annex 2) at the Workshop in Guayaquil when the Ministrar announced his plan for tax reform in the coming year.

Two of the studies are directly related to the Central Government Support of Municipalities and its implication for local government resource mobilizations and infrastructure investment. For at least two reasons these studies are relevant to current reform efforts. First, although it is generally not recognized, the fiscal need of municipalites is one of the consideration underlying the enactment of 006, the Law of Revenue and Financial Control. Moreover, ten (27-36) of the 84 articles in 006 relate to some municipal revenue sources. Second, FONAPAR, the major source of central government grants to Municipal government is funded by 10% share of income taxes. Thus, Central Government Reform of the income tax will affect the amount of monies transferred to the Municipalities.

One of the two studies related to the municipalities "FONAPAR: An Institutional Assessment" is concerned primarily with inter-institutional relationships within the GOE as they affect the flow of FONAPAR's funds and the administrative difficulties they pose for municipalities. While the findings suggest substantial room for administrative reform, the major findings are not closely related to DGR reorganization, 006, administrative reforms or to future tax reform.

The second study, "The Impact Of Intergovernmental Grants On Local Governments in Ecuador." A study of FONAPAR is of particular interest. One of the major findings was that FONAPAR grants stimulated municipal government investments in social infrastructure investments. On this account, tax changes at central government level as they effect FONAPAR transfers to the municipalities and provinces will affect the municipal contribution to national infrastructure investment. It is worth noting that a principal objective of the Fiscal Administration Development Project was increased public investment.

Another finding of this study is particularly relevant to the revenue increase objective of the 006 administrative reform and the anticipated tax reform package. That is that central government grants reduced municipal revenue raising efforts. Thus it is likely that revenue affects of both administrative and tax reform efforts will be offset by countervailing responses to the attendant changes in grant flow. As noted in this study this could be avoided by changing the criteria guiding the distribution of FONAPAR grants.

It is understood that the World Bank made extensive use of these two studies in designing its new municipal development loan.

The final study "Ecuador: Design of an Improved Customs Collection System is a comprehensive analysis of the operation and weakness of customs taxation. While it is not known whether due to this study, one of its major recommendation was implemented by the past government (Discontinue the use of the Swiss firm SGS for import evaluations). The study is not related to 006 reform. However, there have been indications that customs reforms have been considered in the MOF studies mentioned above. Moreover, there are also indication that some initial consultation efforts have been planned in the areas of customs reforms. In this regard it would seem that the organizational and operational reforms would be of relevance to anticipate tax reform activities.

Activity on the studies related to procedural laws and regulation was initiated after the new government took office. A revenue commission was formed under the supervision of Carlos Sandoval, Special Advisor to the Ministry of Finance. One purpose of this group was to identify and initiate studies. While several studies focused on the revenue code and administration of tax law were commissioned and/or supervised by members of the Commission, they did so in their individual capacities as Sub-secretary de Rentas and Special Advisor to the Minister.

All these studies have been classified as "Reservado." It is our understanding that many of these were completed by outside advisors from Colombia, Peru, Argentina and Spain.

To the extent that knowledge of the contents have been made known to us, these studies and their recommendations have been influential in both the design of the tax administration reform legislation (006) and the soon to be provided comprehensive tax reform package which is to be put forth for public discussion at the end of July. As these studies are reputed to provide at least a part of the underlying rational and structure for the pending tax reform, they certainly remain pertinent. Our knowledge of the analysis of the revenue and tax burden implications of these studies is limited. It appears that to the extent these calculations exist they are based on the representative tax payers approach and/or computer models based on the existing tax structure. These techniques are useful for some purposes but they fall short of the type of analytical method and procedures required for efforts of such major importance as tax reform.

Conclusion:

The studies financed under the project are of continuing relevance to tax reform and have been consulted by some of those in the present government who are designing its tax reform package.

C. Forward-looking Approach to Fiscal Policy?

"The degree to which the reforms of December 1988 and the new legislation, currently being developed by the Tax Reform Commission, represent a significant, forward-looking approach to fiscal policy within the context of identified deficiencies."

Finding:

Although it would not be hard to find areas of disagreement with the direction the fiscal reform has taken in Ecuador, overall, the reform is remarkably on the right track in both areas of policy and tax administration.

Discussion:

The extent and nature of the administrative reforms in Law 006 of December 1988 were discussed in I.G above. The extent and nature of the envisioned tax policy reforms to be introduced in late 1989 were reviewed in II.A above. In those discussions, which will not be repeated here, we concluded that overall the administrative changes introduced in 1988 and the tax policy changes being contemplated for 1989 are sound and forward-looking.

There is no precise way to assess the quality of a tax reform. However, there exist several guiding principles that all fiscal reforms should follow. Tax systems should be equitable both horizontally and vertically, should not impede economic efficiency and growth, should cause the least number possible of distortions in the decisions of consumers and businessmen, should be simple and easy to administer and comply with, and should be adequate in revenue raising capacity. The tax structure presently in force in Ecuador does not comply with any of these principles. Perhaps not independently of the tax structure, tax administration has been and is greatly deficient. Inequitable and highly distortinary tax structures are always much more difficult to enforce. High levels of tax evasion, as those existing in Ecuador, are a way, albeit an undesirable one, of redressing deficiencies in the tax structure.

Conclusion:

Comparing the proposed tax reforms against the list of desirable goals of any tax system, we reach the conclusion that the new taxes will generally represent a significant improvement over existing taxes. They will also be, generally, easier to administer. Many of the tax administrative changes introduced in December 1988, should also prove to be valuable in the development of a modern fiscal structure in Ecuador.

D. Receptivity of GOE to Further USAID Assistance

"To the extent that GOE Reform measures fall short, what is the likelihood that the current GOE administration would be receptive to pursuing more far-reaching reforms with USAID assistance?"

Finding:

Recent (006) and planned tax reforms present a plan for action. Background studies are incomplete and the necessary institutional support and requirements have not been systematically evaluated. Higher level MOF officials recognize the need for assistance and it appears that they would welcome it.

Discussion:

The recently initiated tax Reform (006) is viewed within the MOF as a necessary first step. As has been announced, the MOF plans to open public discussions about a broader range of reforms. Several background documents have been prepared, many by foreign consultants, and some studies of the revenue and tax burden implications have been undertaken. Regretfully a complete analysis of these is not possible because they are "Reservado" and have not been provided to the evaluation team. As discussed in II.A, above, the reforms contemplated appear to be both broad and all inclusive. These include further modifications in income taxes (e.g., replacement of deductions with credits, reduction in marginal tax rates, change in business investment incentives, inflation adjustments, simplification of import tariffs and customs duties, improved property tax procedures, changes in public enterprise pricing etc.). Which of these will actually be implemented is unknown. What is clear is that the Minister of Finance and the Sub-secretary of Rentas anticipate major changes in the tax structure during the coming year, to wit, the Sub-secretary is, at this writing, on a trip to Chile for the purpose of seeking advice on custom and tariff reform. In addition, a number of background documents have been prepared by outside consultants. Moreover, the MOF has submitted a proposal to IBD for (among other things) the services of outside consultants, some of whom are internationally renowned fiscal reform experts. It appears that GOE is still negotiating with the IDB on this proposal. In private discussions, the need for expert advise and technical assistance has been underscored by the Minister of Finance and the Sub-secretary of Rentas. In addition, rather persistent inquiries have been made about the availability of team members for such activities.

Conclusion:

The contemplated GOE reform measures far from falling short can be characterized as far-reaching and, if anything, overly ambitious. It is too early to tell which or how many of them will ultimately be implemented or how long it will take. However, it is evident that the GOE has a continuing need for outside consultants and will be receptive to offers of such from USAID. If there appears to have been some reluctance in this regard during the past months, it can be attributed, in part, to the lack of confidence the MOF has had in the DGR and the project contractor OMNIMAX.

Recommendation:

Rather than waiting to see if the present reform measures fall short, the USAID should encourage the MOF to submit a proposal which identifies the nature and type of technical expertise required. By providing such assistance the USAID could help facilitate a tax reform, whose dimensions may be as broad as those undertaken anywhere in Latin America.

E. Relevance of the Present Project for the Tax Reform

"The implications, if any, of the forms for the current project, and the potential role of the project in this changing environment over the short and medium term."

Finding:

Both the tax administration changes of December 1988 and the tax policy changes anticipated in 1989 have been taking place de-facto independently of the USAID Tax Administration project in the DGR. The project activities clearly have not been harmful to the fiscal reform process. However, the project has had only very limited success in some areas (e.g., collections of past due "Titulos de Credito) and has been struck with practically no progress in other areas (auditing and non-filers). With adequate refocusing a major commitment of the GOE and a determined and competent leadership in the DGR, it might still become a key support element of the tax reform process over the short and medium terms.

Discussion:

The Fiscal Administration Project contracted with Omnimax, was conceived as a transformation of the organizational and operational structures of the DGR. The reorganization of the DGR although approved almost two years ago has been extremely slow in implementation. Over the last year, the reorganization plan has been subject to revisions especially in the legal department area. One major cause for the slow progress seems to have been the lack of decision by different Directors Generals when confronted with resistance from Sub-directores and Jefes de Departamento who would be adversely affected by the reorganization changes. There is little justification for delaying any longer the reorganization of the DGR. This should not take any significant amount of the resources left in the project. Moreover, the reorganization should be useful independently of the ongoing tax reform. However in order for this to happen the DGR will need determined competent and continuous leadership for the next three or four years.

In the tax enforcement areas of collections, non-filers and stop filers, and auditing, the performance of the Tax Administration Project has been disappointing. The training of the "agentes tributarios" and the implementation of collections plans have been quite successful. It makes sense to maintain the present level of effort in this area within the DGR. On the other hand, the programs to identify non-filers and stop-filers have been a failure. The same can be said for the audit programs. To continue business as usual in those two areas is likely to be a waste of resources. It could be argued that whatever is done in these two areas would be useful and perfectly compatible with any tax policy environment including the tax reform to be introduced later this year. Although this is a valid argument, it is also incomplete. Two things need be kept in mind. First, the resources available under the project are scarce and these resources may have a much greater impact when put to use in a different way. Second, although the contractor bears some responsibility for the failure of the audit and filers programs, DGR personnel have also been an important cause of the failure. The evaluation team fears that corruption among the ranks of auditors has been at the heart of the lack of progress in the audit and filers programs. Despite the disciplinary actions taken by the new administration, there is no guarantee that this state of affairs (wide-spread corruption) will change over the short or medium term. There is a need to rethink the role of the Tax Administration project in the Ecuadorian fiscal context today. The project should stop being an independent and frequently aimless appendix of the DGR and become a protagonist in the ongoing tax reform process.

The Tax Administration project has had practically no input into the tax reform in process since August 1988. The Borja administration came to power with a well defined agenda for tax reform. The new Minister and his advisor and president of the Tax Reform Commission, Mr. Sandoval, did not rely at all on the DGR or the Tax Administration project. This is not as surprising as it may seem when one realizes that the Minister's team may have seen the DGR as part of the problem (if not the main problem in tax enforcement) rather than part of the solution. Trying to work around the DGR or implement tax policies which ignore the DGR is a pattern that members of the evaluation team have seen repeated through the years in Ecuador shortly after changes at the ministerial level. In the past, the Minister and his advisors have come to the realization that the DGR has to be part of the solution to tax enforcement in Ecuador. It would appear that Minister Gallardo and his team may be close to being converted to this viewpoint.

In order for the USAID to understand exactly how its resurces will contribute to the furthering the new tax reform program, it will first need a detailed proposal from the MOF, which can lead to negotiation and a new project paper.

Such a proposal from the Ministry will have to be examined closely for focus and cost effectiveness. Focus will be important, because with the limited resources available in the project, it will be desirable to concentrate on those activities that will be most supportive of the ongoing tax reform. The tax reform has taken risks which could prove disastrous without proper tax administration support. Clear examples of these are the more extensive use of withholding ("retenciones"), the use of "estimacion objetiva global" and "regimenes de equivalencia," and collections through the banking system. It will also be necessary to pay attention to the issue of cost-effectiveness. It is likely that there will be proposals for equipment and vehicles which may not be warranted. Such proposals should be scrutinized carefully to determine whether there are not alternatives, more cost-effective means of proceeding.

Another aspect of a possible GOE proposal which must be examined closely by the Mission is the long-term commitment of the GOE to the project. The tax reform effort is identified closely with two men, Minister Gallardo and his advisor Carlos Sandoval. The Sub-secretary of Rentas, Juan Acosta appears to have a strong commitment, as well. Nevertheless, a change at the top could radically change what now appears as a bright hope for a substantial and far reaching reform.

While no project paper can anticipate such changes or their consequences, one useful measure of long-term commitment to a project which frequently can outlive changes of personnel at the top is the commitment of additional resources to the project from the outset. The DGR has been referred to as "stepchild" of the MOF and always has had low funding priority. If it is to undertake the administrative function required by the new reforms, it will require substantial resources in addition to outside assistance.

Additional office space has also been identified as a major constraint to the reorganization of the DGR and there are indications that the MOF is taking actions to remedy that problem. This is one action which can help confirm a long-term GOE commitment to improve DGR performance. However, it alone is insufficient. Additional personnel must be hired, salaries of key employees must be raised, travel allowances must be increased, additional funds for supplies and equipment must be provided, etc. In short, if USAID assistance is ultimately to be effective, the DGR's budget must be increased substantially. This would not only signal a degree of commitment by the GOE to the project but would improve the prospects for project success.

Conclusion:

The current project has the potential to play an important role in the present tax reform effort. However, before commiting itself to further funding, the USAID should examine carefully the administrative aspects of new reform, emphasizing, focus, cost effectiveness and long-term commitment on the part of the GOE.

Recommendation:

The Mission should ask the Minister of Finance to provide a new proposal (or a modification paper) which details how the Fiscal Administration project can be integrated in a supportive role of the tax reform effort initiated in December 1988 and still in progress. All parties involved, Minister Gallardo, his advisor Sandoval, the Sub-secretary Acosta, and the Omnimax team, seem to have agreed to the value of such a proposal. It is important that the proposal paper originate in the office of the Minister so as to avoid the continuation of parallel tracks by the Minister's advisor, Mr. Sandoval, and the Sub-secretary of Rentas, Mr. Acosta.

F. Institutional Constraints

"Major institutional constraints to effective implementation of the fiscal reform package within the DGR, and whether these can be addressed under the project as designed."

Finding:

The DGR itself is the single greatest institutional constraint to effective implementation of the fiscal reform package. Within the DGR, the single greatest constraint is lack of executive leadership. This is especially important at the sub-director level and must be addressed if the reform is to succeed. Nevertheless, there is no alternative to the DGR for implementing the reform. Therefore, the eventual reform of the DGR must be part of the reform package.

Discussion:

The single most important institutional constraint to effective implementation of the fiscal reform package is the DGR, itself. One possible sign of this is the way the fiscal reform activities have been developed to date. Since August 1988, the communications between the Reform Commission and the DGR were practically non-existant. New tax administration procedures were introduced in December 1988 without previously preparing the DGR to implement them. There appears to be a lack of confidence in DGR, as an organization, to be able to implement the reform, so whenever possible it is being by-passed.

On the basis of the team's observation and the conclusions of this evaluation, there is good reason for MOF and the Reform Commission to have its doubts about the DGR. The original PP identified many of its institutional short-comings, which this project was designed to remedy.

Unfortunately, as this evaluation testifies, very little progress has been made. This leaves such vital areas as returns filing compliance and an effective audit system for sales and income taxes still far from ready to contribute to making the new reform successful. In addition, new requirements under the reform such as developing a rational process for estimating income by trade or profession and instituting a system for verifying and controlling the magnetic tapes sent by commercial banks to the DGR will put even more responsibilities on an extremely weak institution.

Within the DGR, perhaps the single greatest constraint is the lack of executive leadership. While the Sub-secretary of Rentas in the MOF and the Director of the DGR appear to providing this leadership at the present time, the long-term success of the reform will depend upon the competence of the various sub-directors who have day-to-day responsibilities for implementing the reform.

It is at this level where the reorganization plan and other key elements of this project foundered in the past for lack of support or outright opposition. Therefore, the present reform effort must contemplate taking drastic action at this level if the the reform is to succeed. There are some hopeful signs that the MOF recognizes the problem and may take action. However, if it is not addressed, the long-term prospects of the reform effort will be substantially reduced.

The unfortunate irony of this situation is that there is no substitute for the DGR in carrying out the tax reform. While the Reform Commission could ignore the DGR in formulating policy and promulgating laws, it cannot ignore it implementing the laws.

It is for this reason that the present project continues to be important. Even though its accomplishments have been extremely modest, it has helped the DGR take the first steps toward improving its operating competence. It has also helped the DGR, the MOF and the USAID identify the many real obstacles to successful implementation of the new reform. This experience should not be lost, but built upon. It will be a long and difficult job, but it is essential if the present reform is to succeed.

Conclusion:

The USAID will have to do further analysis to determine how it wants to invest its limited resources in this venture. Many of the deficiencies of the DGR, identified in the original PP are still valid. However, priorities will have to be established in order to achieve optimum results. The across-the-board reform of the DGR, foreseen in the present project agreement, cannot be accomplished within a reasonable time-frame. Focus must be placed on taking the first steps toward making the new reform effective.

Recommendation:

USAID should work with the MOF to establish priorities for its assistance to the DGR aimed at focusing primarily on making the new reform effective.

III. MECHANIZATION PROCESS

A. Progress to Date

"Progress to date on mechanization, both at the regional level and as it relates to the collection system through the private banks."

Findings:

The DGR is organized under five Regional Offices and within each Regional Office there may be one or more Jefaturas. Only Guayaquil and Quito are functional as Regional Offices. Cuenca, which will eventually be a Regional Offices is presently equipped to operate primarily as an Area Office with a functioning agent cashier system. The other Regional Offices have only skeleton staffs.

The collection effort done through the banks is effective, but not complete. A definition is required at the management level. Both at Guayaquil and Quito the data transcribed by the Banks does not go anywhere, it remains in a data base at both NCR Tower computers, probably pending validation. The paper summaries are sent to Quito.

Discussion:

Under the new tax law the MOF signed an agreement allowing banks to do the data entry of the tax returns and collection of all monies associated with the tax return, consolidating the output data onto magnetic tape. The amounts due from the taxpayer may be taxes, penalties or interest. The banks have a certain processing time frame and may be fined if errors are found; or if there are delays in making the appropriate deposits, supplying magnetic data, the actual paper tax returns, or if they miss deadlines. Banks are not obligated to assist taxpayers i: filling out forms or determining amounts to pay. The bank develops its own software to do the data transcription function and to write the output tape to be turned in to the DGR processing center.

The collection system implemented through banks only relates to two Regional Processing Centers, Guayaquil and Quito, both centers are now in operation.

Equipment installed and processes are as follows:

a) Guayaquil processes approximately 60 tapes a week from local banks. The processing of these tapes consists in reading the tape into the disk, comparing amounts in a transmittal sheet and in returning the tape to the bank person that took the tape to the DGR processing Center. Along with a tape data, an envelope is turned in containing the actual paper tax returns. Total processing time is around 15 minutes per tape.

b) Quito processes approximately 100 tapes a week from local banks. The processing of these tapes is similar to Guayaquil.

c) The hardware installed at both sites is more than adequate to process a growing work load during a normal 8-hour shift. The possibility of a second 8-hour shift is always open, but at this time is not required. The physical installation seems adequate at both sites.

d) Guayaquil has installed the following equipment:

NCR Tower 32/600 Minicomputer (68020, 16Mhz),

4 MB main memory
260 MB disk drive, 200 LPM Epson Printer,
22 serial ports, 1 Parallel port,
2 dual density Tape drives 1600/3250 BPI.
1 SNA 3270 Emulation Port, and 1 BSC 3780 Emulation Port.
3 Asynchronous terminals in use, and 1 terminal still packed.

e) Quito has installed the following equipment:

NCR Tower 32/650 Minicomputer (68020, 25Mhz),

8 MB main memory
800 MB disk drive, 200 LPM Epson Printer, 28 serial ports.
1 400 LPM NCR Printer, 2 Parallel ports,
2 dual density Tape drives 1600/3250 BPI.
1 SNA 3270 Emulation Port, and 1 BSC 3780 Emulation Port.
3 Asynchronous terminals in use.

f) Both sites run the same production software:

UNIX Operating System V Release 3, Unix utilities are used, the main applications has been programmed in "C" language. Operating procedures are in place and running smoothly.

Ample evidence exists in the documents consulted to substantiate the choice of hardware and software. The virtues of UNIX as a multiuser, multitasking operating environment are well known. Informix, with an SQL relational database and 4GL languages as well as the "C" and "C ++" languages are adequate for handling the applications intended for the minicomputers. Cost parameters were very reasonable.

The environment was conducive to rapid development of the tape processing after the Nov 1988 decision, the specifications were written and coded in a whirlwind fashion during Dec 1988 and Jan 1989. The documentation, lagging at first, is substantially completed. If this processing had to be done using a conventional computer language such as COBOL, ASSEMBLER or RPG it would have never been accomplished in the record time that it was done. This was largely achieved because of strong support from the contractor.

A follow up project was the validation of the paper tax returns against the tapes supplied by the banks. This project is still not off the ground although some efforts are being made at the programming department of the DGR.

The conversion of the tax returns manual system from the Jefaturas to a computerized format similar to the banks is still under discussion, even for methodology, processing system, people involved, specs, etc.

The data collected from the banks in Guayaquil is backed up daily onto the same tape. This data is also sent to the Quito processing center. Logistically this presents a problem for the DGR due to scarce resources to ship and replace tapes to and from Guayaquil.

Conclusions:

Uncertainty seems to be the word that best describes the operation. The Jefaturas were initially supposed to be closed, all collections were to be done by the Banks, then it was decided that they were to remain open. Tax return processing is done manually in some Jefaturas. Realistically, the consolidation and consistency of processing of Tax returns is not there.

The bank collection project was done in record time, and now the loose ends are being tied. There are trained people operating the system, the capability exists to make modifications to the system when the final aspects of the the reform are in place.

Recommendations:

1) The whole cycle of validation needs to be implemented if the transcription efforts by the banks are to be useful to the DGR. The equipment in place will support this new application.

2) The data collected, i.e., RUC, name and address of the taxpayer, profession, etc. needs to be collected in a central Taxpayer Data Base, perhaps in the mainframe at the DOS. The information collected can be used to determine if a taxpayer using the Cedula has a valid RUC issued or not. The longer time goes by, the more out of date the information collected becomes.

3) As the question has been raised whether the reception of tapes in Guayaquil is a good idea, a decision should be made as to whether the Guayaquil reception center will continue. Once the decision is reached, it is important that resources and personnel be allocated so as to make reception effective.

B. <u>GDR Management Capability</u>

"Real capability of GDR Management and personnel to successfully carry out the processes and procedures necessary for effective mechanization."

<u>Finding</u>:

From the Sub-director level up to the Ministry level there is no real detailed knowledge of what is involved in processing data. Plans, specs, changes, notifications, etc. need to be signed several levels above to become effective. GDR management must put full faith in the people that present the papers to be signed. There are trained people operating the system. What they need is leadership and guidance from the top.

<u>Discussion</u>:

A detailed organization chart of the DGR exists. The chart was drawn up under the Acuerdo Ministerial No. 262 dated June 16, 1989. It has received ample distribution at the Department head level. Many of the functions specified are not staffed. Some of the departments performed cross level functions, i.e., the Departmento Centro de Computo is performing data processing functions as a Regional Office, and as a National Computer Center.

The processes for effective mechanization need to be first defined, communicated and agreed to in a Strategy document with stated goals. From this document then the tactical objectives and work plan can be derived. <u>This document does not exist, thus creating conflicting views within DGR and the MOF</u>.

The procedures necessary for effective mechanization are in place in some areas. Neither a Functional specification of a processing system, nor System Design specifications to substantiate the design were available for examination. There are, however, record layouts and step by step instructions on how to do certain things.

The reorganization of DGR is still too young for people to have settled into their roles and begin to function as a team. In some cases people in new positions have to help out in their old functions. Some people cross department boundaries in an attempt to solve problems. A good sprit de corps exists.

Effective mechanization can only be accomplished when the overall cycle of data is defined. The need for a top-level Functional Specification outlining the processes is essential. From this document you would derive other documents useful in the Software Development effort. A Test plan with test documents produced elsewhere from the Development group is essential.

Conclusions:

It is very difficult to evaluate real capabilities in such a short time. Our impression is that, under the guidance of a competent senior-level system analyst, management and personnel could be brought together to work synergistically to get out of a fire-fighting mode.

Recommendations:

1) Hire a senior systems analyst with responsibilities to create the Functional System Specifications outlining the whole cycle of data processing until the data becomes information.

2) Monitor the reorganization process to streamline functions and assign resources to the functions already defined.

C. Systems Documentation

"Effectiveness of systems documentation and designs utilized and training provided in programming and processing."

Findings:

Two applications are running at DGR:

a) "Area Office Cashier System" in Cuenca and Pichincha. Utilizes 2 Compaq 386 computers and 15 on-line terminals.

b) "Bank Tape Processing System" in Quito and Guayaquil. Utilizes 2 NCR Tower minicomputers with 4 Tape drives and 6 on-line terminals.

DGR needs strong system analysis and design methodology help. DGR needs to understand data base design strategies and trade-offs to enable them to carry on future projects.

Discussion:

The two major applications were developed in a rather short time. The "Area Office Cashier System" originally was to be implemented on the NCR Tower System. Later, the application was implemented using Compaq 386 computers, the system came on line in February 1988. The system design was based on the "Informix" data base running under SCO/Xenix, screen layouts, various record layouts and hardware integration were performed by OMNIMAX advisors to keep costs reasonable and to gain time.

The environment of this application was somewhat turbulent. The motor for the whole application was Bill Hernandez of OMNIMAX, who was knowledgeable of "Informix" and SCO/Xenix. No one else at DGR had heard at that time of "Informix," they had used "Accell" data base on 286-based PC's and "Unify" relational data base package running on the older NCR Tower 32/650 minicomputer. Mr. Hernandez' could only communicate in English to one person in the whole DGR programming department. Mr. John Hervas of DGR became Bill Hernandez' mouthpiece. John expressed to the team that he had "a very good tutor" and that he "had learned a lot from Bill." John is a young, energetic and enthusiastic individual, but of a junior level. Senior analysts at DGR were set aside or reassigned. The operations manuals were to have been created by another department. All of these factors became handicaps.

As soon as some programmers were hired they were trained in the Unix system, specific SCO/Xenix was learned as the project went along to conclusion. Some informal "Informix" training took place.

Systems and programming management people felt that they had no real input into the system design and programming. The DGR people trained their own system operators in the use of the "Cashier system."

The development of the "Bank processing System" was somewhat different but shared some of the same ingredients, with the added handicaps of late deliveries and various formats of tapes from banks in two different cities of Ecuador. Another factor was the development of a "Tape Processing Interface Specification" to give to the banks as third parties, something that DGR had never done before. The banks required a lot of help to capture tax return data and to put it in a processable tape format. In the end DGR had to duplicate bank efforts to capture tax return data to verify bank tapes.

Conclusions:

From the technical point of view the designs utilized were correct. "Informix" is powerful and sophisticated. The system documentation is almost non-existant as no "feasibility study" or design reviews were held. There are record layouts, screen layouts, operation manuals and other documents, it is doubtful whether an outsider would be able to make an informed judgement as to what the system is supposed to do or where the data goes. Test documentation and methodology used was not available.

We concur with people at DGR that this is not the way to run a project with so many handicaps and variables simultaneously. Trying to learn a new system, a new data base package, from a person who does not speak Spanish, while designing a new application that never existed is a tough proposition.

Recommendations:

1) Provide qualified, Spanish-speaking instructors to cover the following topics:

   a) Data base selection, trade-off and capabilities of various Unix or Xenix available packages such as "Unify," "Oracle," "Foxbase+," "Informix," "Accel" and others.

b) Advanced System Analysis topics, with emphasis in teleprocessing and transaction based systems.

c) How to choose computer equipment, capacities, configurations, options, peripherals, availability of manufacturers in Ecuador.

d) Unix advanced techniques in shell programming, "C+" programming. Performance tuning and available tools.

2) System documentation techniques are also required to be successful in future projects.

3) In future implementations the advisors should not be involved intimately with coding, design and testing of applications. Advisors should "advise" 80% or more of the time and "do" 20% or less of the time.

D. Logistical Support

"Logistical support provided by GDR, e.g., space, installations, furniture, supplies, etc., for correct use of equipment already purchased."

Findings:

Space, supplies and paper are all problems in the DGR computer offices. In the programming department terminals do not have computer desks. Terminals do not have non-glare filters. Production is hampered because of uncomfortable height of key-boards, strained viewing angles for monitors and lack of privacy in the work area and there is a shortage of magnetic tape. The RUC department is better organized.

Discussion:

We visited only two sites, Quito and Guayaquil. In both areas the NCR Tower mini computers seem to be housed adequately in clean environments as a result of a very strongly-worded memo prohibiting smoking, eating and drinking in computer rooms from the Director General of the DGR.

The terminals are located on top of small desks where people are supposed to carry out other duties. These desks are not "computer desks" by any stretch of the imagination, as the keyboards are not 29" from the floor for comfortable typing. Lighting in some cases is directly in front of the screens, or worse, very bright light behind the monitors. None of the terminals have non-glare filters installed.

In the programming department, the monitors are turned up very brightly and they sit on top of AT class PC cases. The angle of viewing is bound to create serious neck strain while the uncomfortable height of the keyboard is not conducive to production. The 386 computers are next to each other in a heavy traffic area by the coffee pot. People come and go, a radio plays in the background, others from within and without the department are talking and socializing. There is no privacy whatsoever or at least a "quiet area" where one pondering a complex problem with Unix could hear himself think.

When discussing back ups of source code and data we were informed that DGR only has 40 magnetic reels of tape! This number seems to be inadequate for the storage needs of the DGR. Other magnetic media like high density and double density 5.25" and 3.25" diskettes seem to be in short supply everybody doing what they can to back up today's work.

A new function under the Operations Department is entitled "Archivo de Dispositivos Magneticos", an auspicious beginning for a systems library, but nobody works there nor are there any magnetic media to archive or catalog.

The RUC department was better organized for a processing entity, the terminals there were connected to the DOS mainframe, this department had been in existance since 1973 and consequently was in much better shape.

<u>Conclusions</u>:

Ergonomics in the work place is not a luxury, it is a productivity tool. A central filing system for media and documents is a must. The programming department needs to be more functional in lighting, space, furniture and quiet, without becoming a morgue or a museum.

Ample supplies of media to each programmer will insure that valuable data is not destroyed while they look for a diskette, any diskette to write a very important file.

Recommendations:

1) DGR needs a new building with ample space to allocate individual partitioned workstations to each programmer, system analyst or engineer. A central library area for documents, specifications, media, system manuals, operator's handbooks and trade magazines should be provided.

2) If possible new more functional furniture should be acquired where the desk area has enough room for a couple of open books, a listing and a terminal or monitor.. Enough monitor and keyboard extension cables should be purchased so that the CPU's do not occupy all of the desktop.

3) Curtains to shield sunlight or at least subdue it should also be procured.

E. Hardware and Software Utilization

"Appropriateness and utilization of the hardware and software installed to the requirements of the new tax reform."

Findings:

Both the hardware and the software are appropriate for the applications presently in use. The equipment is being used correctly and there is no redundant equipment. Some backup equipment would be advisable.

Discussion:

Some computer systems, namely the NCR Tower mini computers, have very precise functions, others in the programming department are either test machines, word processors or development machines. The new Compaq 386 machines are used in a SCO/Xenix environment to support the "Cashier Systems" in Cuenca and Pichincha.

No equipment inventory was available by location, type or application.

The word processors are used to write operators manuals, documents, specifications and general correspondence and as such are more than amply justified, given the shortage of typewriters at the DGR and the periodic revision cycles of documentations as procedures are updated. It is to be noted however that printer ribbons are in general very light due to the heavy usage they are subjected to. The light printing due to overuse of the ribbons create poor originals from which manuals and documents are later copied from, in turn copies are just as bad as the originals.

The simplification of the tax forms, the elimination of the annexes, the data transcription and collection functions performed by the banks have done much to alleviate the workload at the DGR. Thus existing equipment is sufficient to handle the applications.

The output from the word processors for the reasons mentioned above is of poor quality due to ribbon supply problems, however a good clean crisp manual does much to improve operations. A low-speed laser printer with appropriate direction switches would allow a more professional crisp output and a much better original from which to produce copies.

The development, test and support systems are under constant usage to refine existing systems and to troubleshoot problems.

The Compaq 386 machines are used to develop applications under Xenix for later installation at the NCR Tower minicomputer. Although this practice is adequate, it is best to develop, test and install in a machine as close as possible to the target machine to simplify development and installation later on at the remote site.

Conclusions:

The software is appropriate for the application and so is the hardware. All equipment installed is being used correctly and we do not believe there is any redundant equipment. A possible addition would be some extra

386 computers as backup. Mobile NCR Tower systems would be too expensive and they are really not justified as they only handle one application, "Bank tape processing." In case of downtime at Guayaquil the tapes could be sent to Quito and vice-versa.

The extra 386 computers, if any, should be on hand in the development area so that can be moved on a very short notice to any site that has experienced a malfunction.

Recommendations:

1) Study the possibility of acquiring a low-speed (8 to 10 PPM) laser printer for the Word Processors along with adequate number of toner cassettes in order to insure print quality.

2) As extra applications, i.e., "Sales Tax Processing" or "Titulos de Credito," are added to the NCR Tower system serious considerations should be given to another NCR Tower System to be used for software development.

3) An inventory of the existing equipment detailing at the very minimum, location, type, application, Operation System type and revision, Utilities type and revision, Data Base type and revision, peripherals installed, printers, disk capacities, etc. To deploy resources effectively.

4) Purchase one or two "Ribbon Re-inking Machines" with appropriate adaptors to reink the ribbons in use at DGR, such as NCR 0101 for the 400 LPM NCR printers, Epson 5000 line printers, Epson FX-1050 and IBM Proprinter XL24. The low cost of these machines will more than pay for themselves in a couple of weeks.

F. Organization Considerations

"Organization considerations such as hours of processing per day, week or month; different applications and shifts, etc."

<u>Findings</u>:

The NCR Tower hardware installed at both sites is more than adequate to process a growing work load during a normal 8-hour shift. The possibility of a second 8-hour shift is always open, but at this time is not required. The physical electrical and environmental installation seems adequate at both sites.

<u>Discussion</u>:

The "Agent Cashier System" in Quito and Cuenca is operating under reduced workloads since the Banks began processing returns. Single shift processing is adequate.

The Bank tape processing center in Guayaquil processes approximately 60 tapes a week from local banks. The processing of these tapes consists in reading the tape into the disk, comparing amounts in a transmittal sheet and in returning the tape to the bank person that took the tape to the DGR processing Center. Total processing time is around 15 minutes per tape if there are no problems such as bad tapes or read errors, therefore processing time is about 15 to 20 hours a week.

The Bank tape processing center in Quito processes approximately 100 tapes a week from local banks, therefore processing time is about 25 to 30 hours a week.

We did not get any feel for "peak" period processing, but a backlog exists almost everywhere, so delays and "time shifting" are not uncommon, nor a cause for concern for anybody. It was almost "expected" that nothing is processed expeditiously.

A practice that we found which could create problems is when programmers use "Production" systems to create new applications, patch existing ones

Conclusions:

Logistics and equipping is not necessarily a high priority or high concern area at DGR. Apparently, timely processing is not a data processing goal.

As more applications begin to load the minicomputers, such as tape validation or Sales Tax processing, the extending of operating hours should be considered.

Recommendations:

1) Plan now to add a "Programming, testing and debugging" system very soon so that a production systems is not subject to the influence of extraneous code, practices and people.

G. Programmers' Capabilities

"Levels of programmer's understanding of, and ability to utilize software purchased."

Findings:

Senior programmers and systems analysts are needed now. Software purchased is being utilized fully, therefore the inference is that the level of understanding is high. A motivated team exists and the information is shared both formally and informally. However, no technical library exists for consultation of detailed topics.

Discussion:

Ability and understanding come with experience in the Data Processing field. Our estimation is that the development team is operating at the junior to average level. Experienced senior-level programmers and systems analysts are needed now. Compensation levels in general are out of touch with private industry in Ecuador.

The personnel study under way would allow the classification of people according to experience level and compensate accordingly. English language should a pre-requisite to new hires to be able to understand the flood of available data in the marketplace. Bibliography of computer software systems is in English and it is unrealistic to expect that software or hardware manufacturers translate completely all technical data, manuals, reference and software.

Conclusions:

Without any kind of in-depth testing of personnel it is very hard to determine levels and abilities. Therefore any estimation is very subjective and perhaps inaccurate.

English proficiency should be required at least at the technical reading level of programmers, system engineers and analysts both to be more productive at work and to qualify for further training in the U.S. as part of the project.

Recommendations:

1) Independent testing of technical topics of the people involved can perhaps be done as a pre-requisite to further training. A workbook could be developed for in-home or correspondence training on Unix, Xenix, "Unify," "Informix," etc. by qualified Spanish speaking instructors.

2) Establish minimum level of knowledge, i.e., a baseline, by position and function. This is better handled as a "Classification of Personnel" project for compensation and staffing purposes.

3) Establish a technical library as soon as budget and space permits to support the computer department.

H. <u>Accomplishment of Objectives</u>

"Overall objectives of processing, level of accomplishment of these objectives, actions taken to successfully accomplish stated objectives in processing."

<u>Findings</u>:

By the end of the project there were supposed to be installed computer hardware in all Regional and Area Offices. Early delays in hardware procurement created problems, but at present no additional equipment is on order. Under the circumstances, the mechanization of Regional and Area Offices will not be realized as this project ends.

Software updates need to keep pace with the evolution of the applications, otherwise, bottlenecks and other problems occur.

In spite of substantial input and effort there is not much to show for it. The overall target was late by one-to-two years in July 31, 1987. As this project comes to an end the objectives have not been realized.

<u>Discussion</u>:

Two applications are running at DGR:

a) "Area Office Cashier System" in Cuenca and Pichincha. Utilizes 2 Compaq 386 computers and 15 on-line terminals.

b) "Bank Tape Processing System" in Quito and Guayaquil. Utilizes 2 NCR Tower minicomputers with 4 Tape drives and 6 on-line terminals.

One application is no longer running at DGR:

"Sales Tax Processing System" programmed in "Unify" language and originally running on NCR Tower 32/600 mini computer.

The design and some coding of three applications have been started and later stopped at DGR:

a) "Secretarial Control System" to keep track of documents and to do Word Processing. This application was Compaq 386-based.

b) "Portfolio de Titulos de Credito" to keep track of taxpayer liability from documents issued by DOS mainframe.

c) "DGR Inventory Control System" to keep track of DGR assets. It will probably be based on Compaq 386 hardware.

The NCR Minicomputer 32/600 was moved to Guayaquil to process the Bank tapes. Processing of Sales Tax returns have stopped completely. This is a step backward. The Sales Tax returns are piled up in a hallway, the Computer processing Chief is not taking any responsibility for those forms.

There are currently no plans to install the Sales Tax application on the NCR Tower 32/650 installed in Quito. The problem here is that the application was written in "Unify" language. The existing "Unify" software (Version 1.03) does not run under the new UNIX operating system (Release 3.2) on the NCR Tower 32/650. Once the "Unify" software is upgraded to run under the new version, then the installation, testing and debugging of the Sales Tax application can be done. New workstations will need to be added to the NCR system in Quito. At this time physical space will be required.

The "Area Office Cashier System" was never implemented on the NCR Tower System as originally envisioned. This project was implemented using Compaq 386 computers. One Compaq 386 is installed in the Pichincha Office using 10 terminals. The other Compaq 386 is installed at the Cuenca Office using 5 terminals. With the advent of bank collections there is doubt as to whether the cashier system will continue.

The decision for the "Area Office Cashier System" was made on June 1987, the system was specified, coded and tested between October and December 1987, the system came on line in February 1988. Documentation and training was completed. This system was not implemented on the NCR Tower System. This project received a final push when advisor Bill Hernandez from OMNIMAX, single-handedly designed, coded, installed and tested this system. The Guayaquil cashier system was never installed although it was badly needed. The need for the system was somewhat relieved by April 1989 with the implementation of the Bank Tape processing system.

All work on the "Secretarial Control System" effectively stopped in November 1988, due to the need to implement the "Bank Tape Processing System" in a hurry.

Another project contemplated was the "Master Inventory Control for DGR" this project involved inputting capital equipment data into a data base. Some planning and specification took place but to this date this project is not implemented.

A couple of other projects had equal false starts and delays in the planning, programming and specification phases. The "Portfolio of the Titulos de Credito System" is also needed, as mentioned in the mid-term evaluation, but it is not even a committed project at DGR.

Every one of the systems on line has trained operators, the Quito computer center is staffed with trained operators. DGR Programmers received training in UNIX operating system, "Unify" and "Informix" data bases. More training on advanced topics is still required.

Specific requests were made to have a UNIX expert conduct classes for DGR programmers, as well as a Data Base Expert with specific emphasis in applications design using 4GL data bases, such as "Informix," "Oracle," "Foxbase+" and "Unify." System Analysis, "C" programming, Shell script programming, parameter and system tuning are also topics that need to be covered if effective utilization is to be made of existing hardware.

Software purchased more than one to two years ago is quickly becoming obsolete as new versions of UNIX, XENIX appear in the U.S. marketplace, newly acquired machines are faster, cheaper and better, they rely exclusively on newer versions of SCO/Xenix and UNIX. These new versions of the Operating system require upgrades of applications software already purchased such as "Unify," "Accel," "Informix," "Reel Exchange" and "Ciprico" tape drivers.

Conclusions:

1) Every one of the applications needs to be reviewed to decide whether it should be installed in other offices or not.

2) Applications that were started and later stopped will need to be re-evaluated under the light of the Tax reforms and the reorganization of the DGR, for possible development or rejection.

3) The "Sales Tax Processing System" needs to be put on line as soon as all applicable software is updated and tested.

I. Flexibility of Current Mechanization

"Degree to which current mechanization is sufficiently flexible to include processes, procedures, and modifications under Tax Reform legislation to go into effect in 1990."

Findings:

New legislation to go into effect in 1990 will further refine some operating aspects of the tax reform changes of 1989. Computer systems existing today are expected to keep pace if enough early notice is given to the system departments. Some aspects of the 1989 reform are still not implemented such as Timbres, and "Estimacion Objetiva Global."

Discussion:

The RUC is still not updated to accommodate the taxpayers' "Estimacion Objetiva Global" fields. When this is done new data processing requirements will come into play. Planning is the key activity that will prevent major disasters and fire-fighting.

The new law is still under discussion and no major results of the negotiations with industry, commerce and labor are expected to come out until September. Feasibility studies along with tentative schedules should be laid out as soon as possible.

Conclusion:

We see no problems in modifying existing processes and operating procedures at the DGR. However, external interface documents to Banks or third parties need to be polished in light of the 1989 experience.

Recommendations:

1) As the new law seeks not to create new taxes but to increase the collection of existing taxes, the processing of taxes must keep pace with the objectives of the new law. So, we recommend the earliest possible involvement of the Departmento de Programacion y Control in conjunction with a senior-level systems analyst in planning for changes in tax administration.

2) Assess what changes might be required to the two functioning systems at DGR: "Cashier System" and "Bank tape processing system." Proceed to develop schedules, tasks and personnel assignment using some sort of Project Management software such as "Timeline" or "Harvard Project Management." PERT Charts would also suffice if employed correctly.

J. Operations, System and Software Recommendations

"These recommendations are given here to overcome some of the problems observed in software development, operation and system areas."

Backup:

There are several kinds of backups that are necessary in any computer operation:

a) Source Code. Latest version running the production systems. From this file it should be possible to compile the entire application, thus producing the object files necessary to run the application.

b) Procedures and batch files necessary for compilation into a complete application should also be backed up regularly. During intense development, perhaps once a week, later while the production systems are in beta phase once a month. Later while the application has matured once a quarter. The frequencies indicated are minimum periods.

c) System Parameters. So that the next version of the Operating system will able to read the installation defaults, disk paths, hardware addresses, printer configurations, etc.

d) Taxpayer Data. Data retention at the site would normally apply but a rotation of child, father and grandfather tapes is recommended. Data could be backed up in disk image format or data base format as long as the method is clearly indicated.

Document Revision System:

The following documents are required for each processing subsystem.

a) Functional Specification.

b) System Design Specification, used for coding and review.

c) Computer Room Operations manual, used to run the subsystems on a daily basis. This manual specifies frequency of backups, installation of updates, installation logs, daily operating procedures, error recovery, error messages, disposition of media, etc.

d) External interface documents. Used when some facet of processing is done by a third party; i.e., banks, service bureaus, contractors, etc.

Some sort of procedure is necessary to control changes to documentation specifying reason for change, who performed the change, who reviewed the changes, and the date that the change is effective. A master log of all documentation should be kept. Production systems should be updated as required. In the case of external documentation this document revision control is imperative.

System Test Data:

Any system or subsystem should have a set of test data prepared by an independent party to the Systems Department. In the specific case that we are aware "Bank Collections" no such test data exist. Our recommendation would be as follows:

a) Select a suitable number of Completed tax returns. (Perhaps 100 documents.)

b) Change the names and assign fictitious or reserved RUC numbers. Completely fill out all possibilities for numbers, including those cases that "should never happen."

c) Process the returns manually as a batch to know exactly what the payments and line item values should be.

d) Verify that the existing system at DGR and at each Bank comes up with the same numbers and values.

e) Any new institution should come up with the same data as the master regardless of programming language, computer system or method used based upon the master interface language.

f) As changes are made to the Tax Code, or to the Forms the test documents should be revised.

In summary, the test documents along with the correct source code in the computer should yield a correct, verifiable output. Changes to any processing programs or formulas should be verified using the set of test documents, as an added benefit the hardware could be checked. Any discrepancy with results produced by any bank would quickly be resolved without resorting to "debugging" the bank's computer system.

IV. TECHNICAL ASSISTANCE

A. Technical Assistance by Project Component

"Assess the technical assistance provided in each project component."

Finding:

The technical assistance provided by the contractor lacked overall concept or guiding vision. The collections and compliance component of the project was the most successful, OMNIMAX probably deserves same credit for this. The audit component was the least successful and OMNIMAX must share the blame. The most serious failure was in the processing component where after four years there is no local technician who can assume leadership of the computerization program. In summary, the technical assistance provided was not up to standard.

Discussion:

Because of the way this project is organized using a contractor to provide all technical assistance, and because the reporting requirements do not focus specifically on the performance of individual technicians and their effectiveness, the written record available to reconstruct the effect of technical assistance on project components is extremely limited. Therefore, what follows is based primarily on interviews and impression drawn from the progress made in each of the project components. Under the circumstances, it is not complete and in some instances the conclusion may be faulty for lack of more extensive information.

Looking at the background and qualifications of the contractor, OMNIMAX, in the abstract, and reviewing the roster of technicians that it was ready to assign to the project it must have seemed to the USAID, as the project started, that it had found the ideal organization to assist the GOE in transforming the DGR into a modern tax administration agency. OMNIMAX was made up exclusively of ex-IRS technicians, many of whom had had foreign experience. In addition, they could draw on a long list of technicians out of IRS who knew Spanish as well as having had years of experience in their specialties.

The contract called for four full-time technicians for the life of the project (4 years): A Chief of Party, an audit advisor, a processing advisor and a collections and compliance advisor. In addition it provided for short-term advisors in seven categories: Inspection, Training, Collections, Compliance, Audit, Systems and Management.

During the life of the project, the contractor was able to provide the assistance as required in all of the categories and for the specified time, with the sole exception of a short term advisor in Inspection. Thus, in general terms the project did not suffer from the lack of technical advisors in any of the project components, except Inspection, and the major project components of collections, compliance, audit and processing had the benefit of both long and short-term advisors.

The record available to the USAID and the evaluators does not reveal the comparative competence of these advisors nor their effectiveness on the job. Therefore, it is necessary to extrapolate from other information to arrive at some conclusions in this regard.

It is interesting to note that the project component which formed the backbone of the DGR administrative reform, Reorganization, was not designated to receive specific technical assistance, neither long nor short term. It was understood that whatever technical assistance that might be required in this area would be supplied by the Chief of Party, who was not on O&M specialist, but had had years of experience in the IRS, much of that time in management positions.

In retrospect, and taking into account that the reorganization under Decree 664, which OMNIMAX helped design, was only partially implemented and has undergone substantial subsequent changes, it might be argued that the project could have used a knowledgeable O&M specialist when 664 was being drafted. This argument becomes even more persuasive, when we take into account that the present revision of 664 recently approved as M.A. 267 was created under the guidance and supervision of a local-hire O&M specialist on OMNIMAX staff.

This does not necessarily reflect adversely on the first two Chief's of Party under the OMNIMAX contract, but it does give some substance to the impression of the evaluators that there was no overall concept or guiding vision on the contract team, which could translate itself into leadership in the DGR.

The project was run by ex-IRS technicians who were guided by their own understanding of how IRS operated in the United States. This was particularly true in the last two years of the project. Perhaps this explains the lack of any real leadership from OMNIMAX to propose radical changes in the project work plans, once the project began to falter and lose momentum.

With regard to collections and compliance, both served by the same long-term consultant, there must have been some satisfaction among the OMNIMAX team, since these were the only components of the project which showed real progress. Yet, it is impossible to judge how much of the progress was due to sound and effective technical assistance and how much to the basic decision to separate collections from audit as a function. Nevertheless, as noted in other parts of this report, the results were positive and OMNIMAX should be given some of the credit.

Audit is another story. This is probably the weakest single component of the project and OMNIMAX must share some of the blame for the lack of progress. The first full-time audit advisor had to be replaced after one year because of illness. He was succeeded by another advisor who had originally come on a short-term assignment. From the record it appears that he had no experience in initiating new programs and activities, so he concentrated on the one thing he knew and had control over, training. He was replaced by OMNIMAX after a two year tour, even though he had indicated a willingness to stay through the end of the project. The third long-term audit advisor is now the OMNIMAX Chief of Party. The team is well impressed with him, but has no basis for judging his effectiveness as an audit advisor. The audit advisor position is once again vacant.

While it appears that technical assistance in audit was not as effective as it should have been, it is important to keep in mind that this is probably the most difficult of the project components to reform because this is where the money is. Dishonest auditors have it within their power to demand bribes and extort under-the-table payments from taxpayers. It is believed that corruption among auditors is high. It will be recalled that in the beginning days of the project, 56 auditors were summarily dismissed for suspected dishonesty. The Minister of Finance did not support the Director General of Rentas in this action and the 56 were eventually reinstated. And as a result of the dismissals, the Director General lost the support of the MOF, and all aspects of the project suffered as a result. Thus, even if the technical assistance from OMNIMAX had been 100% effective, it is uncertain how much difference it would have made in meeting project objectives.

Perhaps the most poignant of the OMNIMAX technical assistance experiences occurred in Processing. By all accounts and ample testimony within DGR, the processing advisor was an extremely competent and hand-working individual, fully dedicated to having the project achieve its goals.

However, he become frustrated after the first two-years of recurring obstacles and incessant delays in ordering and installing equipment and became an "implementer" instead of the "advisor." He took it upon himself to do what he had concluded the GOE was incapable of doing -- fully computerizing a decentralized tax administration system.

In the process, he alienated managers in the DGR and failed to pass on his own expertise to a high-level counterpart. The net result was that he was just as incapable of achieving the computerization goals as the DGR management, and after four years, he left no one in the DGR with the skills and experience necessary to assume leadership for the computerization program.

In part, because of these problems and in part because the new government came in with a strong commitment to tax reform and an effective tax administration, it put OMNIMAX under strong scrutiny and found it wanting. The Director General de Rentas endorsed an earlier request that the Chief of Party be allowed to cut his tour short. He wanted him to be replaced by a technician who could speak Spanish. He later asked that the processing specialist and his short-term consultant be removed because of problems they created in the DGR. As a result, the present OMNIMAX team has been reduced to two individuals, the ex-audit advisor who is now Chief of Party and a local hire O&M advisor.

Conclusion:

On balance, it can be fairly concluded that OMNIMAX technical assistance was generally not up to standard, in spite of the firm's credentials and its impressive stable of technicians. A telling, but probably unfair, irony which reinforces this view is that the only project component which did not receive specific help from a designated OMNIMAX technician was the Inspection Service because a qualified Spanish speaking specialist could not be found. The irony is that the Inspection Service is one of the two organizational units which can be judged a success under the reorganization.

Recommendations:

1) The reporting system for contractors on project progress should be revised so that the USAID has on-going information on individual technicians' performance and effectiveness.

2) The USAID clearance system for approving contract technicians should be reviewed and possibly tightened. Future contracts should give USAID full authority to monitor on-going performance of individual technicians and to recommend replacements where necessary.

3) It is difficult to obtain top quality technicians under any system, a replacement of the OMNIMAX contract might not yield any better results. Thus, a strict limitation on long-term positions, greater use of local hire talent and a closer screening of all candidates for technical positions might be a wiser course to follow.

B. <u>Constraints to Performance</u>

"Major constraints to effective performance of the Contractor."

<u>Finding</u>:

The two major constraints to the effective performance of the contractor was the waning support at the highest levels of the GOE for the project and the internal resistance to change at the sub-director and middle-management level of the DGR.

<u>Discussion</u>:

The two major constraints to the effective performance of the contractor have been amply documented in other sections of this report, (1) the waning support at the highest levels of the GOE for the project and (2) internal resistance to changes at the sub-director and middle-management levels of the DGR.

The first of these constraints was beyond the control of OMNIMAX since it did not have it within its power to effect a change. The only course it had was to try to encourage implementation of the project at the working level, hoping for a change of attitudes at the top.

The lack of high level support for the project made it easier for those resisting change at the mid-management level not to accept the advise of OMNIMAX technicians, thereby reenforcing the second major constraint.

However, unlike the first constraint OMNIMAX did have some power to effect change at the managerial level. It had limited success in this regard, being able to influence certain personnel changes and reassigrments.

However, this is a particularly tricky area. One of the major changes which OMNIMAX was successful in having influenced, the transfer of the Sub-director of Processing in the Central Office, may well have led to its single most important failure, the absence at the end of the project of a senior specialist in processing to guide and direct the computerization of a nationwide collection system.

In the end, OMNIMAX ability to effect change at the managerial level was not sufficient to overcome this major constraint.

All of the other problems which slowed or stopped project progress, such as lack of space, slow procurement of equipment, lack of resources in the DGR, and which can be considered constraints to contractor success, are really consequence of the two major constraints discussed above.

Another constraint for the contractor, at least in the first two years of the project, was the way the contract was written with regard to procurement. The PP assigned full responsibility for procurement to the USAID. The contractor had no obligation under the contract for procurement. Yet, the OMNIMAX systems and computer specialist had to dedicate a good portion of his time to prepare specs and initiate procurement documents. This is covered in greater detail in the mid-term evaluation. Time spent on such matters obviously detracted from his primary functions of advising and training local staff.

Conclusion

Even though the contract technicians had been of the highest quality and had been generally successful in transferring their expertise, the project goals would not have been met because of the waning commitment of the GOE to the project.

Lesson Learned:

1) When a project loses or appears to lose the high-level support which it had when it was initiated, the USAID should undertake a major review to decide whether the project should proceed or be cancelled. Temporizing too often leads to unproductive wheel spinning and ultimate waste.

C. Appropriateness of Technical Assistance

"Appropriateness of technical assistance as currently designed, with relation to the major focus and content of the MOF tax reform strategy and the reorganization of the DGR."

Finding:

The technical assistance as currently designed is not appropriate to the focus and content of the MOF tax reform strategy. Listed below are some of the critical needs which should be addressed in a new project design.

Discussion:

A good portion of this report is dedicated precisely to examining the current project activities in the light of the ne' GOE tax reform and discusses in some detail present technical assistance requirements under the reform legislation. Sections I and II of Part Two are especially detailed in this regard. Therefore this section will be limited to highlight some of the more critical needs.

However, before considering these needs, it should be noted that the major conclusion of this evaluation is that the present project should be closed out and an amended project should be designed. Therefore, it follows that the technical assistance as currently programmed is not appropriate to the focus and content of the MOF tax reform strategy. This does not mean that many of the activities currently being carried out will not be useful to the reform. It does mean, however, that continued USAID funding of technical assistance should be based on the priorities growing out of the reform and should not be driven by the momentum of past project decisions, which while important do not have the urgency of reform related activities.

Particular needs which a redesigned project should focus on, and which are discussed in detail throughout the report, are the following. They are listed by functional area rather than in order of priority:

1) Policy Reforms

a) Limited analytical base, need for more studies.

b) Tax Reform developed without clear understanding of DGR capacity to administer.

2) Tax Administration Policy

a) Difficulties of coordination between DOS and DGR.

b) Need for clear definition of functions for DGR and DOS.

c) Need to develop master file.

d) Need to develop a system of cross reference.

e) Responsibility for processing and audit of returns of larger taxpayers must be decided.

3) Tax Administration DGR

a) Lack of overall concept of what a modern internal revenue service should be.

b) No sense of system.

c) Need for an overall design of an on-going system of tax collection, audit and control.

d) No self-image in DGR - no internal control.

e) Need for professional up-grading.

f) Need for timely processing of tax files.

g) Need for control of non-filers and stop-filers.

h) Increase number of field auditors.

4) Systems and Processing

a) A process of effective mechanization must be defined and agreed to.

b) An overall data cycle must be defined.

c) A system for verification and validation of bank tapes must be developed.

d) Future of the Agent Cashier system must be defined.

e) Role of the Jefaturas must be clarified.

f) Need for a strong systems analysis and design methodology.

g) Need to undertand data base design strategies and trade offs.

h) Need for advice on additional computer acquisitions.

i) Need to get sales tax processing put back on line.

5) Reform Related Activities in Which DGR Needs Help

a) Withholding (Retenciones en la Fuente).
b) Control and Audit of Withholding Agents.
c) Training in "Estimacion Objetiva Global."
d) Supervision of "Regimen de Equivalencia."
e) Verifications, validation and control of bank tapes.

Conclusions:

All of the above listed needs should be addressed. However, they do not necessarily have to be part of a USAID project. They may be covered by technical and commodity assistance from other donors or by the GOE itself. The important thing is that they are taken into account within the new project design.

D. Critical Areas for Technical Assistance Support through December 1989

"Identification of critical areas in which technical assistance is needed through the proposed new PACD (December 1989)."

Finding:

The period between now and the end of December 1989 is a transition period between the phase out of one project and the initiation of another. All of the activities undertaken during the transition must be aimed at making the new tax reform effective.

Discussion:

The period between this end-of-project evaluation and December 31, 1989, should be viewed by the USAID as a transition period between the end of the present project and the beginning of a new or redesigned, amended project. The concepts, goals, targets and outputs which formed the basis for the present project are no longer valid as guideposts and benchmarks for the period ahead. However, it is unrealistic to think that the present project should be cut off summarily, especially when it appears that the USAID would like to continue assisting the GOE in its tax reform effort. Therefore, the on-going project should be used to phase into the new project.

This evaluation cannot provide a detailed list of the type of technical assistance activities which should take place between now and the end of the year, but we can provide some guidelines for both the USAID and the Contractor to follow in making determinations in this regard.

As a first step, the Contractor and the DGR should review the 1988 Project Strategy Statement. This document was produced using the objectives, goals and criteria of the present project to formulate the 1989 program. It should now be reviewed on the basis of the findings of this evaluation — that the present project should be considered terminated and all future activities should be oriented specifically toward supporting the present tax reform.

There are many activities planned in the 1989 Strategy which are essential to the improvement of DGR effectiveness and which could be justified whether there was a tax reform or not. Nevertheless, it is important that all of the previously planned activities be subjected to close scrutiny to determine their urgency and priority following the new guidelines, which is support for the tax reform effort. On balance, most of the activities in the Strategy Statement can probably be justified under this new criteria, but it is important that this review exercise take place so that there can be a reordering of priorities and an agreement between the USAID, Contractor and the DGR as to what the priorities will be for the next six months.

This will require that the DGR and the contractor submit a list of priorities for pending activities and a brief justification for the priorities based on the new criteria. From the listing of critical needs in IV.C above, there are a number of items which it would be impractical to expect be addressed in the next six months and which will have to be part of the considerations of the longer-term effort. The items listed under Policy Reform and Tax Administration Policy both fall in this category. Therefore, activities for the next six months should be concentrated on Tax Administration - DGR, Systems and Processing, and Reform Related activities in Which the DGR Needs Help. Within these categories, the highest priority is on the latter two areas . All of the items under these categories are urgent in nature and can be directed immediately at making the tax reform more effective.

Another activity which the USAID should consider as high priority within the on-going technical assistance program is the utilization of short-term consultants to work with the MOF and the DGR to help prepare a new proposal and for the follow-up work of project design. Such short-term consultants can also serve the USAID as advisors providing guidance on the implementation of the on-going project, helping it focus on high priority activities and guiding it toward linking up with the design of the new project. These short-term consultants should be brought in as soon as possible, since time is of the essence in supporting the new law. The new project design should be completed by the end of September.

Conclusions:

The 1989 DGR Strategy statement should be reviewed by the DGR and the Contractor in the light of the findings of this evaluation. There should be a reordering of priorities to conform to the requirements of the new tax law. Each activity carried out should be justified on the basis of the new priorities established by the USAID and the DGR.

Recommendations:

1) The USAID should request the DGR and the Contractor to review the 1989 Strategy Statement and came up with a list of priorities aimed specifically at furthering the new tax reform effort. Each activity proposed should be justified on the basis of the new priorities and the tax reform requirements.

2) The USAID should consider bringing in short-term consultants to help the MOF and the DGR prepare a new proposal and for the follow-up work on project design.

3) This work should be completed by the end of September.

E. Critical Areas For Technical Assistance Support Beyond December 1988

"Identification of critical areas for technical assistance support if project were to be extended beyond December 1989 in the light of the GOE's proposed tax legislation."

Finding:

The critical areas for technical assistance beyond December 1989 were identified in IV.C above. Only a full-scale USAID review of each of these items as part of a project redesign exercise can identify in detail what technical assistance the USAID should provide. However, it can be stated now that two or perhaps three long-term technicians should be sufficient.

Discussion:

Section IV.C above has identified the critical areas for technical assistance in light of the new tax legislation. A definitive plan for providing technical assistance in these areas will have to await a more thorough USAID review of each one of these items. This should be carried out by a tax specialist working closely with the MOF and the DGR. It will be only through such a process and the subsequent redesigning of the project and the negotiations of a project agreement amendment that the technical assistance requirements can be specifically identified and defined.

However, in general terms, it can be stated at this time that approximately two technicians or maybe three should be sufficient to provide the long-term assistance required. The first one who should be Chief of Party, should be fully qualified in Tax Policy Reform and Tax Administration Policy and should be prepared to address all of the critical issues identified under IV.C.1), 2), and 3) above. In addition there will be a need for a Systems and Processing technician, who can address all of the critical items under IV.C.4. Finally there might be a need for a long-term Collections and Compliance Technician to help the Chief of Party in Tax Administration. But this need might also be filled by short-term assistance. There is at present a part-time local hire O&M specialist on the contractors staff. There will be continuing need for his services and he should be retained. This paper will not try to identify the short-term technicians who might be required since this will depend to some extent on the qualification of the long-term consultants and their preferences as well as where the redesign effort places its priorities.

Conclusion:

If the contractor can find technicians with the right qualifications there is no need for a large permanent technical assistance staff.

F. Other Donors Contributions

"The extent to which these technical requirements are satisfied by other donor contributions and their direct presence with the MOF."

Findings:

Several donors have provided and/or will be providing support for the DGR and MOF tax administration-tax reform programs. Two donors IBRD & IDB will be providing funds for equipment to be used in the processing, audit and control of tax payer information. Funds for studies, travel, and consultancies in support of the MOF planned changes in tax structures are anticipated to be forthcoming from IBRD, ILDIS, and the Spanish Embassy.

Discussion:

For activities related to tax reform and DGR reorganization the MOF and DGR have had and continue to have support from international organizations (other than AID). With the exception of one equipment grant, the funds provided have been for activities and background papers in support of tax reform.

The DGR in collaboration with OMNIMAX developed a proposal for the purchase of equipment. This was submitted to the World Bank in October 1988. The proposal was refined, resubmitted and a grant has been approved. Specification for purchase are being prepared by DGR with assistance from OMNIMAX. Equipment has been put on order by the World Bank, the total cost of the equipment is $100,000.

The equipment is to support three activities: A) a pilot project in the DGR audit office for the processing of third party information as part of the "informacion cruzada" program. The largest part of this activity ($26.000) is for hardware and software for the Departamento de Programacion y Control, Subsection of Determinacion Tributaria. The second part $15,000 for the Processing Department of Litoral Regional Delegation in Guayaquil.

The second part consists of office equipment for the Director and Sub-director of the DGR, ($41,000). This is to facilitate word processing and statistical analysis. The third part is for a computer and ancillary equipment to develop the UNIX computing system in DGR and to support the development of systems and programming compatibility between the DGR and DOS.

This activity was evaluated by the World Bank in the context of the OMNIMAX/DGR Strategy Document and considered to be in support of and not duplicative of the Strategy.

The Spanish Embassy has funds for travel and support for foreign consultants who have prepared background papers for the pending Tax reform. They also have supported travel of DGR officials to other countries to observe activities and consult with foreign tax officials on tax reform matters (e.g., Juan Acosta's trip to Chile). The support is provided on an ad-hoc basis and is not programmed formally as a grant or loan. To the extent we have seen them (they are all classified as Reservado) the papers which have been produced by consultants are generally conceptual/theoretical and well done. A paper prepared by Sr. Sevilla, financed by Spain, is the intellectual foundation for the proposed tax reforms.

It appears that support from this source will be used in the future to obtain expert advise and guidance in the more practical aspects of implementing the tax reforms which are planned for 1989/90.

While these activities have not been in conflict with those of the AID/DGR project, the activities which have and are likely to grow out of them have important implications for tax administration. The obvious examples are the use of the banks as collection agents, and the "retenciones en la fuente." The former duplicates established tax collection channels (via the Jefaturas) and both demand new data processing and audit procedures. A need for new and/or modified tax Administration procedures is likely to follow the tax reform planned for 1989/90.

The UNDP through Robert Nathan Associates has funded a program "Proyecto de Gestion del Sector Publico." A major element of this program was the development of methodologies for revenue projections. This activity was undertaken in the revenue Section of the Division of Budget. Econometric models for revenue projections were estimated, programs for their use on computers were operationalized and personnel were trained in their use. The programs and procedures are used in the Division of Budget as an aid in developing the revenue estimates included in the budget. It effectively brought the revenue projection capacity in the MOF up to a level comparable to, or above, what is used by state governments in the U.S.

While this effort is complete, it is worth noting that Sub-secretary de Rentas Juan Acosta considers the document produced by this project "Informe Sobre la Revision de Proyecciones de Ingresos al Presupupuesto General y Possibles Medidas para Incrementar las Recaudaciones" (prepared by Jorge Martinez) as his bible for tax reform. In this regard it should be noted that a substantial number of the measures recommended to increase revenues are extracted directly from two AID studies one of which was part of this project being evaluated.

The Instituto Lationamericano de Investigaciones Sociales (supported by the Fundacion Frederich Ebert) has been a source of support to MOF in their activities related to the development and implementation of the tax administration reform package 006. In this regard the objective of ILDIS participation has been to encourage policy development and broaden participation in the deliberation of policy reform.

Following these lines ILDIS has funded the activities of Colombian Consultants particularly in the development of the bank collection system and "retenciones en la fuente." ILDIS also has supported two workshops. The first, in April, took place in Quito focused on the Tax Reform package (006). The second, July 10/11, in Guayaquil provided the forum for the Minister of Finance to announce the outline of a major tax reform package for 1989/90.

Both took the form of workshops involving people from the private sector, universities, and government ministries. Both involved prepared papers which set the topic for commentary and discussion.

ILDIS plans a continuation of these activities and support of consultants to the MOF special advisor through the coming year. In addition the ILDIS contemplates support of work in the areas of central government budgeting and provincial planning.

ILDIS takes the position that it has no specific policy objective, it provides no personnel and seeks to broaden the form of participation. The relation with the MOF is considered to be one of its major activities. The ILDIS director is willing to consider areas where cooperation with other donors might be productive.

The MOF has submitted a proposal to the InterAmerican Development Bank (IDB). The proposal requests two sets of activities. One set is to support consultancies, travel and studies related to the changes in the tax structure planned for 1989. These activities are to be focused around the MOF policy group.

The second set of activities are designed as an extention of the tax administration activities which have been initiated in the DGR.

The original proposal developed by DGR alone requested support for equipment (computers etc) to undertake activities not funded by AID in the Fiscal Development project.

The equipment is to be used by DGR to update and improve the RUC and develop current account. These activities would require collaboration with DOS. The proposal to the IDB takes for granted that AID will be providing equipment under the Tax Administration Reform project. The IDB has assigned this proposal to its Technical Cooperation Department. The proposal has received favorable review in part because it was framed as a continuation of existing tax administration and tax structure reform effort. It is anticipated that the IDB loan committee will give its approval by the third week of July, and the directors approval by the end of August. According to this schedule, project implementation could begin before the end of the year.

Conclusion:

There is a great deal more interest and possibly participation in tax reform activities by other donors now than there was through most of the life of the project now under review. This is another good reason for the present project to be closed out and redesigned taking into account the role of other donors.

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ANNEXES

ANNEX 1: PERSONS INTERVIEWED

ANNEX 2: DOCUMENTS CONSULTED

ANNEX 3: METHODOLOGY

ANNEX 1: PERSONS INTERVIEWED

USAID/Quito

Frank Almaguer	Director
Thomas Chapman	Project Officer
Bambi Arellano	Deputy Chief, General Development Office
Eduardo Ortiz	Project Coordinator
Steffi Meyer	Backstop Project Officer
Sandra Eguez	Program Economist

OMNIMAX/Quito

Octavio Garza	Chief of Party, Fiscal Administration Development Project, OMNIMAX
Bill Hernandez	Processing Advisor, Fiscal Administration Development Project, OMNIMAX
James Westrick	Processing Advisor, Fiscal Administration Development Project, OMNIMAX
Carlos Davalos	Consultant, Fiscal Administration Development Project, OMNIMAX

Ministry of Finance

Jorge Gallardo Zavala	Ministro de Finanzas y Credito Publico, MOF
Juan Acosta Andrade	Subsecretario de Rentas, MOF
Carlos Sandoval Peralta	Presidente Comision Permanente de Reforma Tributaria, MOF
Patricio Mastre	Programacion de Ingresos, Division de Presupuesto, MOF

Carlos Troya	Subdirector de Programacion de Ingresos Divisiçn de Presupuesto, MOF

Direccion General de Rentas

Miguel Realpe Nogales	Director General de Rentas, DGR
Carlos Velasco	Project Coordinator, DGR
Pilar Almeida	Chief, Seccion de Estadistica Depto. Planificacion, DGR
Walter Andrade Bravo	Subsecretario del Litoral, DGR
Rodrigo Chiriboga Gallegos	Subdirector General de Procesamiento y Recaudacion, DGR
John Hervas	Programador, Departamento de Sistema, DGR
Ivan Garrido	Programador, Departamento de Sistema, DGR
Roberto Lopez Alarcon	Subdirector General de Control Tributario, DGR
Gonzalo Mogollon Vivanco	Delegado Regional de Rentas del Norte, DGR
Pola Olmedo	Jefe Departamento Centro de Computo, DGR
Marco Ocabo	Jefe Departamento de Registro Unico de Contribuyentes, DGR
Emilio Parra Ramos	Delegado Regional de Rentas del Litoral Centro, DGR
Fernando Pineda	Jefe Departamento de Programacion y Control, DGR
Melida Ramos	Jefe Departamento de Sistemas, DGR
Virgilio Ribadeneira Valdez	Subdirector General de Control Tributario, DGR
Luis Toscano Soria	Subdirector General Tecnico Administrativo, DGR

Almagro Velasquez	Jefe Departamento Procesamiento y Recaudacion, Guayaquil, DGR
Aida Villacres	Chief, Depto. de Planificacion, DGR
Franklin Rodriguez	Jefe Departamento de Determinacion Tributaria, Guayaquil, DGR
Manuel Vivanco Riofrio	Project Coordinator World Bank
Reinhart Wittman	Director, Instituto Lationamericano de Investigaciones Sociales

Annex 2: DOCUMENTS CONSULTED

Project Paper — Fiscal Administration Development Project 518-0042, Loan-V-061

Mid-Term Evaluation Ecuador Fiscal Administration Development Project, by Patrick F. Morris, Jorge Martinez and Hernando Garzon. August 1987.

Reforma Tributaria, Ministerio de Finanzas y Credito Publico. March 1, 1989.

Estrategia del Proyecto 1989 - OMNIMAX - Proyecto para el Mejoramiento de la Administración tributaria.

Informes Trimestrales, from Dr. Rodrigo Garcés Moreano, Juan Acosta Andrade and Dr. Miguel Realpe Nogales to Thomas Chapman as follows:

Oficio 1423, dated 5 Oct. 1987

Oficio 0642, dated 25 March, 1988

Oficio 1341, dated 21 June, 1988

Oficio 0370, dated 20 Sept, 1988

Oficio 1744, dated 6 April, 1989

Características Generales de la Primera fase de la Reforma Tributaria
Probably dated around Jan 1, 1989.

Registro Official - Dec. 29, 1988 - No. 97
Law 006

Paper Title "Mini computadores en la Dirección General de Rentas", dated June, 1989.

Reglamento Financiero de la Dirección General de Rentas - (sin número) to further define function under Ministerial Accords 267 July 1989.

Omnimax - Training Statistics, 1989 to 1989
Training Plans, 1987, 1988

USAID Issues Paper 7/26/88 - Fiscal A[illegible]stration Project June 15, 1989.

MOF study on Revenue Collections - Boletin # 144
December 1988

Papers presented at ILDIS, Worshop, Guayaquil, July 10 + 11, 1989

1. Perspectivas de la Reforma Tributaria Gravámenes Para Sus Sociedades. Juan F. Franco Parras.

2. Criterios Para Una Propuesta de Reforma a Legislación Tributaria Existente, Jose Larrea García.

3. Algunos de Los Problemas Que Presenta La Actual Estructura Del Impuesto a La Renta, Wilson Ruales M.

4. Analaysis De la Estructura De Exenciones y Rebajas Tributarias Determinación De Su Conveniencia. Recomendaciones Para Su Simplificación . Jose Vicente Troya Jaramillo.

5. Tasa Inspections Marginales Para Grupos de Contribuyentes, José Luis Cagigal.

Selected Tax collecton Data - Dept. de Planificación, DGR

Proyecto Piloto: Systema Integrado de Administración de Personal en las Unidades de Rentas Internas del Ministerio de Finanzas.

Informe Sobre el Espacio Físico De La Dirección General de Rentas (undated) A Los Agentes de Retencion y Percepción de Impuestos - April 1989.

Excerpt from CDSS Fy90-94- "Inadequate Income Growth"

Informe Sobre La Revisión de Proyecciones de Impuestos Al Presupuesto General y Posibles Medidas Para Incrementar Las Recaudaciones - MOF, June 1988, Roberth Nathan Associates Inc.
UNDP Contract No. 88005.

Informativo De Los Impuestos Corrientes Transferencias Del Presupuesto Del Estado FONAPAR y FONEN - 1989 MOF

"Políticas Tributarias Del Actual Gobierno"
Speech by Minister of Finance, Jorge Gallardo to Ecuadorian American Business Luncheon March 1989.

La Dirección General de Rentas En la Ruta del Cambio - Report DGR - 1988

Reforma Tributaria - "Ecuador en Marcha Hacia el Cambio" Min. of Finance - Information Bulletin March 1, 1989

Plan de Control Tributarion Dirigido a Los Agentes de Retención y Percepción De Impuestos - April 1989

Omnimax - Semiannual Reports

April 1, 1987 Sept 30, 1987

Oct 1, 1987 - March 31, 1988

April 1, 1988 - Sept. 30, 1988

Oct 1, 1988 - March 31, 1989

Omnimax- Monthly Reports - August 1987 to June 1989

End of Tour Report - James R. Westrick, Processing Advisor

End of Tour Report - Bill Hernandez, Technical Advisor

Memo dated Feb 28, 1989 - James R. Westrick to Fernando Pineda, DGR.

Oficio dated March 6, 1989 - Miguel Realpe to Carlos Sandoval, MOF.

Memo dated March 17, 1989 - James R. Westrick to Thomas Chapman, GDO.

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USAID/Memo dated June 26, 1989 Steffi Meyer to Eduardo Ortiz Fiscal Administration Project Evaluation,

Letter, June 15, 1989 Jorge Gallardo, Minister of Finance to Frank Almaguer, Director/USAID, discussing increases in tax revenue from January through April 1.

Letter dated March 20, 1989	Octavio Garza to Fernando Pineda, DGR.
Letter dated April 3, 1989	James R. Westrick to Fernando Pineda, DGR.
Letter dated April 5, 1989	James R. Westrick to Fernando Pineda, DGR.
Letter dated April 6, 1989	Octavio Garza to Fernando Pineda, DGR.
Letter dated April 13, 1989	James R. Westrick to Fernando Pineda, DGR. (Subject: DGR personnel experience)

140

Letter dated April 13, 1989	James R. Westrick to Fernando Pineda, DGR. (Subject: Establishment of a Test Group)
Letter dated April 21, 1989	James R. Westrick to Miguel Realpe, DGR.
Letter dated April 25, 1989	Octavio Garza to Miguel Realpe, DGR.
Letter dated May 9, 1989	Octavio Garza to Miguel Realpe, DGR.
Memo dated May 19, 1989	NCR/MACOSA Internal Memo on Sabotage.
Letter dated May 31, 1989	Octavio Garza to Miguel Realpe, DGR.
Memo dated June 14, 1989	James R. Westrick to Thomas Chapman, GDO.

ANNEX 3: METHODOLOGY

The two major factors affecting the methodology of this report were: (1) the many specific questions posed by the Scope of Work, and (2) the varying amounts of time each of the four team members had to complete his assignment. Only the team leader worked on the report from beginning to end. One member of the team was available for only eight working days at the beginning of the evaluation, another arrived a week after the evaluation started and left a week before it ended. Therefore, it was necessary to tailor the methodology to accommodate not only the specific questions of the Scope of Work, but the availability of team members as well.

The two primary sources of information for the evaluation, as is usual, were interviews and documents. The one advantage the team had was that two of the team members had done the mid-term evaluation on this project and a third member had worked on a preliminary study related to the project. Thus, only one of the team (the computer specialist) was coming to the project "cold," without any prior knowledge. This advantage got us off to a fast start and eased our way in choosing people to interview, in conducting interviews, and in knowing which documents to choose from and focus on.

Our interview schedule was, to a large extent, determined by the limited amount of time one of the team members had in-country. So we scheduled interviews for the entire team with all the project principals during the first week of our stay, which included the Minister of Finance, Special Advisor to the Minister for Tax Reform, the Sub-Secretary of Rentas, DGR staff working on the project, OMNIMAX technicians, the Director of USAID, and USAID staff. During that time, also, documents were collected, a tentative format for the evaluation report was developed and circulated for comments and clearance, and assignments were made to team members to address the specific issues raised in the Scope of Work.

Assignments were made on the basis of interest and expertise of each team member, keeping in mind, as well, time availability. A separate interview schedule was prepared for the one team member who would arrive in the second week. There was no time in the first week of intensive interviews for the first departing team member to begin drafting his contribution to the report, so it was agreed that he could fax it within a week after his departure. This, in turn, required frequent meetings of team members to exchange opinions and impressions and to develop a consensus on the report's major conclusions and recommendations. It also required meetings with the USAID Director and staff to indicate the direction the report would take. Thus, while the bulk of the work of gathering, sifting and sorting information and commiting it to paper within the prescribed format was still to be completed, the team was able to inform the USAID of its major conclusions and to get the USAID's reaction within the first ten days.

After that, there was nothing in the document review or in follow-up interviews which changed the major thrust of the report. On the contrary, all of the additional information subsequently gathered confirmed our initial conclusions and served to provide additional support for them. The one team member who had not participated in the initial week of interviews had responsibility for the technical computer aspects of the report, so his findings and recommendations had little effect on the policy conclusions reached before his arrival and, in general, supported those conclusions.

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