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

ECUADOR

PROJECT PAPER

**ECONOMIC SUPPORT FUND
(PAAD)**

AID/LAC/P-751

**PROJECT NUMBER: 518-0116
GRANT NUMBER : 518-K-604**

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CLASSIFICATION:

AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)	1. PAAD Number 518-0116	518-K-604	
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	4. Date	September 30, 1992	
5. To Mission Director: Charles Costello	6. OYB Change Number	N/A	
7. From USAID/Ecuador/ETIO: Peter B. Lapera	8. OYB Increase	To be taken from: N/A	
9. Approval Requested for Commitment of \$ 6,200,000	10. Appropriation Budget Plan Code 72-111/21037 BPC LESI 92-35518-KG31		
11. Type Funding <input type="checkbox"/> Loan <input checked="" type="checkbox"/> Grant	12. Local Currency Arrangement <input type="checkbox"/> Informal <input checked="" type="checkbox"/> Formal <input type="checkbox"/> None	13. Estimated Delivery Period	
15. Commodities Financed N/A		14. Transaction Eligibility Date	

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<input type="checkbox"/> U.S. only	U.S. 6,200,000
<input type="checkbox"/> Limited F.W.	Industrialized Countries
<input type="checkbox"/> Free World	Local
Cash 6,200,000	Other

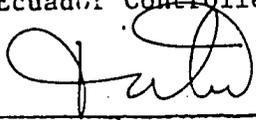
18. Summary Description
 The purpose of the proposed ESF program is to provide support to Ecuador's Economic Reform program, as well as its counter-drug efforts. The dollar funds will be used to reimburse the GOE for financing eligible imports from the U.S. Policy conditionality for which dollars will be disbursed relate to the establishment of economic reform measures, provision of a GOE privatization office and strategy, and GOE support for counter-drug activities. The local currency program will support the economic reform measures and will be implemented by the GOE in accordance with A.I.D local currency guidelines.

The President has submitted the annual certification required under section 481 (h) of the FAA, and under the International Narcotics Control Act of 1990 and the Congressional Review periods have passed without objection.

The waiting period for the Congressional Notification has expired without objection.

"I certify that the methods of payment and audit plan are in compliance with payment verification policy".

USAID/Ecuador Controller



19. Clearances	Date	20. Action
USAID/DDir <i>Am</i>	9/30/92	<input checked="" type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED
USAID/O/Cont <i>ms</i>	9/30/92	
(Incl. Funds Available)	9/30/92	
USAID/RLA <i>g</i>	9/30/92	Authorized Signature
USAID/PPD <i>ms</i>		<i>Charles Costello</i>
		Date
		Sept. 30, 1992
		Title
		Charles Costello
		Mission Director

PROGRAM ASSISTANCE APPROVAL DOCUMENT

ECUADOR ECONOMIC REFORM PROGRAM

518-0116

PROGRAM ASSISTANCE APPROVAL DOCUMENT

ECUADOR ECONOMIC REFORM PROGRAM

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I. SUMMARY

On July 28, 1992, Deputy Secretary of State Lawrence Eagleberger made the commitment to President-elect Sixto Duran Ballen to support the new GOE's economic reform program with a cash grant of \$6.2 million. Accordingly, the Mission will provide a cash transfer of \$6.2 million in one tranche in support of the GOE'S major economic reform program which was announced as a comprehensive package and has begun implementation. Conditions precedent to the disbursement of dollars will require that: 1) the GOE has officially announced and put into effect a comprehensive package of macro-economic reforms, including fiscal, monetary, and Government streamlining measures, and that such a program has begun to be implemented through appropriate decrees and/or regulations; 2) a privatization strategy and program has been adopted by the GOE, an office for coordinating privatization efforts with clearly specified functions and authority has been established, and legislation has been introduced as needed; and 3) that the GOE provide counter-narcotics support as described in a side letter. Cash transfer dollars will be used to finance eligible imports from the U.S. via reimbursement. The local currency program will directly support the Government's economic reforms via extra-budgetary activities.

This cash transfer assistance is extremely important for the following reasons: 1) in meetings with the highest levels of the USG (followed up by meetings with U.S. Mission officers) the GOE has committed itself to a dramatic, immediate and essential economic stabilization package that will result in short-term economic and social problems; 2) based on our carefully cultivated place at the table with the GOE and the private sector and our constant presence in Ecuador, the new Duran Ballen administration has urged us to help in the establishment and initial implementation of the reform package including privatization efforts and of a LC-funded social safety net; and 3) the highest GOE officials have indicated that the cash grant assistance, although moderate, is extremely significant to the GOE in terms of showing USG support and facilitating other donor support for the reform program, which would be larger in amounts, but slower in materializing.

The Mission considered providing the assistance through a commodity import program (CIP) but concluded that a CIP would not be as supportive of the GOE's reform package as the cash transfer based on important policy conditionality described in this PAAD.

II. BACKGROUND

II. A. Summary of the State of Ecuador's Economy

The Sixto Duran Ballen government is inheriting an economy with major macroeconomic and structural weaknesses, the result of fiscal immoderation in the last year of the Borja government and

half-hearted structural reform efforts throughout the Borja administration. The Borja administration's first priority when it took office in August, 1988 was stabilizing an economy suffering from high inflation, large fiscal deficits and a foreign exchange crisis. During its first two years in office it reduced the overall fiscal deficit from 10 percent of GDP to about 2 percent of GDP and the annual rate of inflation from 100% to 50%. In support of this stabilization effort, the GOE signed two stand-by agreements with the IMF although it promptly fell out of compliance mainly due to increased public spending.

As a result of the suspension of monthly fuel price increases and unbudgeted spending, the public sector fiscal deficit facing the Duran-Ballen administration is projected to increase from its level of 1.2 Percent of GDP at the end of 1991 to 7.0 percent of GDP in 1992. The annual inflation rate, which remained stuck at 50 percent over three years because of an accommodating monetary policy, has increased slightly over the past few months because of the fiscal loosening.

Employment and growth worsened under the Borja Government as the unemployment rate increased to 12 percent and underemployment to about 30 percent. The economy grew in real terms at the average growth rate of about 2.3% during 1989 to 1991 period, just below the population growth rate of 2.4%. The Borja Administration was unable to renegotiate its external debt which amounts to over \$12 billion with accumulated interest arrears of about \$2.5 Billion. The GOE'S efforts to buy-back part of its debt failed and the surge in imports from lower tariff rates and precautionary imports resulted in net international reserves decreasing from \$760 million at the end of 1991 to \$320 million in July 1992.

Despite these major economic problems left to the Duran Administration, some reforms were initiated during the Borja administration, but haphazardly and not as part of a comprehensive reform program. Important reforms include: tariff reform which reduced the maximum nominal rate from 290 percent to 20 percent and the average rate from 29 to 9%, a reduction in import prohibitions from more than 900 items to 52; tax reform which established a corporate tax rate of 25% for both domestic and foreign companies (except for petroleum companies which are subject to a higher rate); a new monetary law which sharply curtailed credit subsidies; in-bond manufacturing under the Maquila Law and an Export Facilitation Law greatly reducing red tape; labor reform reducing excessive protection; an investment law which eliminated ceilings on repatriation of capital and profits; and stronger protection for intellectual property rights, and a new mining code.

The U.S. Mission helped whenever it could-e.g. by providing technical assistance to draft and implement the Export Facilitation Law and advise the GOE on the Monetary Reform Law, by

sponsoring seminars to build consensus and by constantly emphasizing the importance of improving the investment climate in discussions with high GOE officials. However, because some of these reforms were flawed and other important reforms were not made, the investment climate in Ecuador remains poor. For example, no new exploration contracts with petroleum companies were signed and Conoco pulled out of the country. The Emelec issue was not resolved and consequently Ecuador has not been approved for trade preference under the Andean Trade Preference Act.

II. B. Recent Counternarcotics Performance

Unlike its neighbors, Ecuador has no tradition of significant coca cultivation and processing but is a transit country for large quantities of precursor chemicals used to refine cocaine, as well as a money laundering center. Ecuador is very concerned not to fall victim to the drug dependence and violence suffered by its neighbors. It has passed strong laws and regulations to criminalize and control trafficking in illicit narcotic plants, drugs, chemicals and narco-assets; centralized drug enforcement in the narcotics police; legalized a drug control role for the armed forces; adopted bilateral accords to control chemicals and money laundering and established a Ministerial-level Drug Council to coordinate national drug policy and efforts. In 1991, it signed a chemical control agreement and initialed a draft money laundering agreement with the U.S. Ecuador was one of the first South American countries to ratify the 1988 UN convention against illicit traffic in narcotics and psychotropic substances. In September 1991, it passed comprehensive anti-narcotics legislation based on the UN convention and OAS model regulations. The GOE has also signed Anti-drug Cooperation Agreements with other South and Central American Governments and participates in regional and multilateral anti-drug forums.

Coca eradication figures have tripled since 1990, mostly as a result of the destruction of 73,000 plants in 1991. According to Interpol drug police enforcement statistics, Ecuadorian law enforcement agencies seized approximately 1 mt. of cocaine, paste and base in 1991. In early 1992 the Government seized 3 mt of cocaine along the Colombian border. The major event in 1992 was the take-down of the Reyes Torres organization (RTO) in June, which has resulted in the arrests of 51 persons and an ongoing search for a number of others. On August 7, 1992, the GOE Minister of Foreign Affairs, and the Charge d'Affairs signed the money laundering agreement. A description of most recent anti-narcotics events is contained in Quito 7817.

In spite of efforts and accomplishments of the GOE, Ecuadorian drug enforcement agencies and capabilities, remain deficient, undermanned, and poorly funded and managed. The U.S. Mission's counternarcotics plan, aimed at reducing such deficiencies, is described in Quito 12199. The plan consists of

four programs: a) National Police/Interpol, b) Military Customs Police, c) National Drug Council, and d) Drug Awareness and Education. Briefly, the objectives of the program are to: strengthen Ecuadorian capabilities to collect analyze and process actionable drug intelligence and to plan and execute counternarcotics operations; reduce/impede illegal chemicals licenses, imports, processing, transit and diversion; reduce and impede money laundering through Ecuador; eliminate coca cultivation in Ecuador; eliminate drug processing labs in Ecuador; end drug overflights and landings in Ecuador; educate Ecuadorian officials and public on U.S. drug policies and drug-related dangers to their society; and promote effective drug prevention and education programs to reduce drug abuse.

II. C. The New Administration's Economic Program

A major portion of the President Duran's inaugural address described the GOE's economic program which will face up to the major economic problems facing the Ecuadorian economy: "the lack of encouragement to the productive sector, the inefficient administration of the State, the deficit of the public sector that comprises 6.5% of GDP, the unfulfillment of international obligations to both private creditors and international institutions, subsidies and other distortions that further worsen the distribution of the income, are some of the elements that exacerbate this serious crisis." The following description of the new Administration's program is based on the inauguration speech, Mission meetings with Vice President Dahik and several Ministers, and articles in the press. In addition, the specific measures announced on September 3, 1992 are described and analyzed in terms of potential impacts.

II. C. 1. Reducing Inflation as the Central Theme in a Comprehensive Program of Fiscal, Monetary, and Exchange Rate Reform

The GOE has committed itself to a comprehensive anti-inflationary program including austerity in reducing public sector expenditures, elimination of subsidies and other distortions, putting a stop to waste and privilege rampant in some Government entities, and a moratorium on new Government projects. Anti-inflationary policy is viewed as key to not only a healthy economy but to a positive investment climate, which is accorded top priority. Coherency of government macro policies has been stressed and fiscal, monetary, and trade policies will be closely coordinated. The National Development Council (CONADE) is now effectively a Planning Ministry and will elaborate short-, medium- and long-term programs to achieve the Government's goals in strengthening the economy and meeting social needs. Fiscal discipline and control will accompany the design of new tax policies, designed to broaden the tax base and increase collection and enforcement, thus minimizing the extreme consequences of the

present system: corruption and tax evasion. A measure that has already been taken is the elimination of gasoline and electricity subsidies.

II. C. 2. Reforming the State and Reducing its Role

An important ingredient of the GOE fiscal discipline will be reducing the number of Government employees. This has been referred to as modernization of the state and reducing the size of the public sector. It has been discussed specifically and openly by the GOE's economic team, including Vice President Dahik, Finance Minister Ribadeneira and CONADE Secretary General Lucio-Paredes. In USAID discussions with the latter two officials, the topic of reducing the number of employees was strongly emphasized. This will be accomplished through a systematic plan to streamline the GOE through examining all public entities. Other state reform measures being defined include constitutional reforms, in a number of key areas affecting trade and investment reduction of budgetary earmarking, and increased decentralization along with strengthening of provincial and municipal Government. Privatization of State-owned enterprises and increasing private sector participation and competition in executing public works and providing services are areas for which strategies are being defined. As discussed below, the Mission has and continues to provide technical assistance in several of these areas.

President Durán, in his inauguration speech, made a specific reference to judicial reform by asking the Congress to extend tenures of Supreme Court judges, to enable careful congressional analysis of a reform project of the court's functions and to review new constitutional reform proposals to improve the administration of justice to be presented by the Executive branch in the next few days. This reference was largely a result of the Mission's work in AOJ and assistance to the supreme court in designing the reform project.

II. C. 3. Reestablishing Ecuador's Credibility in the International Community

Reduction of the public deficit in order to contain inflation is viewed as an important means to reestablishing credibility in the International community. The GOE is holding discussions with donors and banks in order to fulfill obligations, normalize relations, and to identify and negotiate realistic solutions to the external debt problem.

II. D. Privatization and Apertura

The new Administration strongly emphasizes the importance of opening up the economy i.e. of "apertura" and of competing in the world free market. The discussion of these themes by GOE officials has been quite extensive. Trade and investment-related

actions to be undertaken by the Duran Administration will include:

II. D. 1. Investment: Addressing Ecuador's inadequate legal framework, bureaucratic bottlenecks and an unfavorable investment climate now impeding Ecuador in attracting foreign capital; equal treatment of foreign investment and domestic investment; passage of a Capital Markets Law; providing security in property rights in order to attract investment; establishment of mechanisms to stimulate reinvestment, and technifying ~~and modernizing~~ non-traditional agricultural export production to put Ecuador in an increasingly competitive position; and through the establishment of a Tourism Ministry, addressing the constraints to tourism and establishment of tax incentives for attracting investment in tourism infrastructure.

II. D. 2. Trade: Accessing the Andean Trade Preference Act and the Enterprise for the Americas Initiative; incorporation into the GATT; ~~participation in the Andean Pact as a step to participation~~ in the world free market; strengthening of commercial ties with Colombia and Peru; implementation of a real exchange rate policy favoring exports; addressing the lack of credit for the agricultural and trade sectors; and elimination of price controls in order to stimulate production.

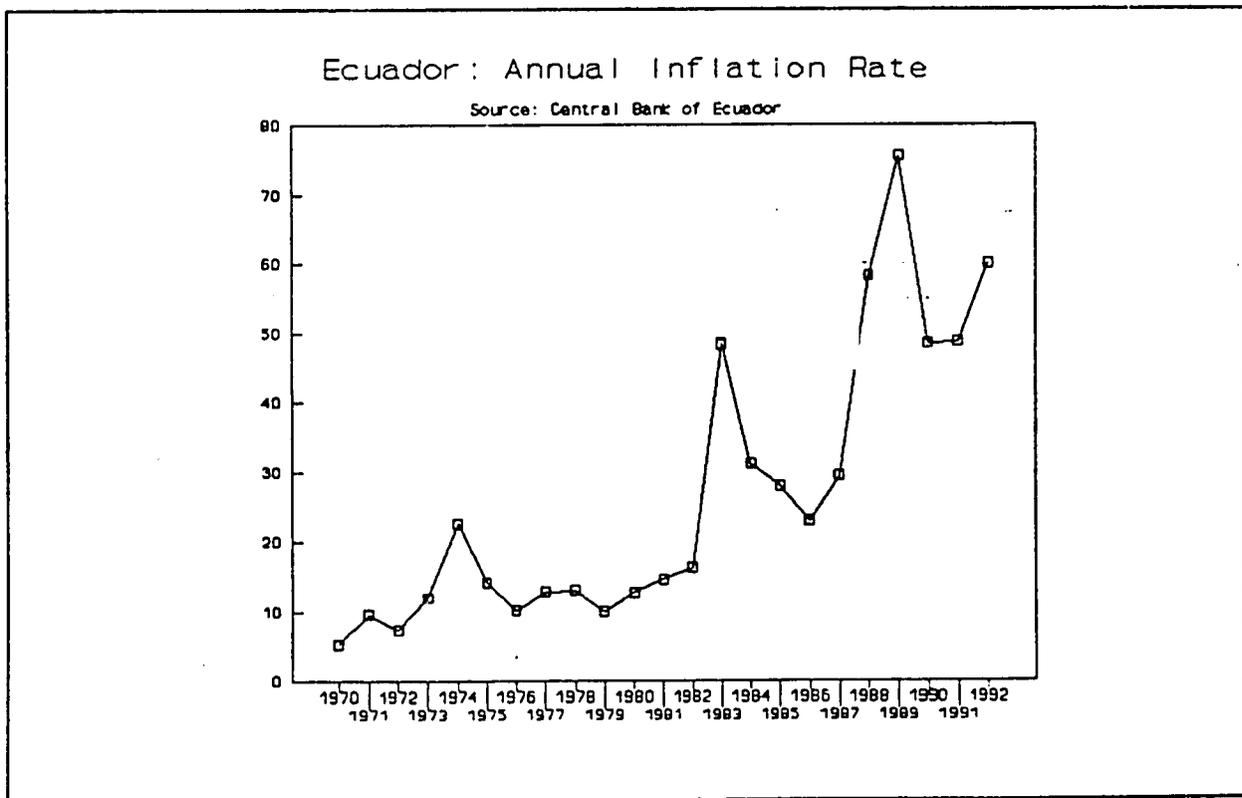
II. D. 3. Privatization: The GOE is proceeding albeit with some caution in this area. President Duran's specific references to privatization-related measures include opening up of the petroleum industry to permit foreign investment and opening up capital structure of electricity distribution companies to permit user and employee stock ownership. The mission has discussed privatization in meetings with various members of the new cabinet including Pablo Lucio Paredes, the Secretary General of CONADE, Mario Ribadeneira, the Minister of Finance, Mariano Gonzalez, the Minister of Agriculture, and Andres Barreiro, the Minister of Energy. The GOE plans to establish a privatization office in either CONADE or directly under the Presidency to coordinate all of the GOE's privatization efforts and requested USAID to fund a technical assistance team to assist the office in privatization efforts. Minister of Energy Andres Barreiro and AID/Embassy staff have discussed planned efforts to privatize electric distribution companies, most of which already have the requisite legal structure conducive to privatization. In several discussions with Minister of Finance Mario Ribadeneira, USAID was requested to provide advisors in privatization, as well as public sector reform, tax administration and economic development in general. Also, the Ministry of Agriculture has requested technical assistance to privatize a number of state-owned firms under its control

III. ANALYSIS OF THE IMPACT OF THE ECONOMIC MEASURES

III. A. Background to the Inflationary Process in Ecuador

Ecuador's economy grew rapidly at an annual rate of about 9 percent during the oil boom of the 1970s. Growth under the import-substitution model was financed by petroleum exports and a fast build-up of commercial bank external debt. Despite significant increases in real incomes, employment opportunities, and gains in health and education, economic growth with economy-wide controls could not be sustained in the 1980s. External financing for GDP growth was reduced in 1982 as the external debt crisis suspended commercial bank lending and petroleum prices decreased dramatically compared to the decade of the 1970s.

As the economy grew slowly at rates just above the population growth rate of 2.8 percent during the 1980s, real per capita income decreased from US\$ 1,668 in 1981 to US\$ 996 in 1990. Moreover, the tradition of a stable economy for Ecuador was broken during the 1980s as the annual rate of inflation in the fourth quarter of 1983 and 1988 peaked to 58 percent and 100 percent respectively. Both attempts to stabilize the economy after these high rates left inflation at much higher plateaus than previous rounds of price increases. These new levels of inflation were more than double those in the previous period at 29 percent in the 1983-1987 and 58 percent in the 1988-1992 period.



The effort to stabilize during the Borja Administration was serious during the first two years in office as the public sector fiscal deficit was reduced from 10 percent of GDP in 1988 to about 2 percent of GDP in 1990. As a result of the gradualistic approach to economy, however, inflation, which had been decreased from 100 percent to 50 percent in 1990, remained stuck at the 50 percent level. In support of this stabilization effort, the GOE signed two Stand-by agreements with the IMF which went out-of-compliance mainly due to increased public spending in 1991-1992. The monetary authorities of Ecuador, who were also facing a quasi-fiscal deficit at the Central Bank which had resulted from the conversion of the private sector external debt into sucres, tried to offset the expansion in the public sector by squeezing the private sector. This attempt resulted in increasing interest rates which managed to stay positive in real terms. When the Durán-Ballen administration took office on August 10, 1992, it inherited a public-sector deficit amounting to 7.0 percent of GDP, inflation stuck at the annual rate of 50 percent, unemployment increasing to over 12 percent and underemployment to about 30 percent, and a pending external debt negotiation with commercial banks amounting to US\$ 7 billion in principal and US\$ 2 billion in interest arrears.

Despite the previous GOE's gradualistic approach to stabilization and structural adjustment policies, it did manage to achieve more significant reform in the areas of monetary policy and tariff reform. First, the new Monetary Law put an end to the Central Bank's financing of the fiscal deficit. Second, a major tariff reduction program essentially shifted incentives for producing for the domestic market to producing to compete with the rest of the world. However, with respect to other areas of trade, the Borja GOE left the decision to join the Andean free trade region starting with Colombia and Bolivia on October 1, 1992, to the Durán-Ballen government.

III. B. The Stabilization Program

The stabilization program of the new GOE is composed of fiscal and monetary measures and includes social safety net measures designed to make the program more equitable.

III. B. 1. Elimination of Subsidies

The GOE increased prices of gasoline by over 100 percent to opportunity cost levels. These increases included a 125 percent increase in the price in the most widely consumed "extra" gasoline from 650 sucres per gallon to 1,460 sucres per gallon, and for "Super" gasoline an increase from 950 sucres to 2,400 sucres -- roughly the same as the price as in the U.S. The GOE also increased utility rates (electricity and water) to levels covering costs. Electricity rates, over a consumption of 200 kwh/ month,

were increased by 25-90 percent on a progressive consumption scale. The increase the price of gas for domestic consumption was 194 percent.

III. B. 2. Foreign Exchange System and Exchange Rate

The official sucre rate was devalued by 35.5 percent and the crawling peg system was replaced by a fixed exchange rate system, with the rate pegged at 2,000 sucres/dollar. The foreign exchange surrender requirement at the Central Bank was maintained. Purchases of foreign exchange from the private sector take the form of 85 percent in sucres (1700 sucres/dollar) and 15 percent in 180-day, non-interest bearing dollar-denominated stabilization bonds, which are fully negotiable. Purchases of foreign exchange from the public sector are at 1700 sucres/dollar, without the additional bonds. Sale of foreign exchange to both the private and public sectors is at the 2000 sucre/dollar rate.

III. B. 3. Monetary Policy

The GOE has reiterated that fiscal, monetary and exchange rate policy would be fully coordinated to reduce inflation. The exchange rate system described above was designed to offset some of the expansion resulting from the increase in net international reserves arising from the foreign exchange surrender requirement by exporters at the Central Bank. The dollar denominated stabilization bonds issued for the exporter basically mops up 15 cents of every dollar which would normally have been received in sucres.

However, because of strong speculative pressures before the devaluation, the government also decided to include as part of its September 3 economic measures a reduction of the legal reserve requirement by 2 percent. This was in response to pressures from the banking system which was facing a liquidity crisis with an interbank lending rate of 200 percent. As the tight liquidity situation has eased and the interbank rate has fallen to 30 percent, the Central Bank has now started to increase the sale of stabilization bonds to the public and to commercial banks to return to the GOE's original policy of absorbing liquidity.

III. B. 4. Fiscal Measures

The GOE seeks to reduce the size of the government, consolidating government entities/functions, dismissing or forcing retirement of surplus personnel and freezing all new hiring. This should lead to a reduction in government expenditures and consequently a reduction of the fiscal deficit. The state enterprises or services to be eliminated, privatized or merged with other entities in coming weeks include: Empresa Nacional del Semen, Empresa de Abonos del Estado, Programa de Mecanización Agrícola, Empresa de Suministros del Estado, Centro Nacional de Promoción de

la Pequeña Industria, Empresa Pesquera Nacional, Empresa Nacional de Pronósticos Deportivos, Fonapre, Dirección Nacional de Construcciones Escolares, Dirección Nacional de Deportes, Unidad Ejecutora del Programa de Microempresas, Corporación Nacional de Unidades Populares Económicas, and Instituto Nacional de Empleo.

The privatization of state-owned enterprises will occur on a case-by-case basis and will take various forms -- e.g. total-or-partial transfer of public sector assets to private sector or simply permission for the private sector to compete in an area currently reserved to the public sector. For the time being, EMETEL, the state-owned telephone company, will remain in the public sector.

The GOE will increase tax-revenue by broadening the tax base by eliminating exemptions and reducing tax evasion. The measures will also include a one-time capital tax on business assets.

III. B 5. Social Safety Net Measures

The GOE has also provided for a number of measures designed to ameliorate the negative impact of economic stabilization efforts. These so-called "social safety net" measures include subsidies for public services used by lower income groups (e.g. for the first units of consumption of water and electricity), for low octane gasoline and kerosene used for cooking, and for bus transportation.

Additionally, the GOE will assure that low-cost basic foods and generic medicines are available, will seek a 16th salary (60,000 sucres in 1992, in three tranches) and a cost of living compensation of 10,000 sucres per month, and will increase employment through public works programs. The budget for the Red Comunitaria, which provides child care and nutritional programs, will be increased from \$30 million to \$60 million per year. And greater support for the poor will be given in the areas of medical care, shelter, sanitation (e.g. latrines), water and sewage, and food delivery.

III. C. The Impact of the Stabilization Program

The comprehensive stabilization program summarized above, gives a strong signal about the commitment of the GOE to return the economy of Ecuador to a stable and sustained path of economic development and growth.

The program is composed of strong revenue-generating measures for the GOE and an exchange rate policy designed to reduce inflation rapidly. The center-piece was the increase in gasoline and fuel oil prices to their opportunity cost levels. The price of unleaded gasoline was increased to US\$.80 to the gallon and

unleaded to US\$ 1.20 to the gallon. The price of LPG gas used for cooking by almost all Ecuadorian households was originally increased by 194 percent. However, in response to labor unrest the GOE then lowered the price, but the new level was still 142 percent above the pre-Duran-Ballen price. Electricity rates, over a consumption of 150 kwh/month, were originally increased by 25-90 percent on a progressive consumption scale. However, again as a result of discussions with labor groups, the government agreed to increase the subsidized consumption floor for electricity from 150 kwh/month to 200 kwh/month. The one-time assessment tax on business assets increased from 0.2 to 0.7 percent. The revenue from the devaluation is due to public sector petroleum exports registered at exchange rate of 1700 sucres to the US dollar.

Impact of Fiscal Measures (As a percent of GDP)	
Domestic gasoline prices and domestic LPG	1.8
Electricity rates	0.3
Capital assessment tax	0.3
Devaluation	0.3
Expenditure cuts	0.4
VAT	0.1
Total	3.4

The increase in domestic gasoline prices and LPG household gas used for cooking is projected to generate about 1.8 percent of GDP and is by far the strongest revenue measure. The one-time assessment tax on business assets, which is projected to generate about 0.3 percent of GDP, was more political as it tried to make the stabilization program seem more equitable. Expenditure cuts are projected to amount to approximately 0.4 percent of GDP and are the most the GOE can do during the remainder of 1992 as the full impact from the sale of public sector assets and state enterprises will take effect during 1993. These measures will reduce the public sector deficit from 7 percent of GDP to 3.5 percent by the end of 1992. The fiscal account is projected to be balanced by the end of 1993.

The new exchange rate system has multiple rates: 1700 sucres/US dollar and for public sector exports and 2000 sucres/US dollar for private sector exports. Furthermore, by paying private sector exporters 15 cents out of every US dollar exported in dollar-denominated Central Bank bonds, the Central Bank will offset

some of the rapid increase in currency issue arising from foreign exchange surrender requirement for exporters at the Central Bank.

Moreover, this foreign exchange system will allow the Central Bank to build up its net international reserves which decreased from US\$ 760 million dollars at the end of 1991 to US\$ 258 million dollars on August 14, 1992. The Central Bank is conservatively projecting an increase in net international reserves to US\$ 500 million dollars by the end of 1992. This increase in net international reserves will also improve the GOE's chances to conclude negotiations on Ecuador's external debt in 1993. One of the major hurdles is arrears which are projected to reach US\$ 2.5 billion dollars by the end of 1992.

As a result of the strong revenue measures, and the issue of the dollar bonds to pay part of exporters receipts, the Central Bank projects that currency issue will increase only 40 percent by the end of the year. This is considerably down from the increase of 60 percent during the same 1991 period. Money supply growth is also projected to decrease by the end of 1992 to a 40 percent annual rate. However, the initial impact of the revenue measures will result in inflation going up during the last quarter of 1992 to an annual rate of 65 percent. As these measures start to reduce excess aggregate demand, inflation should start to decrease in 1993. The inflation target for 1993 is 30 percent. However, crucial to this stabilization program is the commitment of the GOE to maintaining tight fiscal and monetary policy. As time passes and pressures mount to loosen these policies, the GOE's commitment and credibility to stabilize the Ecuadorian economy will be tested.

III. D. Structural Adjustment Measures

In addition to the stabilization measures, the GOE is planning to initiate a strong adjustment program designed to reform the public sector by reducing the number of government positions, divesting shares owned by the public sector in private companies, and privatizing state enterprises. The first GOE attempt to pass emergency legislation through Congress failed. Laws requiring obligatory retirement of public sector employees at the age of 65 and the firing of civil servants put on the payroll of the previous GOE during the last year in office did not have majority support in Congress.

The GOE is planning to send to Congress shortly new legislation to begin its structural adjustment program. This will include: the Budgetary Reform Law, Capital Markets Law, Privatization and Modernization of State Law, Customs Law, Reform of Law on Superintendency of Companies, Tax Reform Law, Reform of Law on Public Sector Contracting, and Reform of Code on Administrative Procedures.

IV. RECENT AID ACTIVITIES IN POLICY REFORM, PRIVATIZATION AND CAPITAL MARKETS DEVELOPMENT

IV. A. Privatization

USAID and the Fundacion Ecuador, under the Trade and Investment Project (518-0094) and through a buy-in with the Price Waterhouse International Privatization Group (PW-IPG), has sponsored activities in educating important private and political figures in the "hows" of privatization. These activities included visits to Argentina, Chile, Mexico and Costa Rica to review privatization experiences. Shortly after their return, the participants were involved in drafting privatization legislation, with the help of an expert from PW-IPG, and under the coordination of Pablo Lucio Paredes, now Secretary General of CONADE. PW-IPG has also provided experts to complete analyses for the privatization of a number of state owned firms under the management of the National Development Bank and the National Finance Corporation. The Minister of Agriculture has requested assistance in privatizing 12 companies in his Ministry's portfolio. An IPG advisor assisted the Fundacion Ecuador and the GOE with ideas to structure the privatization units and facilitated seminars on port and municipal services privatization.

IV. B. Other Policies

In addition, through the local Price Waterhouse office, Ecuadorian experts were contracted or they donated their time to completing draft laws or strategies in a number of areas under an exercise called "Reform of the 90's". The laws were organized according to the following categories: modernization of the state, economic stabilization, apertura, and improvement of quality of life. Examples of specific legislation topics include the Commercial and Civil Codes, Customs Law, the Foreign Investment Regime, Copyright and Patent Law, Maquila and Free Zone Laws, Implementation of the Export Facilitation Law, Drawback Regulation, and Capital Markets Law. The group working on the Capital Markets Law and a Presidential Commission received extensive assistance from an SEC advisor in drafting the law. The Secretary General of Conade intends to make the Reform of the 90's package the basis for the GOE's reforms and draft legislation. Also, under the Trade and Investment Project, the Ecuadorian Federation of Exporters contracted a group of economists to devise a National Export Strategy, which will be delivered to CONADE, and the Ministries of Industry and Agriculture. Under the Non-Traditional Agricultural Export Project, technical assistance was provided to the GOE and Ecuadorian congress in the drafting of an Export Facilitation Law which is now being successfully implemented. As discussed above all of these efforts are highly complementary to, and in some cases important components of, the GOE's reforms.

IV. C. Consensus-Building and Education

The purpose of the Policy Dialogue Support Project (518-0089) is to establish a process and a mechanism for informed macroeconomic policy dialogue, based on the knowledge, analysis, implications and advantages of outward and market oriented policy reform in the medium to long term. Under the project, the implementing entity, INCAE, has provided USAID with analyses of various stabilization and structural reforms in the Ecuadorian context, identified winners and losers related to the implementation of given policies, and conducted seminars with certain sectors and pressure groups to educate and build consensus.

Activities of the Policy Dialogue Support Project have had a direct influence on the policies of the Duran-Ballen Administration. The very successful National Conference held in March of 1992, included participation by some of the new cabinet ministers of the Duran-Ballen Administration, as well as by members of the new Congress. Many of the conclusions of the conference concerning nine areas of policy reform have been or are in the process of being implemented by the new GOE. In addition, a recent amendment to the Policy Dialogue Support Project allows for a fifth component in which INCAE will provide technical assistance to the new GOE in the areas of strategic planning, analysis, and implementation.

V. ESF CONDITIONALITY

V. A. Consideration of a CIP and Informal Negotiations on Cash Transfer Conditionality

The Mission considered providing the assistance through a Commodity Import Program (CIP). However, as discussed above, the primary motivation for the assistance is to support the new GOE in its efforts to quickly establish an economic reform program. Time is of the essence and the GOE immediately requires the dollars and local currency for a good start in implementing its measures. A CIP would not be as supportive of the GOE's reform package as the cash transfer assistance described in this PAAD. A quickly disbursing cash transfer based on important policy conditionality, and which reimburses the GOE for dollars used to import U.S. goods, is in the best interests of the USG and the GOE, in terms of meeting mutually shared objectives in economic policy reform and for purposes of management efficiency.

In August, 1992, USAID staff met with Pablo Lucio-Paredes, to discuss the ESF program and conditionality. Lucio-Paredes, who has been charged with leading the economic reform effort by Pres. Duran and Vice President Dahik, responded that the major macro economic reforms would begin immediately. He mentioned the following broad categories: fiscal-elimination of subsidies and reduction of government expenditures; financial-liberalization of interest

rates; monetary-measures to reduce inflation; and public sector reform-streamlining the GOE, reduction of the number of public sector employees. As described above, an initial stabilization package was announced on September 3, 1992 and has started implementation. Because it is extremely important that the reforms begin early on, and given the modest amount of ESF and the larger amounts of assistance which could be available from World Bank, IMF and IDB if the reforms are undertaken, USAID believes that ESF conditionality should focus on putting the economic reform package into place and more specifically, on stimulating the privatization efforts that have already begun. As discussed above these are areas in which USAID has done considerable preparation work, and also the themes most strongly emphasized by the GOE. They are also areas which need immediate resolution by the GOE.

V. B. Conditions Precedent to Disbursement

-----Accordingly, the following conditions have been negotiated (evidence of the following, in form and substance satisfactory to A.I.D):

V. B. 1. Evidence that the GOE has officially announced and put into effect a comprehensive package of macro-economic reforms, including fiscal, monetary, and government streamlining measures, and that such a program has begun to be implemented through appropriate decrees and/or regulations.

V. B. 2. Evidence that a privatization strategy and program has been adopted by the GOE, an office for coordinating privatization efforts with clearly specified functions and authority has been established, and legislation has been introduced, as needed.

V. F. 3. The GOE as part of its counternarcotics effort, agrees to provide adequate support for counternarcotics operations.

V. C. Rationale for Conditions Precedent

This set of conditions matches the high-priority themes in the GOE's reform plan, and is closely related to the mission's trade and investment activities and Strategic Objective no. 1 (Increase trade and employment). They follow up on the Mission's careful and steady dialogue with both the government and the private sector over the past year. As discussed above, the conditions are appropriate for the amount of ESF, and require actions which must take place early on for the GOE to get a good start for accomplishing its economic and privatization objectives. Making these conditions to disbursement will result in earlier accomplishment of the actions than otherwise. The actions are needed particularly in the case of privatization, because, in spite of earnest intentions for beginning privatization early, there is confusion regarding where the office of privatization will be located and what its functions, authority and relationship to the

Ministries will be.

The Condition Precedent requiring establishment of a comprehensive economic reform package is purposely worded in general terms because the Mission believes that the event, i.e. establishment of the stabilization program, is extremely important to both relieving public apprehension and uncertainty regarding the reforms and to concretely lining up other donor support for implementation of the program. The GOE announced its initial program on September 3, 1992. The condition will result in a GOE letter describing the macro program in detail.

The Condition Precedent on privatization is more specific, in that it requires a strategy and establishment of a Government structure to coordinate and implement privatization actions. Both events are important to coordinating the individual initiatives of individual Ministers, which to date have been very encouraging. Privatization has been discussed openly by the GOE and private sector and in the press only in the past year. There are still significant sensitivities which have caused the new GOE to proceed with care. Therefore, at this time, while a strategy should be pronounced by the GOE, specification of specific targets via conditionality would be premature. In the deliberations on how to set up the privatization office or offices in the GOE, important political and technical factors are being considered. The Mission has been in close contact with GOE counterparts on this matter and is hoping that the right decisions will be made. As described above, the Mission also assisted the GOE with a draft Privatization Law. However, the correct form of legislation (law, regulation, decree, etc.) is still under debate. It would be inappropriate to require passage of a law in the condition, but in the strategy, we would expect to see the appropriate form of legislation identified. The Mission is also arranging technical assistance to the Fundación Ecuador in privatization. The Fundación Ecuador, in turn, has received requests from certain Ministers (e.g. Minister of Agriculture), the Municipality of Guayaquil, and the Province of Guayas to help privatize parastatals. The Mission's approach is to work through the Fundación Ecuador in order to foster private sector support for privatization activities, to build private and public sector consensus, and to minimize A.I.D.'s public exposure in privatization issues.

Recent counter-drug performance by the GOE is discussed above, as are the USG's plan and activities under II.B. Recent Counternarcotics Performance. In order to better accomplish several objectives of the plan, the U.S. Mission and Washington have agreed on the need to elicit more support for counter-drug operations. The sideletter required by the C.P. will commit the GOE to providing that support. The U.S. Mission will follow up on the two points discussed in the Concepts Paper guidance cable: (1) vigorous implementation of the money laundering agreement; and (2) development of an Ecuadorian National Counternarcotics Strategy.

In effect, the assistance directly and indirectly addresses the three concerns shared by the U.S. Mission and Washington: (Adequate support, activities against money laundering and development of strategy). The first area of concern is addressed in the present conditionality and progress in the other two areas will be taken into account in considering future NSD-18 related assistance.

V. D. - Tranching

The dollar disbursement will be made in one tranche, because of the modest amount of the assistance (\$6.2 Million) and because the GOE will need the local currency early on to bolster the ambitious reforms it has already started to institute.

V. E. EMELEC

The Mission considered setting as a Condition Precedent the resolution of the EMELEC (Electricity Company) nationalization to the satisfaction of the U.S. investor. During Concept Paper development the Mission decided that the U.S. Mission's ongoing negotiations and the requirement of EMELEC resolution for Ecuador to qualify for eligibility under the Andean Trade Preference Act were adequate measures. There was discussion of this issue in the AID/W review of the Concept Paper. Consequently the U.S. Mission and Washington agreed that the Mission would try to secure GOE commitment to expeditiously resolve the EMELEC issue. The Chargé and other Mission officers have met with the GOE Minister of Mines and Energy and Vice President Iahik and have secured their commitment to exert best efforts to resolve EMELEC in the quickest manner possible. In addition, a high level GOE team recently travelled to Washington and in meetings with State and A.I.D. officers stated their intentions to resolve EMELEC expeditiously. Developments will be monitored closely and progress in resolving EMELEC will be considered in planning for any FY93 ESF assistance.

VI. DOLLAR USES AND MANAGEMENT

VI. A. Cash Transfer Use and Procedures

The Mission has considered the options of debt servicing of official debt to the U.S. and financing of imports from the U.S., and has decided that use of dollars for financing imports via reimbursement is appropriate. As in past programs, the Ministry of Finance will be responsible for managing the dollar separate account. The Mission's experience with past programs, as confirmed by audits, demonstrate that the MOF has been efficient in carrying out its responsibilities under cash transfer management.

Once conditionality is met, the dollars will be deposited via electronic funds transfer in a separate account under the control of the Central Bank. As under past ESF agreements, local currency will be deposited, in a single deposit, into a separate special account within 15 business days of the deposit of the dollars. Subsequently, dollars will be released from the dollar separate account upon acceptance of documentation of eligible imports from the U.S., in a manner consistent with A.I.D. reimbursement guidelines. A special unit established in the Subsecretariat of Public Credit, MOF, will manage local currency as it has under previous ESF agreements. The unit has a solid track record in the effective management of LC programs.

VI. B. Mission Experience with Private Sector Imports of Essential Goods and Services from the U.S.

In 1989, USAID/Ecuador and the GOE signed a Cash Transfer Agreement in the amount of \$9.0 million, under the Economic Stabilization and Recovery Program (518-0078). Under this program, dollars in the separate account were used to finance the importation of U.S. capital goods for the private export sector. The agencies involved were the MOF, which was responsible for reviewing documentation on eligible transactions, and the Central Bank, which compiled and maintained the documentation. The dollar separate account was established in a U.S. Bank by the Central Bank. The local currency special account was opened in the Central Bank. The Mission found the above-described arrangements worked well and the reimbursement system mechanisms will be used again.

VII. LOCAL CURRENCY USE AND MANAGEMENT

As a Condition Precedent, the Program Agreement will require: written procedures governing the deposit and disbursement of the Dollar Grant Funds into and from the Dollar Separate Account, and the Sucre Special Account. Those procedures will specify: 1) the uses of the funds for economic development/reform purposes; 2) that the funds may not be commingled with any other funds prior to use for proper purposes; 3) that interest earned on the funds shall be programmed and disbursed as if it were principal; 4) procedures for approval by the Parties of specific eligible transactions for uses of the dollars; 5) procedures for approval by the Parties of specific eligible projects, programs or activities prior to disbursement of sucres from the Sucre Special Account; and 6) procedures by which USAID may monitor and account for deposits and disbursements from both the separate and special accounts and by which financial reports on the activities and status of each account be sent to USAID on at least a quarterly basis.

Local currency will be deposited in a single amount into a special account (and invested in interest-bearing instruments) and

disbursement of dollars into the dollar separate account (i.e. subsequent to the satisfaction of conditions precedent), calculated at the highest rate of exchange which is not unlawful as of the date of the dollar disbursement. In this way, local currency will be available on a timely basis for mutually agreed upon uses, including for the OE trust fund. To maintain value local currency will earn interest at the highest rate possible, presumably which will exceed inflation.

Uses for local currency will be mutually agreed upon after the signing of the Program Agreement. At the moment, the Mission is still considering possible uses for the local currency, and will reach agreement with the GOE on general categories shortly after signing the Program Agreement and before the disbursement of dollars. The four possible uses thus far discussed with the GOE include a public works program to soften the blow of major economic reform, selective purchase of resignations of public sector employees as part of the GOE's public sector reform efforts, provision of ecuadorian technical assistance in macro reform, privatization and social safety net measures (to complement U.S. technical assistance) and general activities to support the reform process. All four uses would fall under the guidelines for "extra-budgetary support" contained in State 204855.

VII. A. Managing Local Currency via Extra-Budgetary Support

Local currency use will be programmed and managed via "extra-budgetary support" as defined by State 204855. Under the FY 1989 cash transfer program, this mechanism was used for all but 10 percent of the local currencies, with the remainder dedicated to an Operating Expense Trust Fund. Subject to negotiation with the GOE, the system for managing these resources will be the one installed under the Economic Stabilization and Recovery Program of 1980 and still in use today (since local currency is still being generated through interest earned on the special account). The use of local currency will be jointly programmed in negotiations between USAID and the GOE (Credito Publico) shortly after the signing of the Program Agreement on September 30, 1992, reflecting highest GOE/AID priorities. The program will be consolidated to fund a few major categories in support of the GOE's economic reform program, where impact can be clearly demonstrated. The Subsecretariat of Public Credit of the Ministry of Finance will be responsible for disbursing funds to recipient organizations, accounting for the funds, verifying reports, and arranging for audits of the recipient organization. The Mission, through the Office of Program and Project Development, will receive financial and progress reports, and the Controller's Office will review accounting systems and records when necessary. The Mission will approve procedures to be used to manage the program in the basic PIL and will approve activities to be financed by local currency after initial MOF screening of their appropriateness and feasibility. The MOF will be responsible for performing financial assessments of recipient

organizations in cases where there is no reasonable assurance that the organization has adequate financial management systems in place to account for the local currency.

No activity will be approved without including performance indicators for that activity to allow the Mission to verify whether the purpose of the chosen use of the local currency has been achieved and to allow for the monitoring of impact as required under NSD-18 ESF funding.

Since the MOF and the Mission are already operating a local currency program as described above, it is not necessary to conduct a formal financial assessment of the MOF, Subsecretariat of Public Credit since the Mission has positive experience with past (and present) performance. Instead, an assessment of the management system is provided below.

VII. B. OE Trust Funds

The Mission will use 10 percent of the local currency generated to establish an OE Trust Fund. The Mission has experience with this type of fund since the Economic Stabilization and Recovery Program (518-0078) included this arrangement. A.I.D. will enter into a trust fund agreement with the GOE and will administer account for and report on to the GOE the uses of these funds. The trust fund will be placed in an interest-bearing account and will be governed by procedures established in the Mission Order on local currency. The use of trust funds was not contemplated at the time the FY 1994 Annual Budget Submission was prepared; however, appropriate adjustments to the level of operating expense dollars needed for FY 93, will be made at the time of deposit. This is estimated to take place early in FY 1993.

VII. C. Assessment of the Current Local Currency Management System

91 State 204855 provides Agency-wide guidance on programming and managing host-country owned local currency, and calls for a financial assessment in the PAAD of "the host government agency or the specific unit within an agency responsible for the management of the Local Currency Special Account". The guidance further notes that the "conclusion as to the capability of the host Government agency responsible for the management of the special account may be based on an independent review of the financial systems of the Agency (a formal assessment) or may be based on the Mission's past experience with the Agency's performance (an informal assessment)." The guidance further notes that "if the designated host Government agency has experience in managing special accounts, then the Mission may choose to rely on its record as an indicator of capability. The mission would then state in the PAAD the favorable experience which it has had with the Agency as a basis to justify an informal assessment."

USAID/Ecuador chooses to present an informal assessment of the Project Implementation Unit of the Subsecretariat of Public Credit of the Ministry of Finance of Ecuador, the unit that will manage local currency generated under this Economic Reform Program, as follows:

USAID/Ecuador has two on-going local currency programs. These exist to manage local currency generated from two cash transfers: 518-0058 and 518-0078. Implementation Letter No. 36 of August 20, 1987 revised the procedures for management of the local currency program under 518-0058 (the earlier program) such that responsibility for management of the local currency would rest with the Ministry of Finance. On September 29, 1989, a Program Agreement was signed with the GOE, establishing the program 518-0078. PIL No. 4 of January 4, 1990 set out the procedures for managing Program-generated local currency. These procedures are the same as those adopted under 518-0058 in 1987.

Under the two current local currency programs, the Project Implementation Unit of the Ministry of Finance is responsible for the following:

1. Screening proposals for local currency funding to ensure that the proposals are consistent with the development priorities of the GOE and with the terms and conditions of the program.
2. Analyzing the proposals to ensure that they are substantively adequate and are presented in the correct format.
3. Ensuring that each proposed implementing entity has the capacity to control and account for the local currency resources in accordance with generally-accepted standards and practices (financial assessments)
4. Forwarding the proposals to the appropriate officials of the Ministry of Finance and to AID for review and approval or disapproval.
5. Monitoring the progress of the approved activities through receipt of periodic reports, site visits and arranging for audits and evaluations.

Thus, the Project Implementation Unit has been fully managing the local currency programs, with the exception of drawing checks for disbursement, which is handled by the Treasury Subsecretariat, and with the exception of programming and approving activities, which is conducted jointly with USAID/Ecuador

Over the last five years, USAID/Ecuador has conducted financial reviews of the performance of the unit, the latest one conducted in September of 1992. These reviews have allowed the

Mission to have confidence that management of the local currency was proceeding smoothly and that problems were being corrected as they arose. Also, the Project Implementation Unit has been arranging for audits (performed by the Controller General of Ecuador) and evaluations as they are supposed to, and USAID/Ecuador has received copies of these reports throughout the five years. No major problems with management of local currency has been uncovered during the time period.

Therefore, USAID/Ecuador has a high level of confidence that the GOE will manage the local currency generated under this Economic Reform Program in an accountable and effective manner.

VIII. AUDIT ARRANGEMENTS

The Program Agreement will contain the following language: "The GOE shall afford authorized representatives of USAID the opportunity at all reasonable times to inspect the books, records and other documents relating to the use of both dollar and sucre deposits and disbursements made pursuant to this agreement." This language will allow for audits to be performed according to guidelines set forth by the Office of the Regional Inspector General in Honduras, as well as periodic inspections performed by financial analysts from the Mission's Controller's Office. In addition, the GOE has its own audit procedures under its Controller General and both the separate dollar account and the special local currency account reviews will be subject to these procedures.

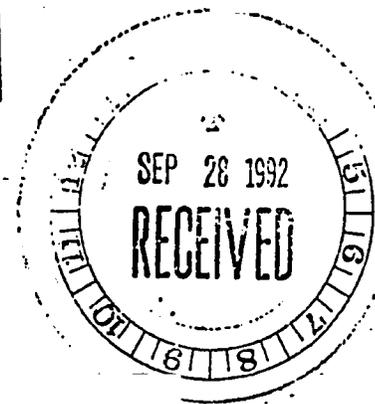
The MOF will complete financial reviews of all entities to receive LC funds and will conduct periodic internal reviews to ensure optimal control and accountability.

ACTION AID-2 INFO DCM

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PP RUEHQ
DE RUEHC #0140/01 2700736
ZNR UUUUU 22H
P 260733Z SEP 92
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TO AMEMBASSY QUITO PRIORITY 3618
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REPLY DUE 10/2
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E.O. 12356: N/A
TAGS:
SUBJECT: DAEC REVIEW OF FY 1992 ESF CONCEPT PAPER
REF: (A) QUITO 08203 (B) QUITO 08205

1. THE CONCEPT PAPER SUBMITTED VIA REFTTEL A WAS REVIEWED SEPTEMBER 8, 1992 BY A DAEC CHAIRED BY AA/LAC MICHEL. IN ADDITION TO EMBASSY AND USAID REFS SIMONS AND LAPERA AND AID/W PERSONNEL, THE FOLLOWING ORGANIZATIONS/OFFICES ATTENDED THE MEETING: INM, USTR, ONDCP, ARA/AND, ARA/ECF, TREAS, USDOC, AND EP/ODF. BASED ON THE GUIDANCE PROVIDED BELOW, MISSION SHOULD NOW PROCEED TO DEVELOP THE PAAD FOR THIS PROGRAM. CONCLUSIONS OF THE MEETING AND GUIDANCE FOR PAAD PREPARATION ARE PROVIDED BELOW.

2. COUNTERNARCOTICS: THE DAEC CONCLUDED THAT THE COUNTERNARCOTICS MEASURES DESCRIBED IN REFTTEL B WERE APPROPRIATE AND SUFFICIENT TO JUSTIFY NSD-18 FUNDING FOR THIS PROGRAM. FUTURE YEAR ESF SHOULD DEEPEN COUNTERNARCOTICS CONDITIONS ON ASSISTANCE. WHILE THESE MEASURES ARE ADEQUATE FOR THE PROGRAM-SPECIFIC CONDITIONALITY, THE DAEC REQUESTS THE EMBASSY TO DISCUSS TWO ADDITIONAL POINTS WITH THE GOE AND URGES YOU TO CONSIDER ADDING THESE POINTS TO THE SIDE LETTER PLANNED.

PER REFTTEL B. THE FIRST IS OUR CONCERN THAT THERE BE CONTINUED PROGRESS TOWARD RATIFICATION AND VIGOROUS IMPLEMENTATION OF THE MONEY-LAUNDERING AGREEMENT. THE SECOND IS OUR EXPECTATION THAT THERE BE ONGOING DIALOGUE ON DEVELOPMENT OF A NATIONAL COUNTERNARCOTICS STRATEGY, AND THAT THIS PROCESS CULMINATE IN DEVELOPMENT OF A STRATEGY WITHIN THE NEXT SIX MONTHS.

3. MACROECONOMIC CONDITIONALITY: THE DAEC AGREED THAT THE GOE HAS MADE IMPORTANT PROGRESS IN THE DEVELOPMENT OF A PLAN FOR RESTRUCTURING THE ECONOMY AND THAT THIS PROGRESS MERITS OUR ENCOURAGEMENT WITHOUT CONDITIONALITY BEYOND THAT PROPOSED BY THE MISSION IN THE CONCEPT PAPER. HOWEVER, CONCERN WAS EXPRESSED IN SEVERAL AREAS, AND THAT CONCERN SHOULD BE COMMUNICATED TO THE GOE IN THE MISSION'S ONGOING POLICY DIALOGUE. AT THE TOP OF THE LIST OF CONCERNS IS THE MECHANISM TO ENSURE MONETARY DISCIPLINE AND CONTROL EXPANSION OF THE MONEY SUPPLY. WITHOUT SUCH

ACTION: il
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GMEDIA
PHUCO
RF 3
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EMB
WASHDC

CONTROL, THE POTENTIAL GAINS FROM OTHER PROMISED REFORMS COULD BE LOST. THE GOE SHOULD DEMONSTRATE ITS INTENT TO CREATE A TRANSPARENT CENTRAL BANK IN WHICH CHANGES IN MONETARY BASE AND INTERNATIONAL RESERVES ARE CONTINUOUSLY MADE AVAILABLE TO THE PUBLIC AS A CHECK ON MONETARY POLICY. ALSO OF CONCERN ARE THE MAINTENANCE OF FISCAL DISCIPLINE AND A REALISTIC UNIFIED EXCHANGE RATE. FINALLY, THE ECUADORIANS SHOULD BE MADE AWARE OF THE IMPORTANCE WE ATTACH TO THE PROGRESS AND SUSTAINABILITY OF THE ANNOUNCED REFORMS. FOLLOW-ON IS ESSENTIAL FROM ENACTMENT OF LEGISLATION TO SUSTAINED IMPLEMENTATION OF THE REFORMS.

4. COMMODITIES OR DEBT: THE DAEC AGREED WITH THE MISSION'S PROPOSAL TO UTILIZE THE DOLLARS PROVIDED BY THE PROGRAM TO REIMBURSE THE GOE FOR IMPORTS OF COMMODITIES FROM THE UNITED STATES. ALTHOUGH ECUADOR IS TO BE APPLAUDED FOR ITS MOVEMENT TOWARD A LIBERALIZED TRANSPARENT FOREIGN EXCHANGE REGIME, IT IS NOT THERE YET, NOR IS IT LIKELY TO BE IN THE LIFE OF THIS PROJECT. THEREFORE SINCE IT WILL BE POSSIBLE TO TRACK THE COMMODITIES TO THEIR SOURCE/ORIGIN AND SINCE THE MISSION HAS THE RESOURCES AND SYSTEMS IN PLACE TO DO THIS TRACKING, U.S. COMMODITY PROCUREMENT IS THE PREFERRED USE FOR THE DOLLARS. IN SHORT, IT IS THE POSITION OF THE BUREAU TO SUPPORT THE PURCHASE OF U.S. GOODS AND SERVICES WHEREVER PRACTICABLE. THIS IS SUCH A CASE.

THE CONCEPT PAPER MAKES NO MENTION OF THE OPTION OF USING THE ESF RESOURCES TO FINANCE A CIP PROGRAM; YET AGENCY POLICY CALLS FOR CONSIDERATION OF THIS MECHANISM AS A

MEANS OF PROVIDING PROGRAM ASSISTANCE. THIS CONSIDERATION SHOULD BE REFLECTED IN THE PAAD, AND THE RATIONALE FOR THE ASSISTANCE MECHANISM CHOSEN SHOULD BE DESCRIBED.

5. LOCAL CURRENCY: THE CONCEPT PAPER PROPOSES A SERIES OF EXTRA-BUDGETARY LOCAL CURRENCY INTERVENTIONS IN SUPPORT OF THE POLICY REFORMS BEING UNDERTAKEN BY THE GOE. WHILE THE DAEC SUPPORTED THE PROPOSED USES OF THE LOCAL CURRENCY, THE CONCERN WAS EXPRESSED THAT TO MAKE THESE EXPENDITURES OUTSIDE THE BUDGET PROCESS COULD TEND TO UNDERCUT GOE EFFORTS TO DEVELOP AN INTEGRATED PUBLIC SECTOR BUDGET AND A DISCIPLINED BUDGET PROCESS (WHICH THE PROGRAM IS SUPPORTING). THEREFORE THE DAEC CONCLUDED THAT ALL LOCAL CURRENCY PROGRAMMING SHOULD BE INCLUDED IN THE GOE BUDGET.

HOWEVER, IN CONSULTATIONS WITH THE MISSION SUBSEQUENT TO

THE DAEC, THE CASE WAS MADE CONVINCINGLY THAT TO INSIST ON INTEGRATION OF LOCAL CURRENCY PROGRAMS THROUGH THE GOE BUDGET PROCESS WAS UNWORKABLE, AT LEAST FOR THIS PROGRAM PERIOD. THE GOE BUDGET PROCESS IS SO WEAK THAT AID COULD HAVE NO ASSURANCE THAT THE FUNDS WERE IN FACT BEING USED FOR AGREED UPON PURPOSES. AID IS PROVIDING SUPPORT TO IMPROVE THIS SYSTEM, BUT IT IS NOT NOW IN PLACE AND WILL NOT BE IN PLACE IN TIME TO MANAGE RESPONSIBLY THE LOCAL CURRENCY ASSOCIATED WITH THIS PROGRAM.

THEREFORE, THE MISSION'S PROPOSAL TO UTILIZE THE LOCAL CURRENCY OUTSIDE THE GOE BUDGET PROCESS IS HEREBY APPROVED ON AN EXCEPTIONAL, ONE-TIME BASIS, WITH THE EXPECTATION THAT A REFORMED BUDGET SYSTEM WILL BE IN PLACE FOR ANY FUTURE PROGRAMS. THESE EXTRA-BUDGETARY ACTIVITIES ARE TO BE LIMITED TO A FEW LARGE INTERVENTIONS SUCH AS PRIVATIZATION AND THE REDUCTION OF THE PUBLIC PAYROLL. THE MISSION SHALL ENSURE THAT RESPONSIBLE FISCAL SAFEGUARDS ARE UTILIZED AND THAT THE AID MANAGEMENT REQUIREMENTS ARE KEPT TO A MINIMUM.

ONE ATTRACTIVE SUGGESTION FOR SUCH A PROGRAM WOULD BE THE CREATION OF AN INTEREST BEARING FUND TO FINANCE THE PURCHASE OF RETIREMENTS FROM WHICH INCENTIVE PAYMENTS WOULD BE MADE TO PUBLIC SECTOR EMPLOYEES WHO OPT FOR EARLY RETIREMENT, THEREBY REDUCING PUBLIC SECTOR EMPLOYMENT. THE GOE'S PLAN CONTEMPLATES A SCHEDULE OF PAYMENTS OVER TIME RATHER THAN LUMP SUM PAYMENTS.

THE OE TRUST FUND IS HEREBY APPROVED BY THE DAEC.

6. MANAGEMENT INFORMATION SYSTEM: NSD-18 REQUIRES THAT A MANAGEMENT INFORMATION SYSTEM BE IN PLACE IN EACH COUNTRY RECEIVING NSD-18 FUNDS IN ORDER TO MONITOR AND MEASURE BOTH COUNTERNARCOTICS PROGRESS AND MACROECONOMIC REFORM. SINCE THE PROGRAM IS TO BE NSD-18 FUNDED, THE MISSION WILL NEED TO MAKE PROVISION FOR ECUADOR TO BE INCLUDED IN THE BUREAU'S MANAGEMENT INFORMATION SYSTEM, ALBEIT IN A LIMITED FASHION IN FY 92 REPORTING GIVEN THE MODEST SIZE OF THE PROGRAM. IF FUTURE ESF ASSISTANCE IS PROVIDED, A MORE COMPREHENSIVE MONITORING AND EVALUATION SYSTEM WILL NEED TO BE PUT IN PLACE, AND USAID/ECUADOR WILL BE EXPECTED TO CONTRIBUTE TO THE REGIONAL PROJECT BEING IMPLEMENTED BY MSI.

7. EMELEC: THE EMELEC ISSUE IS TREATED SEPTEL.

8. CONTINGENT ON SATISFACTORY RESOLUTION OF POINTS RAISED IN PARAS 2-6 ABOVE AND IN SEPTEL CONCERNING EMELEC, MISSION MAY AUTHORIZE PAAD. EAGLEBURGER

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REPUBLICA DEL ECUADOR
MINISTERIO DE FINANZAS

OFICIO No. SCP-92- 232

Quito, 15 SEP 1992

Señor
Robert Kramer
DIRECTOR ENCARGADO DE LA MISION USAID
Ciudad

Señor Director:

En relación con nuestras conversaciones relacionadas con el apoyo del Gobierno Americano al Fondo de Estabilización Económica para el Programa de Reforma Económica del Gobierno del Presidente Sixto Durán Ballén, deseo informar a usted sobre las medidas que han sido tomadas para mejorar las perspectivas económicas del país.

El objetivo fundamental del programa económico en el corto plazo es la reducción rápida de la inflación, junto con el fortalecimiento de los sectores fiscal y externo del país, con miras a sentar las bases para la recuperación de la inversión, el crecimiento de la economía y por ende, el mejoramiento sostenido en las condiciones de vida de los ecuatorianos.

La lucha antinflacionaria se fundamenta en un program macroeconómico coherente que implica medidas fiscales, cambiarias financieras y monetarias, que se resumen en lo siguiente:

POLITICA FISCAL:

El Gobierno entiende que la restitución del equilibrio fiscal se debe lograr principalmente a través de la reducción del gasto público corriente, por lo cual se ha iniciado el recorte de gastos superfluos y privilegios especiales. Sin embargo, se tenderá a mantener la inversión pública de alta rentabilidad económica y social.

El Ministerio de Finanzas ha dispuesto una reducción general en el presupuesto de gastos del Gobierno Central para 1992, que consistirá en una restricción a los gastos variables por un monto aproximado de 70.000 millones de sucres (US\$ 35.000.000).

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Se procederá a la eliminación, fusión o transferencia al sector privado de varias empresas y dependencias adscritas, cuyos objetivos sean ajenos al espíritu propio del sector estatal o que dupliquen funciones o presupuestos.

Se ha resuelto modificar los precios de los combustibles de consumo interno, de tal forma que reflejen el costo de los hidrocarburos y que incluyan una utilidad razonable sobre el valor de los activos que el Estado destina al abastecimiento del mercado interno.

Igualmente se ha previsto un incremento en el precio de las tarifas eléctricas de manera que cubran los costos directos de operación y mantenimiento, las cuotas de depreciación y la rentabilidad sobre la base tarifaria.

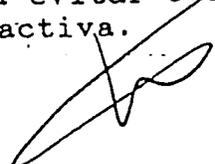
El Gobierno ha llamado a la solidaridad del sector privado, a través de un proyecto de ley con carácter urgente que enviará el Señor Presidente de la República al Congreso Nacional, en el que se dispone, por primera y única vez, un impuesto extraordinario que va del 2 al 7 por mil a los activos reales de las compañías registradas en la Superintendencia de Bancos y de Compañías.

POLITICA MONETARIA:

El programa monetario y financiero del Banco Central tiene como objetivo fundamental el control del proceso inflacionario, conjuntamente con el incentivo al ahorro nacional, la dinamización de la intermediación financiera y el fortalecimiento de la inversión productiva.

El Banco Central fortalecerá su intervención a través de mecanismos de mercado, para ello modernizará y hará más efectiva la aplicación de su política monetaria a través de operaciones de mercado abierto y mesas de dinero y cambios que controlarán el crecimiento de agregados monetarios y reducirán la volatilidad de las tasas de interés.

Para el efecto, el Banco Central ha decidido eliminar el margen financiero o ancla de las tasas de interés, con el fin de reducir distorsiones y permitir una asignación más eficiente de recursos. Se ha fijado una reducción del encaje en 2 puntos para disminuir los costos de intermediación y para evitar eventuales presiones alcistas sobre la tasa de interés activa.



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POLITICA CAMBIARIA:

El Gobierno ha diseñado una política cambiaria especialmente diseñada para apuntalar el programa antinflacionario y a defender la posición externa del país. Este sistema implica una devaluación inicial significativa que restaura la competitividad de la producción de bienes exportables, abre espacio para el realineamiento y ajuste de otros precios y permite mantener el tipo de cambio nominal constante con el fin de reducir las expectativas de devaluación e inflación y así propender a anclar el nivel de precios.

El tipo de cambio de intervención para el dólar ha sufrido una devaluación del 35%, la misma que permanecerá fija en el mediano plazo. Los exportadores deberán liquidar sus divisas en el Banco Central por lo cual recibirán el 85% del valor de sus exportaciones en sucres y, el restante 15% en un bono de estabilización cambiaria denominado y pagadero en dólares. Este bono no devengará interés y tendrá un vencimiento a 180 días. Cabe destacar que el Banco Central no entregará este bono para las exportaciones del sector público como una forma de ahorro forzoso que vigorice el programa de restricción fiscal.

De otro lado, se ha intentado dar un especial énfasis al área de privatización como parte de nuestra estrategia de modernización del Estado y reducción del tamaño del Sector Público. En ese sentido, el Gobierno del Presidente Durán Ballén enviará al Congreso Nacional en las próximas semanas y con el carácter de urgente, varios proyectos de Ley que faciliten la modernización del Estado, y que son los siguientes:

Ley de Privatizaciones y Modernización del Estado
Ley de Presupuestos del Sector Público
Reformas a la Ley de Contratación Pública
Código de Procedimiento Administrativo.
Ley de Aduanas

Uno de los objetivos centrales del presente Gobierno, es dinamizar la asignación de recursos hacia proyectos de alta eficiencia y rentabilidad económica. Conjuntamente con el sector financiero, el mercado de capitales constituye un elemento crucial para cumplir con este objetivo, por lo que se enviará también los siguientes proyectos:



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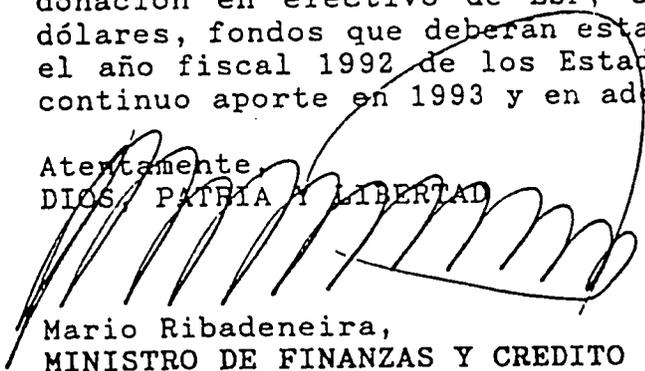
Página No. 4.

Ley de Mercado de Valores
Reforma a la Ley de Compañías
Reforma a la Ley de Impuesto a la Renta

El Gobierno del Ecuador está conciente del grave problema de narcotráfico que se afronta en los países latinoamericanos, y en especial el nuestro que al momento está convirtiéndose en un país de tránsito. Por tal motivo, y como parte de los esfuerzos en la lucha contra este mal social, el Presidente Durán Ballén acuerda proveer todo el apoyo necesario para las operaciones anti-narcóticos que se desarrollen en nuestro país. Para el éxito de estas operaciones es necesario señalar además que el Estado Ecuatoriano cuenta con una Ley de Control de Estupefacientes y Sustancias Sicotrópicas.

Nosotros tenemos la esperanza de recibir su aporte para este ambicioso y comprensivo programa tan importante para el futuro de nuestro país. Específicamente, nosotros requerimos una donación en efectivo de ESF, en un monto de 6.2 millones de dólares, fondos que deberán estar disponibles antes de terminar el año fiscal 1992 de los Estados Unidos (Septiembre 30) y el continuo aporte en 1993 y en adelante.

Atentamente,
DIOS, PATRIA Y LIBERTAD



Mario Ribadeneira,
MINISTRO DE FINANZAS Y CREDITO PUBLICO

ANNEX C: Policy Reforms Under the Borja and Duran-Ballen Administrations

The Borja Administration

The Borja Administration made significant progress in the areas of trade reform, and some progress in the reform of labor and maquila laws, tax reform, intellectual property rights, and the encouragement of foreign investment. On the other hand, the administration did little in terms of reducing the size of the state and the fiscal deficit, reforming and liberalizing the financial sector, or controlling inflation. It is with respect to these areas that the Duran-Ballen Administration faces the greatest challenges.

The Duran-Ballen Administration

In contrast to the gradualist approach assumed by Borja, the Duran-Ballen Administration has announced and taken a series of rather ambitious policies during its first six weeks in office. Among these include:

1. a thirty-five percent devaluation of the official exchange rate to stimulate exports, followed by the replacement of the former mini-devaluation system with a new fixed-rate to stem inflation. One of the consequences of the new exchange system is that reserves have increased tremendously by US\$ 80 million since the new GOE took office when reserves were at a level of US\$ 260 million. This will give Ecuador a more favorable negotiating position with international lenders and will keep excess money out of circulation.
2. the elimination or reduction of subsidies on electricity, water, and gasoline. This will help to reduce the fiscal deficit by effectively moving prices to more efficient levels, but may also impose a burden on some lower-income consumers.
3. the recognition of the need to reform state institutions and enterprises through privatization, financial overhaul, and new management systems. The GOE has talked about privatizing or reforming a gamut of enterprises such as state-owned agricultural enterprises, the state social security system, and the health sector. These reforms should ease the financial burden on the state and improve the provision of services.
4. significant steps toward opening Ecuador's borders more to free trade. This includes new progress on the Andean FTA and, by October 1, 1992, the elimination of tariffs between Ecuador and Colombia.

Obstacles Facing the GOE

1. Weak control of Congress and problems with legislative efforts.
2. Potential labor unrest and general strike; opposition in Congress to initial, "quick" efforts to reduce the number of

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3. Bureaucratic resistance to structural reforms. (For example, the GOE backed-down on its appointment of a more reform-minded Director of IESS, the state social security system.)
4. Indigenous unrest and lack of inclusion of indigenous peoples from decision-making processes.

AID's Assistance to the New GOE

All of the obstacles mentioned above could be eliminated or alleviated through improved dialogue with a broader variety of policy players. This underscores the need for consensus-building activities through INCAE. Thus, the thrust of AID's technical assistance to the new government will be through a new component to the Policy Dialogue Support Project, administered by INCAE. INCAE will assist the government in analyzing and implementing its policy reforms, as well as with strategic planning. AID will also contract Price Waterhouse's International Privatization Group to assist in the new GOE in its privatization efforts. In agricultural and health-related projects,, respectively, IDEA will continue to work closely with the Ministry of Agriculture and AID's General Development Office will continue to work with the Ministries of Health and Social welfare.

The matrix on the following page summarizes the two administrations' policies, as they pertain to the LAC/Mission strategic objectives and activities.

ANNEX D: Policy Reforms under the Borja and Duran-Ballen Administration:

LAC/Mission Strategic Objective	Policy Under Borja Administration	Policy under Duran-Ballen Administration	AID Activities that Contributed to Policy Change
1. Increased trade and employment in non-traditional exports.	Encouraged exports through passage & implementation of "ventanilla unica" (one-stop export shop); passage of Maquila, Free Zone, and Labor laws; eliminated required import deposits; mini-devaluations of sucre.	Andean FIA passed; privatization of state enterprises to be cornerstone of efforts to reduce state; capital markets law to be submitted to Congress; improved foreign investment and export facilitation laws to be submitted.	On-going projects through Trade and Investment Project have provided technical assistance on privatization and trade issues; AID-sponsored conferences/seminars addressed issues of commercial options, infrastructure, and labor.
2. Increased income on small and medium farms from selected commodities.	Most food price controls not enforced; Banco Nacional de Fomento (BNF) interest rates for agricultural credit moved toward market rates, but remained subsidized; INIAP autonomy law passed.	State-owned agricultural enterprises such as PROMANEC are slated for privatization; tariffs reduced; land titling law to be reviewed by Congress in next few weeks; most price controls removed.	Land Titling Project created prototype land titling & registration system; creation and expansion of Fundagro; support for IDEA's policy dialogue efforts.
3. Increased use, efficiency, and sustainability of family planning and selected health services.	Agreement signed with MOH to increase allocations for family planning services. Family planning and urban & rural water and sewage programs in place.	GOE has demonstrated interest in modernizing the entire social security system (IESS).	Policy Dialogue with CONADE on implementation of population policy; AID-sponsored conferences/seminars addressed issue of social policy in times of adjustment.
4. Improved responsiveness of selected democratic institutions with greater citizen participation.	Free and fair elections were held; abolished the Criminal Investigation Service (SIC) responsible for notable human rights violations.	GOE pursuing reform of Administration of Justice (AOJ) system; Congress is discussing legislation for AOJ.	Arranged for AOJ sector assessment; INLANUD provided technical assistance to draft new criminal & civil legal codes and procedures; CAPEL assistance to electoral process.
5. Stem loss of bio-diversity and accelerate transition from resource mining to management in and around selected protected areas.	Laws were passed, but not enforced.	Semi-autonomous national parks institute has been established to administer national park system.	AID supported Fundacion Natura developed specific plan for parks institute; IDEA program on natural resource policy funded.

Selected General Policy Reform Areas/ Cross-Cutting Issues

Reform of State (privatization, management reform)	Did little or nothing to reduce the size of state.	GOE submitted legislation which calls for early retirement of older public sector employees, dismissal of recently hired employees, and a hiring freeze.	AID-sponsored conferences/seminars addressed issue of modernization of the state.
Reduction of fiscal deficit (reduction of subsidies)	Did little to reduce the fiscal deficit; power of Central Bank to issue credit subsidies abolished under new financial law.	Reduced or eliminated subsidies on gasoline, electricity, and water.	On-going activities through the Policy Dialogue Support Project.
Liberalization of interest rates.	Interest rates remained controlled.	Completely liberalized interest rates.	AID-sponsored conferences/seminars addressed issue of reform of the financial sector.
Liberalization of exchange rate.	Did very little to manage inflation through exchange rate policy -- only very small, regular devaluations.	Official rate devalued by 35 percent to stimulate exports, and fixed official rate replaced system of mini-devaluations to stem inflationary pressures.	On-going activities through the Policy Dialogue Support Project.

TABLE I

APPENDIX

GROSS DOMESTIC PRODUCT BY SECTOR

	GDP	AGRICULTURE FORESTRY FISHING	PETROLEUM MINING	INDUSTRY	CONSTRUCTION	SERVICES	OTHER
MILLIONS OF 1975 SUCCRES							
1985	184054	24178	23075	28710	8742	78344	4205
1986	169136	26658	24513	28241	8841	78847	4238
1987	159016	27323	11107	28729	7011	80840	4208
1988	175742	29416	28312	28312	6024	82912	4114
1989	178185	30230	21842	27858	8284	85389	4812
1990	180178	31047	21528	27485	5403	88001	8714
1991	188033	33098	22559	28494	5232	91008	7843

ANNUAL PERCENTAGE CHANGE

1985	4.3	9.9	9.1	0.2	2.4	2.8	9.3
1986	3.1	10.2	2.7	-1.8	1.5	3.0	0.8
1987	-8.0	2.5	-54.7	1.7	2.5	2.5	-0.8
1988	10.5	7.7	115.8	2.0	-14.1	2.8	-2.2
1989	0.3	2.8	-9.7	-5.0	4.0	3.0	17.0
1990	2.3	2.7	-0.5	-1.3	-13.7	3.1	38.5
1991	4.4	6.8	4.8	3.7	-3.2	3.4	13.8
1992 Proj.	3.5	--	--	--	--	--	--

SOURCE: CENTRAL BANK

TABLE II

ECUADOR: PRINCIPAL EXPORTS, 1988-1992

PRODUCT	1986	1987	1988	1989	1990	1991	Proj. 1992
CRUDE OIL	912.4	739.4	875.2	1,033.0	1,258.0	1,059.0	1,260.0
Volume	71.3	45.4	69.0	63.7	62.3	65.3	70.0
Unit Price	12.8	16.3	12.7	16.2	20.2	16.2	18.0
OIL DERIVATIVES	70.1	78.2	100.5	114.7	150.2	93.0	102.6
Volume	6.7	5.7	9.5	8.4	9.7	9.4	9.0
Unit Price	10.5	13.7	10.6	13.7	15.5	9.9	11.4
BANANAS	263.4	266.9	301.4	369.8	468.5	715.6	712.8
Volume	1,399.6	1,406.2	1,570.0	1,761.1	2,200.8	2,714.9	2,970.0
Unit Price	0.188	0.190	0.192	0.210	0.213	0.264	0.240
COFFEE (Unprocessed)	298.9	192.3	152.4	142.2	104.5	84.8	93.0
Volume	102.7	98.8	74.2	96.1	88.6	64.7	62.0
Unit Price	2.91	1.95	2.05	1.48	1.18	1.31	1.50
COCOA (Unprocessed)	71.1	82.8	77.6	55.6	74.7	53.6	39.6
Volume	38.3	45.4	52.9	46.7	68.5	53.1	36.0
Unit Price	1.86	1.82	1.47	1.19	1.09	1.01	1.10
COCOA (Processed)	77.2	57.1	47.7	52.8	56.4	59.1	60.9
Volume	35.4	24.2	27.0	33.0	40.0	43.1	42.0
Unit Price	2.18	2.36	1.77	1.60	1.41	1.37	1.45
SHRIMP	287.9	383.1	387.0	328.3	337.9	491.3	504.0
Volume	31.1	48.7	58.2	46.3	52.8	71.0	80.0
Unit Price	9.26	7.87	6.89	7.09	6.40	6.92	6.30
OTHER FISH PRODUCTS	99.7	96.6	122.9	107.2	93.0	91.7	97.0
OTHER	105.2	124.9	121.0	150.3	171.1	203.2	235.7
TOTAL	2,185.9	2,021.3	2,185.7	2,353.9	2,714.4	2,851.4	3,105.6
PETROLEUM	982.5	817.6	975.7	1,147.7	1,408.2	1,152.0	1,362.6
NON-PETROLEUM	1,203.4	1,203.7	1,210.0	1,206.2	1,306.2	1,699.4	1,743.0

1/ Value in Millions of dollars.

Volume in millions of barrels for oil and derivatives exports.

Volume in thousands of metric tons for non-oil exports.

Unit value in dollars per barrel and per metric ton.

Source: Central Bank of Ecuador, and US-AID Staff Estimates.

TABLE III

ECUADOR: BALANCE OF PAYMENTS
(US\$ 000)

	1986	1987	1988	1989	1990	1991	Proj. 1992
1. Exports, (FOB)	2186	2021	2202	2354	2714	2851	3106
2. Imports, (FOB)	-1643	-2054	-1583	-1693	-1711	-2207	-2280
I. TRADE BALANCE (1+2)	543	-33	619	661	1003	644	826
3. Travel (Net)	14	-3	6	18	13	12	13
4. Interest payments, medium and long-term debt	-728	-738	-802	-907	-892	-815	-770
5. Interest payments, short-term debt	-53	-57	-58	-60	-60	-37	-35
6. Other (Net)	-406	-425	-398	-323	-337	-381	-337
II. GOODS AND SERVICES BALANCE (3+4+5+6)	-1173	-1223	-1252	-1272	-1276	-1221	-1129
III. Transfers	45	132	97	97	107	110	105
IV. CURRENT ACCOUNT BALANCE (I+II+III)	-585	-1124	-536	-514	-166	-467	-198
7. Public Sector	662	277	44	256	-472	-591	-740
a. Disbursements	2822	1708	1742	1587	732	750	640
b. Amortization	-2160	-1431	-1698	-1331	-1264	-1341	-130
8. Private Sector	0	91	101	124	87	87	90
a. Investment	70	75	80	60	82	85	85
b. Disbursements	13	23	57	63	30	27	30
c. Amortization	-83	-7	-36	-19	-25	-25	-25
9. Other 1/	-294	-241	46	21	152	112	50
V. CAPITAL ACCOUNT BALANCE	368	127	191	401	-233	-392	-600
VI. NET OFFICIAL RESERVES 2/ (-(IV+V))	217	997	345	113	399	859	798
10. Arrears 3/	-17	909	313	492	941	1045	948
11. Rescheduling			406	214	236	214	350
VII. NET OFFICIAL RESERVES 2/ (-(VI+10))	234	88	32	-379	-542	-400	-500
Memorandum items							
GDP (US\$ dollars)	9491	9524	8528	10263	10435	11517	11920
(In percent of GDP)							
Current Account Balance	-6.2	-11.8	-6.3	-5.0	-1.6	-4.1	-1.7
Trade Account	5.7	-0.3	7.3	6.4	9.6	5.6	6.9
Exports, (FOB)	23.0	21.2	25.8	22.9	26.0	24.8	26.1
Imports, (FOB)	-17.3	-21.6	-18.6	-16.5	-16.4	-19.2	-19.1

1/ Includes errors and omissions and valuation adjustment

2/ Negative sign indicates increase.

3/ Positive sign indicates accumulation; negative sign indicates payment.

TABLE IV

CONSUMER PRICES 1985 TO 1991
(May 1978 to April 1979, Base = 100)

ANNUAL AVERAGE	INDEX	ANNUAL CHANGE (%)
1985	394.0	28.0
1986	484.7	23.0
1987	627.7	29.5
1988	993.2	58.2
1989	1744.4	75.6
1990	2590.8	48.5
1991	3853.1	48.7

DECEMBER TO DECEMBER

1985	423.1	24.4
1986	538.8	27.3
1987	713.8	32.5
1988	1325.6	85.7
1989	2044.7	54.2
1990	3057.3	49.5
1991	4554.9	49.0

MONTHLY CHANGE - 1992

JANUARY	4752.4	48.9
FEBRUARY	4916.3	48.3
MARCH	5054.8	46.7
APRIL	5321.6	49.6
MAY	5518.6	48.8
JUNE	5716.2	50.4

SOURCE: CENTRAL BANK

TABLE V

ECUADOR: SUMMARY CONDITIONS OF THE PUBLIC SECTOR, 1985-1992

(Billions of Sucres)

	1986	1987	1988	1989	1990	1991	Proj. 1992	Proj. Changes	Proj. 1992
TOTAL REVENUES	336.4	396.6	663.6	1365.9	2322.8	3113.3	3979.1	620.0	4739.1
Petroleum 1/	115.7	107.2	233.5	488.0	951.2	1059.2	1503.0	335.0	1838
Non-Petroleum 2/	197.5	263.4	396.4	781.9	1161.0	1681.2	2002.9	285.0	2287.9
Of which: Income Tax	19.0	25.4	36.5	89.6	101.9	123.5	154.4	10.0	164.4
VAT	36.8	46.7	82.6	142.9	236.0	366.3	531.1	20.0	551.1
Operating Surplus of Public Enterprises 3/	23.2	26.0	33.7	96.0	210.6	372.9	473.2	140.0	613.2
CURRENT EXPENDITURES	411.3	523.0	782.4	1417.9	2176.8	3297.0	5286.5		5390.4
Current expenditure	308.0	413.7	639.5	1101.4	1607.9	2475.3	3936.2	143.5	4079.7
Capital expenditure	105.3	109.3	142.9	316.5	568.9	821.7	1350.3		1310.7
CURRENT ACCOUNT BALANCE	30.4	-17.1	24.1	264.5	714.9	638.0	42.9		659.4
OVERALL SURPLUS OR (DEFICIT -)	-74.9	-126.4	-118.8	-52.0	146.0	-183.7	-1307.4		-651.3
External Interest Arrears 3/		87.0	167.3	230.7	279.6	380.1	526.4		526.4
OVERALL BALANCE (Cash Basis)	-74.9	-39.4	48.5	178.7	425.6	196.4	-781.0		-124.9

(As Percent of GDP)

TOTAL REVENUES	24.3	22.1	22.0	26.4	28.5	25.6	21.2	3.3	25.3
Petroleum	14.3	14.7	13.1	8.8	14.2	13.8	10.7	1.5	12.2
Non-Petroleum	14.3	14.7	13.1	12.5	14.2	13.8	10.7	1.5	12.2
Of which: Income Tax	1.4	1.4	1.2	1.7	1.2	1.0	0.8	0.1	0.9
VAT	2.7	2.6	2.7	2.8	2.9	3.0	2.8	0.1	2.9
Operating Surplus of Public Enterprises	1.7	1.4	1.1	1.9	2.6	3.1	2.5		3.3
CURRENT EXPENDITURES	29.7	29.1	25.9	26.0	26.7	27.1	28.2		28.8
Current expenditure	22.1	23.1	21.2	19.0	19.7	20.4	21.0	0.8	21.8
Capital expenditure	7.6	6.1	4.7	7.0	7.0	6.8	7.2		7.0
CURRENT ACCOUNT BALANCE	2.2	-1.0	0.8	5.1	8.8	5.3	0.2		3.5
OVERALL SURPLUS OR (DEFICIT -)	-5.4	-7.0	-3.9	-1.0	1.8	-1.5	-7.0		-3.5
External Interest Arrears		4.8	5.5	4.5	3.4	3.1	2.8		2.8
OVERALL BALANCE (Cash Basis)	-5.4	-2.2	1.6	4.1	5.2	3.8	-4.2		-0.7

MEMORANDUM ITEMS:	1986	1987	1988	1989	1990	1991	Aug. Proj. 1992	Proj. Changes	Sept. Proj. 1992
GDP (In billions of sucres)	1383.2	1794.5	3019.7	5170.5	8160.1	12149.2	18732	18732	18732

1/ Petroleum revenues projections for 1992 is based on the average international price for Ecuadorian oil of US\$ 22.5 per barrel.

2/ This line item includes the following changes in billions of sucres:

Revenues	Expenditure
Domestic derivatives	335
Electricity rates	50
Capital assessment tax	55
Devaluation	90
Expenditure cuts	70
Other, including widening base of VAT	20
Adjust. living	3.5
Salary tax	26
Social security	30
Public sector	34
External	50

3/ These arrears commercial banks include: unpaid principal and interest obligations to commercial banks.

4/ Includes rescheduled interest.

5/ Includes rescheduled principal.

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TABLE VI

CENTRAL BANK OPERATIONS, 1985-1990
(Billions of Sucre as of December 31)

	1985	1986	1987	1988	1989	Draft Proj. 1990
NET INTERNATIONAL RESERVES	15.9	-10.2	-17.4	-84.2	-79.3	74.5
NET DOMESTIC ASSETS	31.8	62.5	68.3	48.3	103.4	-139.3
Non-financial Public Sector	-90.0	-82.0	-58.3	-82.4	-103.2	-171.0
Central Government (net)	-21.8	-34.4	-8.7	3.9	-24.5	
Other (net)	-68.2	-47.6	-49.6	-86.3	-78.7	
Financial Institutions (net)	113.4	111.1	71.4	-9.5	-11.0	33.9
Banking System (net)	113.3	119.2	104.8	47.4	22.7	17.9
Private (net)	57.2	53.5	42.7	-17.1	-60.0	-10.6
Credit	81.8	89.1	88.4	71.7	64.5	
Deposits	-24.6	-35.6	-45.7	-83.8	-124.5	
National Development Bank	17.1	22.4	17.3	27.8	51.1	27.3
Credit	19.2	27	29	34.1	60.8	
Deposits	-2.1	-4.6	-11.7	-6.3	-9.7	
Other Financial Intermediaries (net)	39.0	43.3	44.8	36.7	31.6	1.2
Private Sector (net)	0.1	-8.1	-33.4	-56.9	-33.7	16
Credit	23.3	16.8	12.7	16.2	37.4	
Deposits	-23.2	-24.9	-46.1	-73.1	-71.1	
Unclassified Assets (net)	321.6	380.2	427.1	1628.3	2200.7	42.9
Medium and Long-term Foreign Liabilities	305.7	330.5	329.6	1405.9	1901.4	-46.2
Other Liabilities	4.3	4.7	4.9	20.4	40.0	14.9
Capital and Reserves	3.3	3.5	4.0	4.9	8.0	
CURRENCY ISSUE	15.9	72.7	85.7	132.5	182.7	-213.8

Source: Central Bank of Ecuador

TABLE VII
MONEY SUPPLY, 1985-1992

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		M1		Time & Savings		M2		CD's and other		M3	
		Millions of Sucres	% Change	Millions of Sucres	% Change	Millions of Sucres	% Change	Millions of Sucres	% Change	Millions of Sucres	% Change
Dec.	1985	137846	23.6	71888	33.1	209734	56.0	44129	1518.55	253863	58.14
Dec.	1986	166000	20.4	96855	42.7	262855	29.1	68552	55.34	331407	30.55
Dec.	1987	219575	32.3	146385	51.1	365960	39.2	98299	43.39	464259	40.09
Dec.	1988	337667	53.8	208625	42.5	546292	49.3	120647	22.73	666939	43.66
Dec.	1989	466307	38.1	294290	41.1	760597	39.2	206511	71.17	967108	45.01
Dec.	1990	709658	52.2	466371	58.5	1176039	54.6	423724	105.18	1599763	65.42
Dec.	1991	1039481	46.5	751160	61.1	1790641	52.3	672463	58.70	2463104	53.97
1992		M1	% change Yr basis	Time, Savings, CD's, and other		% change Yr basis		M3	% change Yr basis		
January		918938	44.0	1492034		58.4		2410972	52.6		
February		972684	46.1	1560491		59.6		2533175	54.1		
March		991290	44.7	1633922		61.2		2625212	54.5		
April		1044520	41.1	1722641		63.1		2767161	54.1		
May		1038087	38.7	1704984		56.8		2743071	49.5		
June		1060851	30.8	1730522		59.2		2791373	43.4		

SOURCE: CENTRAL BANK

TABLE VIII

ECUADOR: EXTERNAL DEBT AND DEBT SERVICE PAYMENTS

(In millions of U.S. dollars, unless otherwise indicated)

	1986	1987	1988	1989	1990	1991	Proj. 1992 1/
I. Outstanding Debt (End of Period)							
Medium and long term debt	8153	9034	8966	9544	9911	10094	10541
Multilateral	1243	1557	1806	1918	2186	2292	2478
Official bilateral	978	1505	1585	1878	2040	2193	2388
Suppliers	525	514	379	436	398	369	312
Commercial banks	5408	5458	5314	5196	5289	5241	5363
Short-term debt (including IMF and Latin American Reserve Fund Credits)	923	874	798	529	388	273	239
Of which: IMF	471	438	403	315	252	172	174
Total debt outstanding 2/	9076	9908	9764	1073	10299	10658	11261
In percent of GDP	95.4	104.7	113.4	98	94.7	88.9	92.6
II. Debt Service							
Medium and long term debt servic							
Principal and interest	2062	2009	2262	2094	2089	2127	2011
Multilateral	152	188	230	224	263	315	395
Official bilateral	210	316	464	384	459	449	425
Suppliers	217	226	127	127	160	130	107
Commercial banks	1483	1279	1441	1359	1207	1233	1084
Interest only	700	707	785	884	876	847	792
Multilateral	75	104	134	134	144	161	179
Official bilateral	65	85	126	140	152	149	169
Suppliers	40	51	33	29	33	35	29
Commercial banks	520	467	492	581	547	502	415
Short-term debt service							
Principal and interest	41	178	247	298	229	157	159
IMF	39	147	171	122	147	122	91
Other 1/	3	31	76	176	82	35	69
Interest only	36	49	51	44	35	18	50
IMF	33	33	34	34	32	18	16
Other	3	17	17	10	3	0	33
Total debt service	2105	2187	2509	2392	2318	2284	2170
As a percent of exports of goods and services)	79	89	94	83	71	68	62
Total interest payments (As a percent of exports of goods and services)	736	756	836	928	911	865	842
	28	31	31	32	28	26	24

Sources: Central Bank and IMF

1/ Assuming a debt-reduction operation in 1992

2/ Medium and long term debt, plus short term debt and cumulative financing gaps. Excludes interest arrears.

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5C(2) - ASSISTANCE CHECKLIST

Listed below are statutory criteria applicable to the assistance resources themselves, rather than to the eligibility of a country to receive assistance. This section is divided into two parts. Part A includes criteria applicable to both Development Assistance and Economic Support Fund resources.

Part B

includes criteria applicable only to Economic Support Funds.

CROSS REFERENCE: IS COUNTRY CHECKLIST UP TO DATE?

A. CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUNDS

1. Host Country Development Efforts (FAA Sec. 501(a)): Information and conclusions on whether assistance will encourage efforts of the country to:

- (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

2. U.S. Private Trade and Investment (FAA Sec. 501(b)): Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private

By pursuing economic reform Ecuador will be inserted and competing in the world free market. At the same time private initiative will be fostered as state owned enterprises will be turned to private hands. Free competition will discourage monopolistic practices particularly those of SOEs

The program will finance imports from the US via a reimbursement system. Economic reform and the opening of the economy will attract foreign investors and encourage trade with the U.S.

3. Congressional Notification

a. General requirement (FY 1991-
Appropriations Act Secs. 523 and 591;
FAA Sec. 634A): If money is to be
obligated for an activity not previously
justified to Congress, or for an amount in
excess of amount previously justified to
Congress, has Congress been properly
notified (unless the notification
requirement has been waived because of
substantial risk to human health or
welfare)?

YES

b. Notice of new account
obligation (FY 1991 Appropriations Act
Sec. 514): If funds are being obligated
under an appropriation account to which
they were not appropriated, has the
President consulted with and provided a
written justification to the House and
Senate Appropriations Committees and has
such obligation been subject to regular
notification procedures?

YES

c. Cash transfers and nonproject sector assistance (FY 1991
Appropriations Act Sec. 575(b)(3)): If
funds are to be made available in the form
of cash transfer or nonproject sector
assistance, has the Congressional notice
included a detailed description of how the
funds will be used, with a discussion of
U.S. interests to be served and a
description of any economic policy
reforms to be promoted?

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4. Engineering and Financial Plans
(FAA Sec. 611(a)): Prior to an obligation
in excess of \$500,000, will there be: (a)
engineering, financial or other plans
necessary to carry out the assistance; and
(b) a reasonably firm estimate of the cost
to the U.S. of the assistance?

YES -

5. Legislative Action (FAA Sec.
611(a)(2)): If legislative action is
required within recipient country with
respect to an obligation in excess of
\$500,000, what is the basis for a
reasonable expectation that such action
will be completed in time to permit
orderly accomplishment of the purpose of
the assistance?

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6. **Water Resources** (FAA Se. 611(b); FY 1991 Appropriations Act Sec. 501): If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See AID Handbook 3 for guidelines.)

N/A

7. **Cash Transfer and Sector Assistance** (FY 1991 Appropriations Act Sec. 575(b)): Will cash transfer or nonproject sector assistance be maintained in a separate account and not commingled with other funds (unless such requirements are waived by Congressional notice for nonproject sector assistance)?

YES

8. **Capital Assistance** (FAA Sec. 611 (e)): If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed \$1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively?

N/A

9. **Multiple Country Objectives** (FAA Sec. 601 (a)): Information and conclusions on whether projects will encourage efforts of the country to (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

The program will: - Finance private sector capital goods imports.
- Increase export potential opening of the economy and improve investment climate.
- Privatization of state owned enterprises.
- Reduction of the public sector fiscal deficit through major public sector reforms

10. **U.S. Private Trade** (FAA Sec. 601 (b)): Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Cash transfer dollars will be used to reimburse the GOE for eligible imports from the U.S. Economic reforms will improve the investment climate.

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11. Local Currencies

a. Recipient Contributions (FAA Secs. 612(b), 636(h)): Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

N/A

b. U.S.-Owned Currency (FAA Sec. 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

N/A

c. Separate Account (FY 1991 Appropriations Act Sec. 575). If assistance is furnished to a foreign government under arrangements which result in the generation of local currencies:

(1) Has A.I.D. (a) required that local currencies be deposited in a separate account established by the recipient government, (b) entered into an agreement with that government providing the amount of local currencies to be generated and the terms and conditions under which the currencies so deposited may be utilized, and (c) established by agreement the responsibilities of A.I.D. and that government to monitor and account for deposits into and disbursements from the separate account?

YES

(2) Will such local currencies, or an equivalent amount of local currencies, be used only to carry out the purposes of the DA or ESF chapters of the FAA (depending on which chapter is the source of the assistance) or for the administrative requirements of the United States Government?

YES

(J) Has A.I.D. taken all appropriate steps to ensure that the equivalent of local currencies disbursed from the separate account are used for the agreed purposes?

YES

(4) If assistance is terminated to a country, will any unencumbered balances of funds remaining in a separate account be disposed of for purposes agreed to by the recipient government and the United States Government?

YES

12. Trade Restrictions

N/A

a. Surplus Commodities (FY 1991 Appropriations Act Sec. 521(a)): If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

b. Textiles (Lautenberg Amendment) (FY 1991 Appropriations Act Sec. 521(c)): Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports; of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?

NO

13. Tropical Forests (FY 1991 Appropriations Act Sec. 533(c)(3)): Will funds be used for any program, project or activity which would (a) result in any significant loss of tropical forests, or (b) involve industrial timber extraction in primary tropical forest areas?

NO

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14. PVO Assistance

a. Auditing and registration (FY 1991 Appropriations Act Sec. 537): If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.?

N/A

b. Funding sources (FY 1991 Appropriations Act, Title II, under heading "Private and Voluntary Organizations"): If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government?

N/A

15. Project Agreement Documentation (State Authorization Sec. 139 (as interpreted by conference report)): Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision).

No, the agreement is for less than \$25 million.

16. Metric System (Omnibus Trade and Competitiveness Act of 1988 Sec. 5164, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance activity use the metric system of measurement in its procurements, grants, and other business-related activities, except to the

N/A

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extent that such use is impractical or is likely to cause significant inefficiency or loss of markets to United States firms. Are bulk purchases usually to be made in metric, and are components, subassemblies and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?

17. Women in Development (FY 1991 Appropriations Act, Title II, under heading "Women in Development"): Will assistance be designed so that the percentage of women participants will be demonstrably increased?

The assistance is for balance of payment support and to promote economic stabilization and recovery.

18. Regional and Multilateral Assistance (FAA Sec. 209): Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

This assistance is not appropriate to execution as part of a regional or a multilateral project.

19. Abortions (FY 1991 Appropriations Act, Title II, under heading "Population, DA," and Sec. 525):

a. Will assistance be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?

NO

b. Will any funds be used to lobby for abortion?

NO

20. Cooperatives (FAA Sec. 111): Will assistance help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life?

Assistance for economic reform will eventually lead to help the rural and urban poor.

21. U.S.-Owned Foreign Currencies

This is a cash transfer of ESF

a. Use of currencies (FAA Secs. 612(b), 636(h); FY 1991 Appropriations Act Secs. 507, 509): Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.

b. Release of currencies (FAA Sec. 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No, the U.S. does not own excess Ecuadorian currency.

22. Procurement

a. Small business (FAA Sec. 602(a)): Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?

N/A

b. U.S. procurement (FAA Sec. 604(a)): Will all procurement be from the U.S. except as otherwise determined by the President or determined under delegation from him?

Procurement is planned from host-country and U.S.

c. Marine insurance (FAA Sec. 604(d)): If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?

Ecuador does not so discriminate.

d. Non-U.S. agricultural procurement (FAA Sec. 604(e)): If non-U.S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)

N/A

e. Construction or engineering services (FAA Sec. 604(g)): Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible

N/A

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under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.)

f. Cargo preference shipping (FAA Sec. 603)): Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates?

No, shipping is not excluded from these requirements.

g. Technical assistance (FAA Sec. 621(a)): If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Will the facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?

Technical assistance will not be financed by cash transfer dollars.

h. U.S. air carriers (International Air Transportation Fair Competitive Practices Act, 1974): If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?

N/A

i. Termination for convenience of U.S. Government (FY 1991 Appropriations Act Sec. 504): If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?

N/A

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j. Consulting services (FY 1991 Appropriations Act Sec. 524): If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)?

N/A

k. Metric conversion (Omnibus Trade and Competitiveness Act of 1988, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance program use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?

N/A

l. Competitive Selection Procedures (FAA Sec. 601(e)): Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

N/A

23. Construction.

a. Capital project (FAA Sec. 601(d)): If capital (e.g., construction) project, will U.S. engineering and professional services be used?

N/A

b. Construction contract (FAA Sec. 611(c)): If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable?

N/A

c. Large projects, Congressional approval (FAA Sec. 620(x)) If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed \$100 million (except for productive enterprises in Egypt that were described in the Congressional Presentation), or does assistance have the express approval of Congress?

N/A

24. U.S. Audit Rights (FAA Sec. 301(d)): If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights?

U.S audit rights are provided for in the program agreement

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

NO

26. Narcotics

YES

a. Cash reimbursements (FAA Sec. 483): Will arrangements preclude use of financing to make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated?

b. Assistance to narcotics traffickers (FAA Sec. 487): Will arrangements take "all reasonable steps" to preclude use of financing to or through individuals or entities which we know or have reason to believe have either: (1) been convicted of a violation of any law or regulation of the United States or a foreign country relating to narcotics (or other controlled substances); or (2) been an illicit trafficker in, or otherwise involved in the illicit trafficking of, any such controlled substance?

YES

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27. Expropriation and Land Reform (FAA Sec. 620(g)): Will assistance preclude use of financing to compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President? YES
28. Police and Prisons (FAA Sec. 660): Will assistance preclude use of financing to provide training, advice, or any financial support for police, prisons or other law enforcement forces, except for narcotics programs? YES
29. CIA Activities (FAA Sec. 662): Will assistance preclude use of financing for CIA activities? YES
30. Motor Vehicles (FAA Sec. 636(i)): Will assistance preclude use of financing for purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? YES
31. Military Personnel (FY 1991 Appropriations Act Sec. 503): Will assistance preclude use of financing to pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel? YES
32. Payment of U.N. Assessments (FY 1991 Appropriations Act Sec. 505): Will assistance preclude use of financing to pay U.N. assessments, arrearages or dues? YES
33. Multilateral Organization Lending (FY 1991 Appropriations Act Sec. 506): Will assistance preclude use of financing to carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)? ES
34. Export of Nuclear Resources (FY 1991 Appropriations Act Sec. 510): Will assistance preclude use of financing to finance the export of nuclear equipment, fuel, or technology? YES

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35. Repression of Population (FY 1991 Appropriations Act Sec. 511): Will assistance preclude use of financing for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?

YES

36. Publicity or Propoganda (FY 1991 Appropriations Act Sec. 516): Will assistance be used for publicity or propoganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propoganda purposes not authorized by Congress?

NO

37. Marine Insurance (FY 1991 Appropriations Act Sec. 563): Will any A.I.D. contract and solicitation, and subcontract entered into under such contract, include a clause requiring that U.S. marine insurance companies have a fair opportunity to bid for marine insurance when such insurance is necessary or appropriate?

N/A

38. Exchange for Prohibited Act (FY 1991 Appropriations Act Sec. 569): Will any assistance be provided to any foreign government (including any instrumentality or agency thereof), foreign person, or United States person in exchange for that foreign government or person undertaking any action which is, if carried out by the United States Government, a United States official or employee, expressly prohibited by a provision of United States law?

NO

B. CRITERIA APPLICABLE TO ECONOMIC SUPPORT FUNDS ONLY

1. **Economic and Political Stability** (FAA Sec 531(a)): Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA? YES

2. **Military Purposes** (FAA Sec. 531 (e)): Will this assistance be used for military or paramilitary purposes? NO

3. **Commodity Grants/Separate Accounts** (FAA Sec. 609): If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart, arrangements been made? (For FY 1991, this provision is superseded by the separate account requirements of FY 1991 Appropriations Act Sec. 575(a), see Sec. 575(a)(5).) NO

4. **Generation and Use of Local Currencies** (FAA Sec. 531(d)): Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106? (For FY 1991, this provision is superseded by the separate account requirements of FY 1991 Appropriations Act Sec. 575(a), see Sec. 575(a)(5).) YES. The cash transfer will generate local currency.
YES

5. **Cash Transfer Requirements** (FY 1991 Appropriations Act, Title II, under heading "Economic Support Fund," and Sec. 575(b)). If assistance is in the form of cash transfer:

a. **Separate account:** Are all such cash payments to be maintained by the country in a separate account and no to be commingled with any other funds? YES

b. **Local currencies:** Will all local currencies that may be

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generated with funds provided as a cash transfer to such a country--also be deposited in a special account, and has AID entered into an agreement with that government setting forth the amount of the local currencies to be generated, the terms and conditions under which they are to be used, and the responsibilities of AID and that government to monitor and account for deposits and disbursements?_____

YES

c. U.S. Government use of local currencies: Will all such local currencies also be used in accordance with FAA Section 609, which requires such local currencies to be made available to the U.S. government as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves be available?

N/A

d. Congressional notice: Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance?

YES

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3A(1) COUNTRY CHECKLIST

Listed below are statutory criteria applicable to the eligibility of countries to receive the following categories of assistance: (A) both Development Assistance and Economic Support Funds; (B) Development Assistance funds only; or (C) Economic Support Funds only.

A. COUNTRY ELIGIBILITY CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUND ASSISTANCE

1. Narcotics

a. Negative certification (FY 1991 Appropriations Act Sec. 559(b)): Has the President certified to the Congress that the government of the recipient country is failing to take adequate measures to prevent narcotic drugs or other controlled substances which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully? No.

b. Positive certification (FAA Sec. 481(h)). (This provision applies to assistance of any kind provided by grant, sale, loan, lease, credit, guaranty, or insurance, except assistance from the Child Survival Fund or relating to international narcotics control, disaster and refugee relief, narcotics education and awareness, or the provision of food or medicine.) If the recipient is a "major illicit drug producing country" (defined as a country producing during a fiscal year at least five metric tons of opium or 500 metric tons of coca or marijuana) or a "major drug-transit country" (defined as a country that is a significant direct source of illicit drugs significantly affecting the United States, through which such drugs are transported, or through which significant sums of drug-related profits are laundered with the knowledge or complicity of the government): The requirements of FAA Sec. 481(h) have been satisfied.

(1) does the country have in place a bilateral narcotics agreement with the United States, or a multilateral narcotics agreement?

(2) has the President in the March 1 International Narcotics Control Strategy Report (INSCR) determined and certified to the Congress (without Congressional enactment, within 45 days of continuous session, of a resolution disapproving such a certification), or has the President determined and certified to the Congress on any other date (with enactment by Congress of a resolution approving such certification),

that (a) during the previous year the country has cooperated fully with the United States or taken adequate steps on its own to satisfy the goals agreed to in a bilateral narcotics agreement with the United States or in a multilateral agreement, to prevent illicit drugs produced or processed in or transported through such country from being transported into the United States, to prevent and punish drug profit laundering in the country, and to prevent and punish bribery and other forms of public corruption which facilitate production or shipment of illicit drugs or discourage prosecution of such acts, or that (b) the vital national interests of the United States require the provision of such assistance?

c. Government Policy (1986 Anti-Drug Abuse Act of 1986 Sec. 2013(b)). (This section applies to the same categories of assistance subject to the restrictions in FAA Sec. 481(h), above.) If recipient country is a "major illicit drug producing country" or "major drug-transit country" (as defined for the purpose of FAA Sec 481(h)), has the President submitted a report to Congress listing such country as one: (a) which, as a matter of government policy, encourages or facilitates the production or distribution of illicit drugs; (b) in which any senior official of the government engages in, encourages, or facilitates the production or distribution of illegal drugs; (c) in which any member of a U.S. Government agency has suffered or been threatened with violence inflicted by or with the complicity of any government officer; or (d) which fails to provide reasonable cooperation to lawful activities of U.S. drug enforcement agents, unless the President has provided the required certification to Congress pertaining to U.S. national interests and the drug control and criminal prosecution efforts of that country?

No.

2. Indebtedness to U.S. citizens (FAA Sec. 620(c): If assistance is to a government, is the government indebted to any U.S. citizen for goods or services furnished or ordered where: (a) such citizen has exhausted available legal remedies, (b) the debt is not denied or contested by such government, or (c) the indebtedness arises under an unconditional guaranty of payment given by such government or controlled entity?

The Government of Ecuador is not so indebted.

3 Seizure of U.S. Property (FAA Sec. 620(e)(1)): If assistance is to a government, has it (including any government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?

The Government of Ecuador has not taken such action.

4. Communist countries (FAA Secs. 620(a), 620(f), 620D; FY 1991 Appropriations Act Secs. 512, 545): Is recipient country a Communist country? If so, has the President: (a) determined that assistance to the country is vital to the security of the United States, that the recipient country is not controlled by the international Communist conspiracy, and that

No.

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such assistance will further promote the independence of the recipient country from international communism, or (b) removed a country from applicable restrictions on assistance to communist countries upon a determination and report to Congress that such action is important to the national interest of the United States? Will assistance be provided either directly or indirectly to Angola, Cambodia, Cuba, Iraq, Libya, Vietnam, Iran or Syria? Will assistance be provided to Afghanistan without a certification, or will assistance be provided inside Afghanistan through the Soviet-controlled government of Afghanistan?

5. Mob Action (FAA Sec. 620(j)): Has the country permitted, or failed to take adequate measures to prevent, damage or destruction by mob action of U.S. property? No.

6. OPIC Investment Guaranty (FAA Sec. 620(l)): Has the country failed to enter into an investment guaranty agreement with OPIC? No..

7. Seizure of U.S. Fishing Vessels (FAA Sec. 620(o); Fishermen's Protective Act of 1967 (as amended) Sec. 5): (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing vessel because of fishing activities in international waters? (b) If so, has any deduction required by the Fishermen's Protective Act been made? No.

8. Loan Default (FAA Sec. 620(q); FY 1991 Appropriations Act Sec. 518 (Brooke Amendment)): (a) Has the government of the recipient country been in default for more than six months on interest or principal of any loan to the country under the FAA? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the FY 1990 Appropriations Act appropriates funds? Ecuador is not in default.

9. Military Equipment (FAA Sec. 620(s)): If contemplated assistance is development loan or to come from Economic Support Fund, has the Administrator taken into account the percentage of the country's budget and amount of the country's foreign exchange or other resources spent on military equipment? (Reference may be made to the annual "Taking Into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.) Yes, taken into account by the Administrator at the time of approval of the AID OYB.

10. Diplomatic Relations with U.S. (FAA Sec. 620(t)): Has the country severed diplomatic relations with the United States? If so, have relations been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption? Ecuador has not severed diplomatic relations with the U.S.

11. U.N. Obligations (FAA Sec. 620(u)): What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget? (Reference may be made to the "Taking into Consideration" memo.) Ecuador is not in arrears.

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12. International Terrorism

- a. Sanctuary and support (FY 1991 Appropriations Act Sec. 556; FAA Sec. 620A): Has the country been determined by the President to: (a) grant sanctuary from prosecution to any individual or group which has committed an act of international terrorism, or (b) otherwise support international terrorism, unless the President has waived this restriction on grounds of national security or for humanitarian reasons? Ecuador has not provided such sanctuary or otherwise support international terrorism.
- b. Airport Security (ISDCA of 1985 Sec. 552(b)). Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined, pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures? Ecuador is not a high terrorist threat country.
13. Discrimination (FAA Sec. 656(b)): Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA? Ecuador does not so object.
14. Nuclear Technology (FAA Secs. 669, 670): Has the country, after August 3, 1977, delivered to any other country or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards, and without special certification by the President? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device? If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported (or attempted to export) illegally from the United States any material, equipment, or technology which would contribute significantly to the ability of a country to manufacture a nuclear explosive device? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.) Ecuador has neither delivered nor received such equipment, materials or technology.
15. Algiers Meeting (ISDCA of 1981, Sec. 720): Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. on Sept. 25 and 28, 1981, and did it fail to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the "Taking into Consideration" memo.) Yes, taken into account by the Administrator at the time of approval of the AID OYE.
16. Military Coup (FY 1991 Appropriations Act Sec. 513): Has the duly elected Head of Government of the country been deposed by military coup or decree? If assistance has been terminated, has the President notified Congress that a democratically elected government has taken office prior to the resumption of assistance? The duly elected head of government has not been deposed by military coup or decree.

17. 'Refugee Cooperation (FY 1991 Appropriations Act Sec. 539): Does the recipient country fully cooperate with the international refugee assistance organizations, the United States, and other governments in facilitating lasting solutions to refugee situations, including resettlement without respect to race, sex, religion, or national origin?

Ecuador fully cooperates in facilitating lasting solutions to refugee situations.

18. Exploitation of Children (FY 1991 Appropriations Act Sec. 599D, amending FAA Sec. 116): Does the recipient government fail to take appropriate and adequate measures, within its means, to protect children from exploitation, abuse or forced conscription into military or paramilitary services?

No. Ecuador has taken measures within its means to protect children from exploitation.

B COUNTRY ELIGIBILITY CRITERIA APPLICABLE ONLY TO DEVELOPMENT ASSISTANCE ("DA")

1. Human Rights Violations (FAA Sec. 116): Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

N/A

2. Abortions (FY 1991 Appropriations Act Sec. 535): Has the President certified that use of DA funds by this country would violate any of the prohibitions against use of funds to pay for the performance of abortions as a method of family planning, to motivate or coerce any person to practice abortions, to pay for the performance of involuntary sterilization as a method of family planning, to coerce or provide any financial incentive to any person to undergo sterilizations, to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

N/A

C. COUNTRY ELIGIBILITY CRITERIA APPLICABLE ONLY TO ECONOMIC SUPPORT FUNDS ("ESF")

1. Human Rights Violations (FAA Sec. 502B): Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the President found that the country made such significant improvement in its human rights record that furnishing such assistance is in the U.S. national interest?

Ecuador does not engage in a consistent pattern of gross violations of internationally recognized human rights.

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ENVIRONMENTAL THRESHOLD DECISION

Project Location : Ecuador
Project Title : Ecuador Economic Reform Program
Project Number : E18-0118
Funding : -\$6,200,000 (LOP) (ESF)
Life of Project : FY 93
IEE Prepared by : Howard L. Clark, REA/SA
Recommended Threshold Decision: Positive Determination
Bureau Threshold Decision : Concur with Recommendation
Comments : The Mission Environmental Officer (MEO) shall review project activities as they develop and offer guidance and recommend mitigative measures to minimize environmental impacts. Where significant environmental impacts may result, the MEO shall recommend coordination with the LAC Bureau Environmental Officer for additional environmental review.

Concurrence conditional on the inclusion in the program agreement of AID environmental review of activities, as specified in the attached IEE.

Copy to : H. Robert Kramer, USAID/Ecuador
Acting Mission Director

Copy to : Howard Clark, REA/SA

Copy to : Lewis Lucke, LAC/DR/SA

Copy to : Robert Kahn, LAC/SA

Copy to : IEE File

**ENVIRONMENTAL THRESHOLD
DECISION cont'd**

James S. Hester Date SEP 30 1992
James S. Hester
Chief Environmental Officer
Bureau for Latin America
and the Caribbean