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UNCLASSIFIED

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

ECUADOR

PROJECT PAPER

PAAD
ECONOMIC STABILIZATION AND RECOVERY

AID/LAC/P-266

Loan Number:518-K-601
Project Number: 518-0058

UNCLASSIFIED

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43976

CLASSIFICATION:

AID 1120-1

PAAD

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO.	518-0058 518-K-601
2. COUNTRY	Ecuador
3. CATEGORY	Cash Transfer
4. DATE	3 September 1985
5. TO: AA/LAC, Malcolm Butler, Acting	6. OYB CHANGE NO.
7. FROM: LAC/DR, Dwight B. Johnson	8. OYB INCREASE / TO BE TAKEN FROM:
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 4,000,000	10. APPROPRIATION - LESA85-35518-KG31 (537-65-518-00-50-51) - 72-1151037

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
☐ LOAN ☒ GRANT	☐ INFORMAL ☒ FORMAL ☐ NONE	FY 1985	date of authorization

15. COMMODITIES FINANCED

N/A

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.:
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: $ 4,000,000	Other:

18. SUMMARY DESCRIPTION

The purpose of this Program assistance is to provide immediate balance of payments support to Ecuador, thereby ensuring that adequate funding is provided for private sector productive needs and for the continuation of public sector development investments. This program will assist the Government of Ecuador (GOE) to stabilize the current economic situation and continue with the structural reform process already initiated.

The $.4,000,000 (grant) assistance will be disbursed as a cash transfer into the U.S. bank account of the GOE. Upon disbursement of the assistance, the GOE will deposit into a Special Account an equivalent amount of sucres, calculated at the Central Bank free market intervention exchange rate. These funds will be used for mutually agreed development purposes consistent with the general criteria of the Foreign Assistance Act, especially Sections 103-106.

The GOE will agree to make available an equivalent amount of dollars to the private sector for imports of raw materials and intermediate goods from the U.S. within six months following the disbursement.

19. CLEARANCES	DATE
LAC/SA:FAlmaguer	9/12/85
ARA/ECP:RBeckham	9/13/85
FM:CChristensen	9/17/85
GC/LAC:RMeighan	[illegible]
LAC/DR:ILevy	9-16
LAC/DP:WWheeler	9-18/85

20. ACTION

☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE DATE

TITLE

CLASSIFICATION:

CLASSIFICATION:

AID 1120-1		1. PAAD NO. 518-0058 518-K-601 A
PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	2. COUNTRY Ecuador
		3. CATEGORY Cash Transfer
		4. DATE
5. TO: AA/LAC, Dwight Ink		6. OYB CHANGE NO.
7. FROM: LAC/DR, Dwight Johnson		8. OYB INCREASE TO BE TAKEN FROM:
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 6,000,000		10. APPROPRIATION - LES6-86-35518-KG31
11. TYPE FUNDING: ☐ LOAN ☒ GRANT	12. LOCAL CURRENCY ARRANGEMENT: ☐ INFORMAL ☒ FORMAL ☐ NONE	13. ESTIMATED DELIVERY PERIOD: FY 1986 — 14. TRANSACTION ELIGIBILITY DATE: date of authorization

15. COMMODITIES FINANCED

N/A

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.:
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: 6,000,000	Other:

18. SUMMARY DESCRIPTION

The purpose of this Program assistance is to provide immediate balance of payments support to Ecuador, thereby ensuring that adequate funding is provided for private sector productive needs and for the continuation of public sector development investments. This program will assist the Government of Ecuador (GOE) to stabilize the current economic situation and continue with the structural reform process already initiated.

This $6,000,000 (grant) is the second tranche of the $24 million ESF Program approved in September 1985. The tranche will be disbursed as a cash transfer into the U.S. bank account of the GOE. Upon disbursement of the assistance, the GOE will deposit into a Special Account an equivalent amount of sucres, calculated at the Central Bank free market intervention exchange rate. These funds will be used for mutually agreed development purposes consistent with the general criteria of the Foreign Assistance Act, especially Sections 103-106.

The GOE will agree to make available an equivalent amount of dollars to the private sector for imports of raw materials and intermediate goods from the U.S. within six months following the disbursement.

19. CLEARANCES	DATE
LAC/SA:FAlmaguer FA	12/12/85
ARA/ECP:RBeckham	12/12/85
FM:CChristensen	12/12/85
GC/LAC:MKiedy	12/12/85
LAC/DR:ILevy	12-13-85
LAC/DP:WWheeler	12/13/85
DAA/LAC: MButler	

20. ACTION

☐ APPROVED ☐ DISAPPROVED

Dwight Ink — Jan 3, 85

AUTHORIZED SIGNATURE — DATE

Assistant Administrator (LAC)

TITLE

CLASSIFICATION:

CLASSIFICATION:

AID 1120-1

PAAD

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO: 518-0058 518-K-601 B
2. COUNTRY: Ecuador
3. CATEGORY: Cash Transfer
4. DATE:
5. TO: AA/LAC, Dwight Ink
6. OYB CHANGE NO.:
7. FROM: LAC/DR, ~~Terry Brown~~ T.B.
8. OYB INCREASE:
   TO BE TAKEN FROM:
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 14,000,000
10. APPROPRIATION - 72-1161037 LESA-86-35518-KG31
11. TYPE FUNDING: ☐ LOAN ☒ GRANT
12. LOCAL CURRENCY ARRANGEMENT: ☐ INFORMAL ☒ FORMAL ☐ NONE
13. ESTIMATED DELIVERY PERIOD: FY 1986
14. TRANSACTION ELIGIBILITY DATE: date of authorization
15. COMMODITIES FINANCED:

N/A

16. PERMITTED SOURCE
    - U.S. only:
    - Limited F.W.:
    - Free World:
    - Cash: 14,000,000
17. ESTIMATED SOURCE
    - U.S.: 14,000,000
    - Industrialized Countries:
    - Local:
    - Other:

18. SUMMARY DESCRIPTION

The purpose of this Program assistance is to provide immediate balance of payments support to Ecuador, thereby ensuring that adequate funding is provided for private sector productive needs and for the continuation of public sector development investments. This program will assist the Government of Ecuador (GOE) to stabilize the current economic situation and continue with the structural reform process already initiated.

This $14,000,000 (grant) is the third and final tranche of the $24 million ESF Program approved in September 1985. The tranche will be disbursed as a cash transfer into the U.S. bank account of the GOE. Upon disbursement of the assistance, the GOE will deposit into a Special Account an equivalent amount of sucres, calculated at the Central Bank free market intervention exchange rate. These funds will be used for mutually agreed development purposes consistent with the general criteria of the Foreign Assistance Act, especially Sections 103-106.

The GOE will agree to make available an equivalent amount of dollars to the private sector for imports of raw materials and intermediate goods from the U.S. within six months following the disbursement.

19. CLEARANCES

Clearance	Date
LAC/SA:FAlmaguer	12/12/85
ARA/ECP:RBeckham	12/12/85
FM:CChristensen	1/14/86
GC/LAC:MRiedy	1/9/86
LAC/DR:ILevy	
LAC/DP:Wheeler	

20. ACTION

☐ APPROVED ☐ DISAPPROVED

Malcolm Butler — AUTHORIZED SIGNATURE — DATE 1/14/86

Assistant Administrator (LAC) — TITLE

CLASSIFICATION.

ECUADOR
ECONOMIC STABILIZATION AND RECOVERY PROGRAM
Program Assistance Approval Document
(Program No. 518-0058)

Annexes to the PAAD

/ /

ECUADOR
ECONOMIC STABILIZATION AND RECOVERY PROGRAM
(Program No. 518-0058)

I. Summary and Recommendations

A. Recommendation. USAID/Ecuador recommends authorization of an Economic Support Fund Grant of $25,000,000 for a two-year Economic Stabilization and Recovery Program for the Government of Ecuador. The loan will be authorized, obligated and disbursed in two parts; the first in FY 1985, the second in FY 1986.

B. Borrower/Grantee. The Grantee will be the Government of Ecuador acting through the Ministry of Finance and Public Credit.

C. Program Summary. In 1982, Ecuador entered into a period of severe economic recession, the effects of which were compounded by natural disaster in 1983. In spite of a worsening domestic and international economic situation, Ecuador successfully elected and inaugurated a new President in 1984, the first successful democratic transition in over 25 years.

The administration of President Leon Febres Cordero was elected on a free-enterprise, market-oriented platform which promised to realign the priorities and activities of the GOE, setting a policy framework within which markets can function and focusing government towards those social welfare activities that private initiative cannot support. The administration was, and remains dedicated to restructuring its economy along these lines.

In order to do this, the GOE has chosen a strategy which is designed to stabilize the deteriorating economic situation, first, and then enter into a series of policy reforms aimed at restructuring the economy over the medium term. The GOE has, over the past year, demonstrated its success at implementing this strategy. The most important elements of the stabilization program (exchange rate realignment, private and official debt renegotiation, and negotiation of a Stand-by Arrangement with the IMF) were completed within the first few months of the administration's tenure, and the GOE has begun to initiate policies aimed at a permanent restructuring of the economy. The kind of economic restructuring that is taking place in Ecuador today is designed to open the economy and to increase its overall production, directed by real world markets and prices. This is a significant shift from the import-substitution, protectionist policies of the past.

However, to accomplish its objectives, the GOE needs a significant amount of assistance. While debt reschedulings and two IMF arrangements have helped, more assistance is needed now to help off-set the growing balance of payments gap. This assistance will assist Ecuador to meet its growth targets over the next few years, thereby enabling the continuation of the economic restructuring already begun. The balance of payments gap for 1985 is projected at $45 million, assuming a conservative GDP growth target of 2.5%. Since this target is less than the current population growth rate, it translates into negative per capita growth. It is, therefore, a target that, if achieved, will allow for the minimum growth required to prevent severe political and economic disruption. If this growth cannot be achieved, it is likely that popular acceptance of the economic policies of the Febres Cordero government will decrease, there will be increasing manifestations of social unrest, and further economic reforms will be slowed or postponed.

The Program will consist of a $25,000,000 program to be provided from FY 85 and FY 86 Economic Support Funds. The dollars will be provided on a cash transfer basis and will be attributable to eligible imports from the United States over the six month period following disbursement. Upon disbursement of funds, the GOE will deposit an equivalent amount of local currency (sucres) into a Special Account in the Central Bank of Ecuador, the uses of which will be jointly programmed by A.I.D. and the GOE in support of development activities that meet the general criteria contained in Sections 103 through 106 of the Foreign Assistance Act of 1961, as amended. In programming the local currency, emphasis will be placed on private, production-oriented activities.

II. Economic Setting.

A. Background.

1. The Discovery of Oil and its Consequences (1973-1981). Following the discovery of oil in Ecuador's Oriente in 1967, the completion of the pipeline from that area to the Coast in 1970, and the quadrupling of world oil prices in 1973, Ecuador embarked on a period of very rapid growth. Between 1972 and 1981, GDP doubled, with average annual growth of 8%. Sectors in addition to petroleum itself experiencing particularly rapid growth were manufacturing (127% over the nine year period) and public administration (127%). The agricultural sector, in part because of import competition resulting from the appreciating real exchange rate, lagged notably (23.0%). This growth was made possible by a substantial acceleration of investment. Total, public and private real investment expanded at an average annual compound rate of nearly 16% between 1973 and 1978 and 8.7% over the entire 1972-1981 period. The reliance on foreign borrowing to finance this investment, however, eventually led to an economic crisis in 1982.

During this period, GOE fiscal performance, both good and bad, had a major impact on monetary policy, growth, and the balance of payments. In 1973, largely as a result of oil revenues, the GOE had a fiscal surplus equal to 3.1% of GDP and a balance of payments essentially in equilibrium. Two factors, however, led to a steady and serious deterioration in the fiscal accounts. First, legislation earmarked petroleum revenues for a wide variety of domestic expenditures, encouraging an expansion of expenditures in the earmarked categories which, in fact, exceeded the growth in petroleum revenues. Between 1973 and 1981, revenues from taxes on petroleum increased from 3.9% to 7.9% of GDP. Over the same period, current expenditures, excluding interest, increased from 14.8% to 19.5% of GDP, while capital expenditures increased from 7.3% to 10.3% of GDP. At the same time, tax performance deteriorated as non-petroleum revenues declined from 17.0% to 11.5% of GDP. As a result, by 1981 the earlier surplus had been converted into a deficit equal to 5.8% of GDP. The excessive reliance on foreign borrowing to finance this growing deficit, combined with a lack of growth of the financial system, eventually had a catastrophic effect on the balance of payments.

In other countries which have experienced rapid growth, the expansion has been accompanied by a considerable expansion of the real size of the financial system, which then supplies the real resources needed to sustain high rates of growth. In the case of Ecuador, however, although there was some financial deepening, the increase in the real size of the financial system was much smaller than would have been expected. Banking system liabilities to the private sector measured as a percentage of GDP increased from 21.72% in 1973 to 26.39% in 1977, before declining to 23.78% in 1979. (See Annex E)

The explanation for this relatively poor performance of the financial system lies in monetary, exchange rate and interest rate policies. Most important was interest rate policy which held deposit rates well below current rates of inflation. As a consequence of the very rapid real growth experienced in the early 1970s, fueled by petroleum revenues and heavy external borrowing, and the presence of certain domestic supply constraints, inflation accelerated sharply, despite an appreciating real exchange rate, which tended to reduce measured inflation, and steadily increasing import levels. Inflation, which had averaged less than 5% per year in the previous two decades, increased to 12.1% in 1973, 22.7% in 1974, 14.3% in 1975, then settled within a range of 10-13% for the remainder of the decade. Throughout this period, interest rates on domestic savings deposits were limited to 6%, while time deposits could earn no more than 8-9%. As a result, Ecuadorean residents found foreign assets and a variety of domestic real assets more attactive investments than domestic financial instruments.

To compensate for the slow growth in the real value of domestic deposits, Ecuador increasingly relied on foreign financing. Throughout the 1970s, the GOE sought to expand domestic credit by borrowing from abroad and lending to the domestic financial system, rather than undertake the policy measures needed to promote domestic saving. Thus, in 1973, despite the existence of a public sector surplus equal to 3.1% of GDP, the GOE borrowed an amount equal to 3.1% of GDP abroad, lending the equivalent of 6.2% of GDP to the financial system in that year. Throughout the 1970s, the GOE continued the practice of financing its entire financial requirements, and more, externally. The resulting expansion of domestic private sector credit was a substantial contributor to the very rapid growth of output during the 1970s, but also added to inflation and ultimately to a growing balance of payments problem.

This source of additional credit proved to be inadequate to meet domestic credit demand, however, and in the latter part of the 1970s, and with the government's encouragement, Ecuadorean firms increasingly began to borrow directly from foreign banks. From a level equal to .5% of GDP in 1973, external private sector borrowing grew to 6.7% of GDP by 1979, fully one-third of domestic financial system credit. While the dangers from exchange risk inherent in this type of borrowing are clear in retrospect, the long period of exchange rate stability apparently led domestic borrowers to ignore the financial consequences of devaluation.

Over time these capital inflows contributed to a deterioration in the current account of the balance of payments. As a consequence of the monetary expansion produced by the substantial influx of foreign borrowing, and the domestic price level increases which produced an increasing overvaluation of the sucre, the current account deteriorated steadily. Despite an almost fourfold increase in merchandise exports, primarily petroleum, the deficit in the current account increased from $12 million in 1973 to $1.03 billion by 1981. This deterioration was a consequence both of rising imports and of steadily increasing interest payments on the growing external debt. Imports of goods and non-factor services increased from $509.1 million in 1973 to $3.2 billion in 1981, while interest and profit remittances grew from $144.2 million in 1973 to $809.1 million in 1981. Public and publically guaranteed medium and long-term debt increased from $336 million in 1973 to $4.2 billion in 1981, while private sector debt grew from $14.2 million to $1.5 billion.

2. The 1982 Crisis. The combination of a deteriorating public sector fiscal position and a steadily growing burden of debt service obligations eventually proved unsustainable. The crisis occurred in 1982. Largely as a result of major increases in international interest rates, Ecuador's public sector deficit jumped from 5.8% of GDP in 1981 to 7.9% in 1982. Increasing nervousness on the part of foreign lenders made it impossible to finance a deficit of this magnitude externally. For the first time in over a decade, the GOE made substantial demands on the supply of domestic credit in financing an amount equal to 3.4% of GDP. In attempting to supply this public sector financing while maintaining the flow of credit to the private sector, the GOE greatly expanded domestic credit and the monetary aggregates. The monetary authorities increased net domestic credit of the Central Bank by 59.3% in 1981 and 63.7% in 1982. This, in turn, led to an increase in banking system credit of 28.9% in 1981 and 48.3% in 1982. This monetary expansion would have led immediately to an unsustainable balance of payments deterioration except that the GOE responded to a clearly overvalued exchange rate by the first of a series of exchange rate adjustments. This, however, substantially increased the sucre burden of the private external debt. In addition, the devaluation of the sucre from 25 to 33 to the dollar dramatically accelerated measured inflation.

In addition to the effect of domestic monetary developments, petroleum exports declined from $1,727 million in 1981 to $1,525 million in 1982. Only a decline in merchandise imports from $2,361 million to $2,181 million limited the decline in the current account to $170 million. The major cause of the crisis, however, was the inability of the GOE to finance current account deficits which had grown to more than $1 billion per year. Medium and long-term disbursements on international loans, net of amortization, fell from +$931 million in 1981 to -$262.3 million in 1982. The deficit rose to $460 million and several hundred million dollars in non-banking system arrearages, which are not counted in the deficit, had accumulated as well.

These factors led to a drastic slowing of the rate of growth. From an increase of just under 4% in 1981, real GDP grew by only 1.2% in 1982. Manufacturing and construction were particularly hard hit.

3. <u>GOE Response to the Crisis (1983-1984)</u>. The government of the day responded quickly and skillfully to this crisis by drastically cutting expenditures, devaluating the currency, and carefully managing the monetary aggregates. Non-interest current expenditures were reduced from 19.1% of GDP to 15.4%, while capital expenditures were reduced from 10.1% of GDP to 7.2%. As a result of these drastic reductions, the consolidated public sector deficit was reduced to essentially zero in 1983. As a result, the volume of credit available to the private sector expanded by 46.7% in a period in which overall net domestic credit of the banking system, apart from external refinancing credits, increased by only 29.6%.

Good fiscal performance continued through 1984, despite some relaxation of expenditure constraints. The adjustment of certain petroleum product prices in 1984, as well as a significant effective devaluaton of the sucre, contributed to a substantial increase in budgetary revenues.

As a result of the devaluations, import controls, and the substantial improvement in fiscal performance, and despite a significant drop in non-petroleum exports as a result of climatic disturbances, the balance of payments improved in 1983. Merchandise imports declined by 33%, from $2,101 million to only $1,408 million, while exports remained essentially constant at $2,365 million. Although, much of the improvement depended on debt reschedulings, the Ecuadorean economy in 1983 was significantly less dependent on external credit flows than it was before the crisis. Medium and long term disbursements, net of amortization, were only $237 million in 1983, down from $931 million in 1981. Overall, in one year, the deficit was reduced from $460 million to $58 million.

Despite the significant reduction in imports and, in part because the elimination of the fiscal deficit permitted a major expansion of private sector credit, Ecuador was able to weather the el Nijo disaster of 1983 with only a 3% decline in output, despite an almost 15% decline in agriculture and livestock output and major declines in construction and commerce. Manufacturing output was essentially unchanged, despite the fact that much agricultural processing activity was lost. The full extent of the underlying improvement was demonstrated in 1984 when overall output grew by 4.1%. Merchandise exports recovered to $2,491 million while imports grew only slightly to $1,580 million. Net interest payments remained essentially constant at $756 million.

Nevertheless, the overhang of interest and amortization payments and the heavy dependence of the economy on petroleum meant the the external accounts, and as a consequence, the level of output and employment, are heavily dependent on external developments, despite good monetary and fiscal performance. Developments in 1985 began to show the fragility of the balance of payemnts situation despite strong fiscal and monetary performance. Declining petroleum prices now threaten to choke off the growth of imports which is necessary to achieve sustained recovery.

4. Current Fiscal and Monetary Outlook. The fiscal outlook for 1985 is presented on Table 1. The Mission's best estimate is that the GOE will achieve a consolidated public sector surplus equal to 2.03% of GDP, despite substantial decreases in world petroleum prices. Overall, public sector revenues are projected to increase by 2.48% of GDP, primarily as a result of increased (sucre) receipts from petroleum of 2.03% of GDP. This improvement is a result both of a substantial increase in domestic petroleum prices at the end of 1984 and by exchange rate adjustments which have increased the sucre receipts from export transactions.

In the case of central government tax revenues, higher receipts from import duties, a result both of exchange rate adjustments and improved administration, are expected to offset projected declines in collections of income, sales, and excise taxes, leaving non-petroleum tax receipts by the central government essentially unchanged. (Note that the projections of non-petroleum revenues have not been updated since March. There is some evidence that income, sales, and excise taxes have improved both in nominal terms and as a percentage of GDP during the course of the year.) Real non-petroleum revenues for the rest of the public sector are also projected to remain essentially constant as a percentage of GDP in 1985.

Table 1

SUMMARY: CONSOLIDATED PUBLIC SECTOR
(billion sucres)

	1983	1984 (prel.)	1985 (proj.)
TOTAL REVENUE	152.4	217.8	295.5
Petroleum Revenue	59.7	105.2	150.4
Other Tax Revenue	92.8	112.6	145.1
EXPENDITURES	153.1	217.8	276.6
Current Expenditures	111.7	162.2	198.9
Capital Expenditures	41.4	55.6	77.7
PUBLIC SECTOR SAVING	40.8	55.6	96.6
OVERALL SURPLUS/DEFICIT	-0.6	0.0	18.9
FINANCING	0.6	0.0	-18.9
External	3.4	4.1	0.0
Disbursements	8.5	11.9	14.5
Amortization	5.1	7.8	14.5
Domestic (net)	-2.8	-4.1	-18.9

(percent of GDP)

	1983	1984 (prel.)	1985 (proj.)
TOTAL REVENUE	26.95	29.20	31.68
Petroleum Revenue	10.55	14.10	16.13
Other Tax Revenue	16.40	15.10	15.56
EXPENDITURES	27.06	29.20	29.65
Current Expenditures	19.74	21.74	21.32
Capital Expenditures	7.32	7.45	8.33
PUBLIC SECTOR SAVING	7.21	7.45	10.36
OVERALL SURPLUS/DEFICIT	-0.11	0.00	2.03
FINANCING	0.11	0.00	2.03
External	0.60	0.55	0.00
Disbursements	1.50	1.60	1.55
Amortization	0.90	1.05	1.55
Domestic (net)	-0.49	-0.55	-2.03

On the expenditure side, overall public sector expenditures are projected to remain essentially constant in 1985 as a percentage of GDP, with a slight decline in current expenditures offset by a slight increase in capital investment. The two critical factors upon which the 1985 projections are based are the level of world interest rates and the volume and price of petroleum production and exports. International interest rates are estimated to have declined by approximately 10% from the beginning of 1985. This decline has offset most of the fiscal burden resulting from the effect of exchange rate adjustments on the sucre value of external interest payments. In estimating the fiscal surplus for 1985, it has been assumed that there will be no further movement, either up or down, in world interest rates from their mid-August levels through the end of the year.

In the case of petroleum, some increase in daily producion levels has been assumed for August through December, 1985. It has further been assumed that domestic consumption will increase only moderately, to 30.7 million barrels per year (from 30.5 million barrels in 1984), so that the bulk of the change in domestic production is reflected in exports. Finally, an average market price for the year of $25.25 per barrel has been assumed, reflecting a price at the beginning of the year of $27 per barrel, declining to $24 per barrel at year end, but with somewhat higher exports in the second half of the year. Any variations from these assumptions, particularly the assumption about petroleum price, could have a powerful effect on the fiscal accounts because public sector revenues respond more than proportionally to changes in petroleum prices.

Overall then, the GOE faces a fiscal situation vastly improved since the early 1980s. The public sector is again, as it was in the early 1970s, a major contributor of funds to the financial system. This is not to say that the situation could not be improved. Domestic petroleum prices are still below most international reference prices, encouraging consumption and illicit exports to neighboring countries. Rates of collection of direct and indirect taxes are still poor, while marginal tax rates are quite high. However, the fragility of the balance of payments situation may require additional fiscal improvement if Ecuador is to achieve external balance and still provide an adequate rate of growth of private sector credit consistent with continued growth in per capita GDP.

The strange behavior of the monetary aggregates in 1984 (discussed in Annex E) makes it particularly difficult to explain monetary developments in 1985. In addition, a full set of aggregate banking system statistics is not available for the first half of 1985. Finally, the introduction of certificates of deposit (Polizas de Acumulacion), with market determined interest rates, makes the interpretation of the behavior of the monetary aggregates particularly difficult. However, despite these caveats, a great deal can be said about developments in the financial system during the first half of 1985. On the whole, monetary policy was rather tight during the first half of the year, presumably in response to a loss of net international reserves of $18 million during the period. M1 decreased 3.7% in the period, while total bank deposits (excluding certificates of deposit) increased less than 1%. However, this reflects in large part a very strong seasonal element in M1 (and consequently in M2) which shows a very strong growth in the second half of the year, particularly in the month of December. In 1984, for example, M1 grew by 2.43% in the first six months of the year, by 38.79% in the last six months, and by 12.54% in the month of December alone. In part, therefore, the decline in M1 in the first six months simply reflects a convergence toward trend after a period of abnormally high growth in the second half of 1984, as well as a normal seasonal low growth in the first half. Considering the loss in net international reserves during the first half of the year, which normally has as its counterpart a decline in banking system domestic liabilities, the slow growth of M1 and M2 in the first half of the year is not surprising. Overall, the GOE's announced target for M1 growth of 24% from December to December appears both a realistic and attainable objective. A better measure of monetary tightness or ease is the change in the net domestic assets of the Central Bank, particularly credit to the banking system. Overall, net domestic assets of the Central Bank have declined 13.69% in the first half of the year. However, the very large growth in net public sector deposits, the counterpart of the negative fiscal financing accompanying the fiscal surplus, has enabled the Central Bank to increase net lending to the financial system by 8.98%, well below the rate of inflation but still positive. This expansion has enabled the banking system to increase its lending from ordinary resources by 14.1% and, including resources derived from certificates of deposit, by 19.1%.

The GOE has managed to maintain a neutral to very slightly expansionary growth of private sector credit in the face of a decline in the nominal sucre value of net international reserves and an even larger decline in net domestic assets. This testifies to skillful and innovative management both of monetary policy itself and of the fiscal accounts, the surplus in which played a key role in allowing some real private sector credit expansion to take place.

As discussed elsewhere in this document, there has been a long history in Ecuador of legal controls on interest rates, which have kept interest rates well below the rate of inflation. This is often cited as a major factor discouraging resource mobilization through the financial system and distorting patterns of investment. In discussing the adequacy of interest rate policies, what is relevant is the expected future rate of inflation rather than past experience. However, recent experience, as well as trends in the growth of monetary aggregates, are the only reliable guides to such expected rates of inflation.

The rate of increase in the Consumer Price Index (CPI) accelerated sharply in 1982 in response to monetary stimulus and rose even higher in 1983 as a result of exchage rate adjustments and the loss of agricultural production resulting from the El Nino phenomenon. On a December-to-December basis, the CPI rose by 24.4% in 1982 and by 52.5% in 1983. In 1984, the rate of inflation decelerated sharply, and the CPI rose by only 24.0%. Inflation in 1985 has been heavily influenced by the 78% increase in domestic petroleum prices announced in late December 1984. These increases produced a 6.4 percent rise in the CPI in January 1985. With the usual method of calculating inflation in Ecuador, on a 12 month basis ending in the current month, this large price bulge in January is still being reflected in current inflation figures. For example, the rate of inflation for the 12 months ending June 30, 1985 was 30.4%. In fact, however, the monthly rate of increase settled down quite quickly after January. The rate of increase for the five months February through June, measured on an annualized basis, was 24.2%. The latter figure probably understates the underlying rate of inflation somewhat because it ignores the fact that there will be the need for future adjustments in both petroleum prices and the exchange rate to compensate for current inflation. It is probably a more accurate reflection of future inflation prospects, however, than the past 12-month figure which incorporates a long-overdue adjustment in petroleum prices.

Comparing these inflation estimates with current controlled interest rates, it is clear that the latter are still negative in real terms, although not egregiously so. Maximum lending rates, except rates applicable to funds generated from certificates of deposit, are fixed at 23%, while maximum deposit rates are generally limited to 20%. It is interesting to note that, at the present time, the free market interest rate on certificates of deposit is about 23%.

In general, there is a strong argument for some further upward adjustment in deposit and loan interest rate, both taking into account current inflation and the GOE's reported intention to increase M1 by about 24% in the current year. However, taking into account that large depositors who are likely to be most interest-rate sensitive have the alternative of certificates of deposit open to them, the negative effect on savings mobilization of the existing pattern of negative interest rates is probably small. The effect of slightly negative loan interest rates on resource allocation, taking into account the uncertainty associated with any business investment, is also likely to be small.

B. Analysis of the Balance of Payments.

This analysis will examine the balance of payments prospects in 1985 and 1986 to determine the additional external resources necessary to achieve an acceptable level of growth, the "balance of payments gap". It will also analyze arrears and debt service obligations. A thorough analysis of the fiscal and monetary developments which contributed to the deterioration of the balance of payments situation and which are expected to play an important role in BOP recovery is presented in Annex E. The economic stabilization program, of which fiscal and monetary restraint is one part, will be described below.

1. The Balance of Payments. Balance of payments data for 1984 and projections for 1985-86, before and after the 1985 multi-year reschedulings of external debt, are presented in Table 2. The last two columns of the Table are used as the basis for the gap analysis which follows.

Table 2 shows the projected deficit on current account (Line I), as well as autonomous capital inflows (Line II). Autonomous capital inflows include foreign private direct investment as well as loan disbursements which are not specifically related to balance of payments financing. The resulting surplus or deficit in the balance of payments appears on Line III. Adding assured "compensatory" capital inflows (i.e., loans from commercial banks to reduce arrearages, Line IV), deducting the agreed reduction in arrears (Line V), and allowing for available IMF resources that may be used for reducing banking system arrearages (Line VI), results in the caluculation of an "unfinanced gap" in 1985 equal to $45 million (Line VII). If international reserves, now equal to only one month of imports, were to be moderately rebuilt in 1986 (Line VIII), the estimated unfinanced gap to be covered through external grants or loans, or through additional debt refinancing (line IX), would total $262 million.

It should be emphasized that this analysis does not attempt to arrive at a projection of the <u>ex post</u> balance of payments deficit for 1985 and 1986 since imports could be contracted by the authorities to prevent a deficit. Rather, the analysis is designed to show the <u>ex ante</u> balance of payments gap which will materialize if minimal growth targets are to be met.

The basic assumptions underlying the analysis are:

- a real GDP growth rate of 2.5% in 1985 and 2.75% in 1986 (equal to -.4% real per capita GDP growth in 1985 and -.1% in 1986);
- an increase in crude oil production from 93.8 million barrels in 1984 to 100.5 million barrels in 1985 and to 102.2 million barrels in 1986 (as detailed in footnote (1) to Table 2);
- domestic petroleum consumption of 30.7 million barrels in 1985 and 31.2 million in 1986;
- an average weighted oil export price of $25.25 per barrel in 1985 and $24 in 1986;
- 7.5% annual growth of non-oil exports in both 1985 and 1986; and,
- an import to GDP ratio of 17.0%.

Note that these assumptions do not constitute a worst case scenario. The oil price assumption is particularly important for Ecuador. An average price of $24 per barrel in 1986 is more likely to err on the optimistic than on the pessimistic side.

The 1985 balance of payments gap is based on relatively optimistic assumptions with regard to the ability of the country to increase oil production and exports. During the period January-July, 1985, daily crude production averaged about 270,000 barrels a day (BPD). Texaco and the GOE's Dirección General de Hidrocarburos believe that average production can be boosted to 290,000 BPD during the August 1 - December 31, 1985 period, owing to additional wells to be brought on stream. While the gap analysis in Table 2 is based on this relatively optimistic assumption, the Central Bank maintains its former projection of about 273,000 BPD based on the fact that while the daily production projections of the Direccion have been achieved at times, they have never been sustained over a period of time long enough to convert themselves in average daily production figures. If one were to accept the Central Bank's production assumption, the total value of petroleum exports in 1985 would be $1,775 million[1/] (instead of $1,838 million in Table 2.), and the 1985 balance of payments gap would increase by $63 million to $108 million.

The Embassy Minerals Officer, however, considers these Central Bank projections implausible. Therefore, the more optimistic production projections of Texaco and the Dirección de Hidrocarburos have been used in this analysis and appear in Table 2, even though both the Central Bank and the Dirección's projections are "official." Thus, the $45 million gap for 1985 is based on the Mission's estimate of petroleum production. If production were to fall below this figure, the gap would be larger. An alternative oil export calculation is not provided for 1986, as there is no significant difference in oil production projections among GOE official sources for that year.

In addition to the external resources shown on Table 2, the IMF is expected to provide the equivalent of $84.4 million in reserve assets during 1985. However, the terms of the Standby Arrangement require Ecuador to achieve the same level of net international reserves on

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1. Calculated as follows:

Actual production during January 1-July 31, 1985 (million barrels)	57.9
Projected over August-December	
273,000 x 147 days	40.1
Total	98.0
Less domestic consumption	30.7
Less net exports of refined petroleum	1.5
Total crude production available for export	65.8
65.8 million barrels x $25.25 =	$1,661.5 million
Plus refined petroleum exports:	
4.88 million barrels x $23.22	113.3
Total value of petroleum exports	$1,774.8 million

Table 2
Balance of Payments Projections Before and After Debt Refinancing
1985-1986
(In Millions of US Dollars)

		Before Refinancing			After Recent Refinancing	
		1984	1985	1986	1985	1986
I.	Current Account	-180	-244	-419	-250	-419
	Exports, F.O.B.	2491	2644	2632	2644	2632
	Petroleum (1)	1794	1838	1765	1838	1765
	Other	697	806	867	806	867
	Imports, F.O.B.	-1580	-1750	-1890	-1750	-1890
	Interest Payments (2)	-756	-748	-775	-754	-775
	Services, Credit	370	410	478	410	478
	Services, Debit (3)	-725	-820	-889	-820	-889
	Unilateral Transfers	20	20	25	20	25
II.	Capital Account Autonomous only (4)	230	-1210	-753	205	257
	Direct Investment	50	50	100	98	98
	Disbursements	430(5)	72(5)	359	302(6)	385
	Amortization	-303	-1358(7)	-1212	-278(8)	-226
	Other	53	26	0	83	0
III.	Surplus (+) or Deficit (-) in the BOP (I+II)	+50	-1454	-1172	-45	-162
IV.	Assured Compensatory Capital Inflows from Banks and Suppliers	16	200	0	200	0
V.	Required Reduction in Arrears (-)	-46	-241	0	-241	0
VI.	Availability of IMF resources to finance arrears	0	41	0	41	0
VII.	Unfinanced Gap (+ is surplus) (III+IV+V+VI)	20	-1454	-1172	-45	-162
VIII.	Desired Rebuilding of Intl. Reserves	0	0	-100	0	-100
IX.	Unfinanced Gap After Rebuilding of Reserves (VI+VII)	0	-1454	-1272	0	-262
X.	To be Covered through Additional Debt Refin(9)	-	1431	1047	0	0
	External Grants and loans (10)		23	225	45	262

Source: Central Bank of Ecuador, "The Ecuadorean Economy", March 1985, tables 11, 13, 14 and 15, and Mission estimates.

Footnotes to Table 2

1) Petroleum exports for 1985 and 1986 were calculated as follows:
For 1985:
Total estimated production:
Actual during Jan. 1-July 31, 1985: million barrels 57.9

Projected over August 1-Dec.31, 1985	
290,000 barrels/day x 147 days	+42.6
Total	100.5
Less Domestic Consumption:	30.7
Less Net exports of refined products	1.5
Total	68.3 mill b.
Value of crude exports: 68.3 million barrels x$25.25 per barrel =	$1724.5 mill.
Plus refined petroleum exports:	
4.88 million barrels x $23.22/barrel	+ $ 113.3
Total value of petroleum exports	= $1837.8
For 1986:	
Total estimated production:	
292,000 barrels/day x 350 days	102.2 mill b/y
Less domestic consumption	31.2
Less net exports of refined exports	2.5
Total	68.5 mill.
68.5 million barrels x $24	= $1644 mill.
Plus export of refined products:	
5.5 million barrels x $22	+ 121
Total	$1765 million

2) The Central Bank projections of interest payments for both 1985 and 1986 were reduced by $43 million to reflect the 1% decline in international interest rates since the Central Bank projections were made. Since the debt outstanding to foreign commercial banks is $4300 million, the interest saving is about $43 million.

3) Includes about $150 million in interest on the Central Bank's short-term debt.

4) Only "autonomous capital movements" unrelated to the balance of payments problem are entered under Section II. "Compensatory capital inflows" or balance of payments assistance is entered in section III. The latter includes bank loans to help pay for imports or services the debt.

5) For 1984, Central Bank figure was $446 million Bank loans for $16 million were deducted and entered under IV. For 1985 the Central Bank figure was $272 million, of which $200 million were bank loans entered under compensatory financing in Section IV. These were deducted from the $272 million figure.

6) $502 million projected by Central Bank less $200 million entered under IV.

7) $1558 millions projected by the Central Bank less $200 million entered under IV.

8) $256 million projected by the Central Bank for 1985, less $24 million to allow for 100% refinancing of Paris Club debt amortization in 1985 as the Central Bank had assumed 85% instead of 100% in its projection for 1985. On the other hand, $46 million were added in capitalized interest payments in 1985 which the Central Bank expected to reschedule, but which must be paid as originally scheduled. Similar adjustments were made to the Central Bank projection for 1986.

9) Difference in the balance of payments gap with and without debt refinancing as estimated by Central Bank in tables 14 and 15 of "The Ecuadorean Economy", March 1985.

10) Residual gap after debt refinancing.

December 31, 1985 as it had on December 31, 1984. Thus these resources can be used to reduce reserve liabilities, including arrearages of the banking system, but not to increase imports or reduce the arrearages or other liabilities of the non-financial public sector. On Table 2, they are shown reducing the $41 million in arrearages of the Central Bank outstanding on December 31, 1984. Total "purchases" from the IMF for the period from March 11, 1985 through May 1, 1986 will be SDR 105.5 million (about US$105 million at the current SDR:dollar rate) to be disbursed in five $21.0 million quarterly tranches.

The importance of the recent debt rescheduling is demonstrated by the fact that, in its absence, the unfinanced gap would have been $1.5 billion in 1985 and $1.2 billion in 1986, an amount that the country would not have been able to handle.

It must be recognized that the balance of payments gaps that are projected here are subject to some margin of error, particularly for 1986. Three factors in particular could substantially alter the results. The most important is the price of oil: A $1.00 drop in the price of crude would cause a $ 65 million loss in foreign exchange earnings. A second major factor is the level of interest rates in the international financial market. A 1% increase in interest rates would lead to $40 to $50 million increase in annual debt service charges.

One must also recognize that the level of imports that corresponds to any GDP growth target cannot be predicted with any degree of confidence. While there is a high correlation between imports of goods and services and the Gross Domestic Product over the long term, the import/GDP ratio is subject to wide fluctuations from year to year, depending, among other factors, on changes in the composition of imports over time, the state of inventories, the extent of utilization of productive capacity, and the availability and price of foreign exchange. Thus, import projections linked to a targeted increase in GDP are subject to some margin of error. Still, the Central Bank's import projections for 1985 and 1986 ($1750 and $1890 million, respectively) appear reasonable. They allow for a 10.7% increase in 1985 and an 8% increase in 1986, both in current prices. Given the fact that imports were $2.4 billion in 1981 and contracted by 33% over 1981-84, the 1985-86 projections do not appear to be excessive.

In sum, the balance of payments analysis was based on the most realistic assumptions that can be made at this time. This analysis is consistent with the target of a 2.5% real GDP growth in 1985 and 2.75% in 1986.

Two factors are primarily responsible for the country's continuing balance of payments difficulties: the weakening of petroleum prices, which have declined by almost $2.00 a barrel over the last year and are expected to continue to decline to about $24 a barrel by year-end; and, the country's continuing high interest payments on its external debt, projected at $754 million in 1985 and at nearly the same level in 1986. It should be noted that bilateral creditors in the recent multi-year Paris Club debt rescheduling negotiations refused to reschedule interest payments. The outlook for the remainder of 1985 and 1986 with respect to both factors is not particularly encouraging: petroleum prices are more likely to decline than to rise; and interest rates are not likely to fall given the size of the U.S. FY 1986 budget deficit.

2. Payment Arrears and Net International Reserves. Payment arrears and other short-term obligations of the non-financial public sector are summarized in Table 3. Note that significant progress has been made during the first seven months of 1985 in paying arrears and short-term obligations. Total direct, non-bank arrears were reduced from $60 million to $37 million; arrears to banks were reduced from $315 million to $199 million; the remaining $199 million in arrears to banks will soon be paid with the $200 million bank loan negotiated with the consortium of commercial banks in 1984, but which only became available in August, 1985. The short-term debt of Banco Amazonas to Bahamas Citibank remains at $50 million. This transaction, which is technically a currency swap covered by a Central Bank guarantee, could arguably be treated as a reserve liability of the banking system, but is not. The major remaining debt consists of a $298 million advance payment for future petroleum exports provided to the GOE weeks before the 1984 change in government.

Table No. 3
Payments Arrears and Short Term-Obligations
(In Million of US Dollars)

	Dec 31,84	July 31, 85
Direct Arrears (Non-Bank)	60	37
Arrears to Banks	315	199*
Advances (from abroad) Against Future Petroleum Exports	298	298
Short-Term Debt of Amazonas Bank to Bahamas Citibank	55	50
Total	728	584

Source: Unpublished data from Central Bank of Ecuador.

* Will be paid with $200 million in bank loans negotiated in 1984 which became available on August 14, 1985.

The deterioration in net international reserves over the period 1975-84 is summarized in Table 4. Note that reserves rose to nearly $900 million in 1980 and then declined to $159 million by July 31, 1985. This amount excludes non-banking system arrears and other short-term debt listed in Table 3, and is equal to only one month of imports. The GOE hopes to increase net international reserves by $500 million over 1985-1990, a goal that will be difficult to achieve. However, the rebuilding of reserves to a total level of about $500 million, equal to about three months of imports, is a laudable objective.

Table No. 4
Net International Reserves
(In Millions of US Dollars)

1975	257.2
1976	456.4
1977	612.0
1978	648.0
1979	664.0
1980	892.0
1981	672.7
1982	210.0
1983	151.5
1984	171.0
July 31, 1985	159.0*

Source: For 1975 - 1981, World Bank Report of Oct. 5, 1984. For 1982 - 1984, World Bank, The Ecuadorean Economy, March 1985, table 10. For July, 1985, unpublished information from Central Bank.

*Equal to 1.1. months of imports

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3. Debt Service Charges. The projection of debt service charges on medium and long-term external debt after the recent multi-year debt refinancing is presented in Table 5. Since Paris Club creditors refused to reschedule interest payments, there is no significant difference in interest payments before and after debt rescheduling, except for the fact that interest payments after rescheduling should be somewhat higher in later years owing to the interest accruing on the amortization which remains unpaid due to the rescheduling. Amortization payments during the 1984-89 period will, however, be significantly lower. Note that the debt service ratio (debt service payments as a percentage of exports of goods and non-factor services) declines very significantly in 1985 as a result of the debt reschedulings, from 74% to 33%, though the difference in the two ratios declines over the 1985-89 period. In 1990, as a result of the expiration of the multi-year rescheduling arrangements, the situation is reversed, with the debt service ratio after renegotiation higher than the one without renegotiation (38% versus 32%--See Table 5).

Table 5
Ecuador: Debt Service On Medium and Long Term External Debt
After Debt Refinancing
(In Millions of U.S. Dollars)

	Interest	Amortization	Total	Total as % of Exports of goods and services Before	After
1984	785	184	969	37.0	33.8
1985	754	278	1032	73.9	33.1
1986	775	226	1001	59.4	29.9
1987	852	360	1212	57.7	33.9
1988	851	339	1190	50.2	31.0
1989	864	449	1313	44.6	31.6
1990	878	802	1680	32.0	38.3

Source: Central Bank of Ecuador, The Ecuadorean Economy, March 1985, Tables 15 and 19.

Interest payments for 1985 and 1986 as shown on Table 5 were revised downward by $43 million to reflect a 1% reduction in interest rates in 1985. They are expected to remain at that level in 1986. On the other hand, interest payment calculations were increased from the Central Bank's projections over the period 1986-90 as the Central Bank had assumed that Ecuador would be able to obtain 85% refinancing of interest payments due to Paris Club creditors. This request was refused. The concessions the Paris Club creditors made on repayment of capital were incorporated in the amortization schedule. It should also be noted that "before" refers to before the 1985 rescheduling agreements, but after the 1983-1984 agreements. The debt service burden for 1984 before the 1983-84 agreements was 130% of export earnings.

C. The GOE Economic Stabilization Program.

The publically-announced main policy objectives of the GOE economic stabilization program for 1985 are to:

* Reduce the rate of inflation to an annual rate of 25% in 1985, mainly through improved fiscal policy while achieving a growth rate of at least 2.5% in real GDP.

* Pursue a moderate incomes policy which aims at keeping wage increases in line with the expected 1985 rate of inflation.

* Allow greater upward price flexibility for most agricultural products to ensure moderate increases in earnings to producers, accompanied by vigorous support for private sector agricultural production.

* Encourage foreign investment, particularly in the petroleum and gas sectors. Adjust upward the tariffs of several public utilities to allow adequate return on investment.

* Allow adjustments of interest rates to approximate market conditions to stimulate domestic savings and improve its allocation.

* Achieve an overall surplus in the public sector both to moderate inflationary pressures and to channel more funds to the private sector.

* Reduce the balance of payments disequilibrium through an aggressive export promotion policy by adopting a realistic exchange rate policy as well as by stretching out the debt amortization schedule.

* Improve the expenditure and revenue administration of the public sector.

1. Policy reforms accomplished by the GOE. The seriousness of the economic situation was recognized by the GOE as early as 1982. A series of measures were taken by the authorities in that year, including the first devaluation of the sucre in the official exchange market since 1970, followed by several other subsequent exchange adjustments in accordance with a pre-announced schedule (crawling peg). The payment of principal on the external debt, both private and public, was consolidated and renegotiated with private creditors, though interest obligations were paid on schedule. The authorities adopted a fiscal austerity program and reduced the deficit of the public sector from about 7.9% of GDP in 1982 to about 0.11% in 1983. When this combination of measures proved inadequate to solve the problem, the GOE resorted to imposing import controls.

The austerity and adjustment program was continued and amplified by the Febres Cordero Administration. Its program goes beyond a demand management approach and encompasses fundamental structural reforms. The major reforms accomplished to date are presented below:

a. Exchange Rate. In August 1984, most transactions took place at the official rate of S./67:$1.00. In September, 1984, the authorities created an official "intervention market" at the then-prevailing parallel market rate, S./97:$1.00. The practice of daily depreciation of the official market was discontinued, and the official and intervention rates were fixed at their levels of September 4, 1984. Over the following months, most transactions were moved from the official to the intervention rate, leaving the official market for pharmaceutical imports, Texaco petroleum exports, and debt servicing of loans contracted before September 4, 1984. On August 28, 1985, pharmaceutical imports and Texaco exports were moved to the Central Bank intervention rate, thereby essentially eliminating the official market. The value of the sucre on the free market fell to about S./125:$1.00 in February 1985, before appreciating to S./100:$1.00 in early August 1985.

b. Import Policy. The GOE liberalized import and exchange transactions through removal of all import prohibitions and the reduction of the minimum required financing periods from foreign banks or suppliers to importers from 180-360 days to 120 days.

c. Energy Subsidies. To increase Government revenues and decrease subsidies, the Government increased domestic gasoline prices by an average of 78% (gasoline by 65% and diesel by 100%) and reduced electricity subsidies by continuing the practice of increasing monthly electricity rates by 2% per month.

d. Interest Rate Policy. The GOE increased the flexibility of interest rates by raising interest rates on commercial bank lending from 21% to 23%, raising the interest rate on deposits from 18% to 20%, and allowing the banking system to issue certificates of deposit in amounts over one million sucres at market-determined interest rates. The funds so obtained by the banking system are being loaned at market-determined interest rates not subject to ceiling. By July 1985, this mechanism had become so popular that some $200 million in certificates had been issued, of which it is estimated that some $50 million represents new deposits to the financial system.

e. IMF Agreement. The GOE successfuly completed negotiations with the IMF for a 1985 SDR 105.5 million Stand-by Agreement, which was approved by the Executive Board of the IMF in March 1985.

f. Minimum Wage. In spite of Congressional support for labor's request for substantial increases in the minimum wage, the GOE held the minimum wage increase to less than the inflation rate.

g. Foreign Investment. The GOE opened the economy to foreign investment, especially in the important petroleum sector, concluded an OPIC agreement, and proposed major changes in the mining law which would attract increased investment.

h. Price Controls. To free markets, upon taking office, the GOE eliminated price controls on 48 commodities, leaving only seven items subject to controls.

2. The IMF Standby Agreement. The various stabilization measures agreed to between the IMF and the GOE provide further insight into the scope of the stabilization program that the GOE has committed itself to carry out. The major provisions include (in addition to the standard limits on net international reserves, net domestic assets, payments arrears, etc.):

a. a commitment to unify the official and intervention market exchange rates and to work toward eventual unification of exchange rates; and,

b. the elimination of the requirement for advance payments in sucres for the purchase of foreign exchange for import

3. Long-term Structural Adjustment Measures. In addition to the policy reform measures already adopted and to those agreed to with the IMF, the Government has indicated that it plans to substantially lower protective tariffs on finished goods for the purpose of reducing "effective protection"; to thoroughly revise tax administration to curb the high level of evasion and fraud; to free interest rates and encourage the shift of funds into long-term lending; and, to gradually reduce and eventually eliminate the subsidy on petroleum for internal consumption.

III. Justification for the Proposed Program.

A. Economic Justification.

1. Balance of Payments and International Reserves. The Febres Cordero administration came to office committed to carrying out a thorough restructuring of the Ecuadorean economy along free-market, price-directed lines, minimizing public sector interference in the economy and encouraging foreign private investment. As the previous section indicates, it has been remarkably successful in carrying through this program despite opposition within the Congress and from entrenched special interests.

Nonetheless, the GOE's program of structural reform is now threatened by adverse external developments beyond the GOE's control. The economic program negotiated with the IMF, the commercial bank creditors, and the Paris Club forecast balance of payments equilibrium and 2.5% real growth for 1985, and a manageable deficit and 2.75% real growth for 1986 to be accomplished as a result of innovative multi-year rescheduling arrangements and economic reforms. The prospect for economic growth in 1985 and 1986 is now threatened by deteriorating export prices and less generous Paris Club rescheduling terms. As a result, the GOE now faces a BOP gap of $45 million in 1985 and $162 million in 1986. International reserves are already at minimal levels, equivalent to less than one month's imports. The consequence of such a gap and the alternative measures of closing it, is zero GDP growth in 1985, and an actual decline of GDP in 1986.

A decline of this magnitude will seriously undermine public confidence in the government's restructuring program and free-market policies in general. It is important that the USG assist Ecuador in mobilizing the external resources necessary to sustain real income in the face of deteriorating external markets until the economic reforms can bring about sustained recovery.

2. Progress in Economic Restructuring. The provision of ESF assistance should not be justified on the basis of a balance of payments gap alone. Its major purpose must be to allow a recipient country enough time to take corrective measures to deal with its basic balance of payments disequilibrium, and to make the process of adjustment

less destabilizing than it would be without such assistance. The task of persuading governments of aid-recipient countries to undertake essential self-help measures to put their houses in order is thus a key part of A.I.D.'s strategy, particularly for countries receiving substantial amounts of balance of payments assistance.

The far-reaching policy and institutional changes that Ecuador has already adopted, in addition to those it is in the process of carrying out and that it has committed itself to undertake in the future have been described in detail above and need not be repeated here. It is clear that Ecuador has gone further than any Latin American or Caribbean country in undertaking a thorough program of reform designed not only to restore equilibrium in its balance of payments and fiscal accounts, but also to create an adequate basis for long-term economic growth. This is clearly a continuing process that will extend over several years. U.S. support would not only encourage the process in Ecuador, but would also signal to other nations the USG's willingness to help countries that are willing to make short-term sacrifices in order to improve their long-term growth prospects.

B. U.S. Interests and Support.

1. Background. Ecuador returned to a democratic form of government in 1979. To a great extent, that government continued and extended many of the same economic and foreign policies which flourished in Ecuador during the decade of the 1970's. On the domestic front, government interventionism in the economy ran unabated in the name of protecting the poor and a paternalistic approach to economic development was fostered. A long list of products were affected by price controls to protect poor urban consumers; many productive enterprises came under the control of the government. On the private sector side, large subsidies and high protectionism fed the development of import substitution industries. The foreign policy of the era was one based on Third World concious-raising and fostered solidarity with Third World causes, especially in confronting the industrialized nations. This was probably most typified by Ecuador's participation in, and firm support of the Andean Pact, especially of Decision 24 of the Andean Pact which places severe limits on foreign participation in productive enterprises in the region. On the international front, Ecuador was a member of OPEC and was more likely to vote with the Third World block in the United Nations than vote independently. The GOE's attitude toward the USG during this period can most aptly be described as "cool cordiality" as it attempted to build its own popular base for democratic support at home and to fortify its ties with other Third World and South American countries internationally.

2. The Febres Cordero Government. In contrast, the government of President Leon Febres-Cordero has openly embraced a radically different approach to management of the domestic economy, economic and social development, and its foreign policy and international image. Indeed, the current political and economic climate of Ecuador is unique among Latin American countries. It is one of the few nations that is dealing with its difficult domestic economic situation in a manner that combines taking stringent measures to arrest a deteriorating

situation at the same time that it is adopting comprehensive policy reforms designed to restructure its economy in favor of free-market, private enterprise-oriented initiatives. An essential ingredient of its economic development plan is an open economy where foreign investment is encouraged and increasing exports is fostered. Its general foreign policy approach can be characterized as strongly independent. Most importantly, the Febres-Cordero Administration is taking on the challenge of radically reorienting the structural bases of its economy and forging a new international image within the framework of a nation only recently returned to democracy.

a. Domestic economic policies and the political environment. In 1984, Ecuador experienced the first successful transition from one democratically elected administration to another in over 25 years. The combination of support from medium to lower income groups for the popular political promises of the Christian Social Party platform and from private enterprise and business groups succeeded in electing President Leon Febres Cordero in May 1984. These groups represent the essential constituency of the present administration. The vast majority of this constituency appears to have remained loyal and supportive of the President during his first year in office while his administration has focussed to a great extent on getting its economic house in order, especially on the debt renegotiations and garnering needed international support from the international commercial banks, the IMF, and the Paris Club. At the same time, it must be recognized that some of the economic measures adopted have eroded his political support in some sectors. For example, as one its first actions, and in support of its promise to reduce government interventionism, the GOE reduced the number of commodities subject to prices controls from 55 to 7, which had a direct and immediate impact on the purchasing power of most consumers. In support of his committment to economic austerity, in December the President faced down labor unions and strong Congressional opposition, vetoing a salary increase for wage earners which he considered excessive and inflationary. At virtually the same moment, the administration reduced subsidies on domestic petroleum prices, thereby increasing the price of gasoline to the consumer by an average of 78%. This initiated a price spiral that included increases in all forms of transportation, in turn sparking increases in food prices, etc.; all of which fueled inflation, which spurted to 38%, on an annualized basis, during the first quarter of 1985.

For his private business and industrial support, Febres Cordero promised to reorient the economy and to base it on free-market, competitive principles. In his inaugural address, the newly-installed President reinforced this promise, but also cautioned that restructuring would be a painful process for many segments of the private sector that had enjoyed h[illegible] protection and substantial subsidies over many years. His words have proven true as import substitution industries have gradually seen the erosion of their subsidies over the past year through revisions in the exchange regime, steady increases in the prices of energy, and reductions in their access to cheap credit. As a result over the past few months, the industrial sector has become increasingly more vocal in its criticisms of the actual and proposed policy reforms of the GOE, especially the already implemented elimination of prohibitions on competitive imports and the proposed tariff reforms which would further reduce protection of those industries.

The President's popular support is to a still greater degree contingent upon his ability to make good his promise of "Pan, Techo, y Trabajo" ("Bread, Housing, and Employment"). Progress on these elements of the Febres Cordero platform has been disappointingly slow during the first year of the administration, and the political opposition has begun to use this to sway support away from the President. It is a clear political imperative that the administration move swiftly during its second year to fulfill these campaign promises. In addition, the administration has been subject to an increasing amount of criticism from powerful leftist political groups on the grounds that economic reforms are not leading the country to prosperity.

In sum, the progress made by Febres Cordero in restructuring and opening the economy has not been without its political costs. Domestic supporters of the President have come under the repeated attack of his political detractors. Successfully counterattacking the political criticism will require that the President and the administration he heads succeed in maintaining domestic confidence in the economy, which means restoring growth, increasing incomes, and improving social welfare within the time frame of this administration's term of office, four years.

b. Foreign policy and the political environment. International support for the policies and initiatives of the Febres Cordero administration has been vocal, especially among the financial and international business community of the United States which has heralded the reopening of Ecuador to foreign investment and the mature way Ecuador has dealt with its debt crisis, as compared to the posturing of some other Latin American countries. In dealing with its debt problems, Ecuador has been a model of international financial responsibility and seriousness. Whatsmore, it has become Latin America's most vocal proponent of a mature approach to debt renegotiations among debtor nations. It has participated in several meetings of debtor nations and has always advocated that debtor nations work with the international financial community to renegotiate, rather than stop paying, existing debt. It has also been an advocate of working within exisiting international financial structures, rather than blaming that structure for the debt problem. In fact, when one group of debtor nations recently proposed that the GOE host a meeting in Quito, but that the World Bank and the IMF not be invited, representatives of the GOE politely informed the group that the GOE would not be able to host such a meeting.

Ecuador and its President have been lauded within other segments of the United States for the attitude and actions it has taken to fight international illicit drug trafficking, for its support of U.S. positions in the United Nations (especially those related to international terrorism), and for its outspoken support for U.S. policies in Central America in a variety of international fora. This support and the clear preference of the Febres-Cordero Administration for fostering close ties with the United States has also not been without a certain degree of political costs both domestically and regionally. For example, Ecuador was one of the first nations to "break rank" on Decision 24 of the Andean Pact and sign an OPIC Agreement; it was also one of the few nations to almost openly snub the attempts of OPEC to bring member nations in line on the issue of production levels in spite of high level pressure from other OPEC member nations.

With regard to Central America, Ecuador is neither a member of the Contadora group (Colombia, Panama, Venezuela, and Mexico) supporting Central American peace through dialog, nor a member of the Lima Group (Peru, Brazil, Argentina, and Uruguay) which is critical of U.S. involvement in Central America. It is, in fact, practically isolated from its Latin American neighbors in its open and vocal support for the U.S. position on Central America.

Domestically, President Febres Cordero has been criticized for such open support for U.S. foreign policies, especially support for those policies for which other Latin American "positions" have been developed and pronounced or which appear to undermine Latin American or Andean unity; i.e., Central America and Decision 24. Whatsmore, many critics believe that Febres Cordero's open courtship of the United States has not resulted in tangible evidence of increased support by the USG; especially when compared to neighboring countries which appear to have fared better in terms of assistance levels in spite of their challenging and confrontational attitude toward the United States. While this criticism is not altogether valid (because the USG has doubled U.S. Development Assistance levels to Ecuador in the past year), it is true that the assistance provided to date has not been the type which provides enough immediate economic impact to either address critical short-term problems or to quiet such criticism. At the same time, when compared to levels of assistance throughout the LAC region, USG support for Ecuador appears to be less than supportive.

In sum, there is an opportunity now for the USG to not only quiet domestic criticism by providing tangible support to the Febres-Cordero administration, but also to openly demonstrate USG support for the economic reforms effected by the GOE by providing assistance that can have an immediate impact on the short-term economic crisis facing Ecuador. Such assistance provided immediately would also serve to send an important message throughout the region at an opportune moment to other nations that the USG does provide economic help in times of need to those friendly nations that strive to help themselves.

IV. Program Description.

A. Program Overview.

The overall objective of this program is to assist the Government of Ecuador to stabilize the current economic situation and to continue with economic structural reforms which will lead to economic recovery in the medium term and provide firm foundations for long term economic growth. The specific purpose of this program is to provide immediate balance of payments support to Ecuador, thereby ensuring that adequate funding is provided for private sector productive needs and for the continuation of public sector development investments.

The proposed $25,000,000 program will be authorized in two separate actions, and will be disbursed in tranches over calander years 1985 and 1986. The first tranche will be disbursed as soon as possible after committment of FY 1985 funds as a cash transfer into the account of the Government of Ecuador in the Federal Reserve Bank of New York. Subsequent increments will be authorized in FY 1986 and will be disbursed in separate actions.

The specific timing of disbursement of funds approved under this Program will be responsive to the GOE's needs for balance of payment support and supportive of the GOE's stabilization program and economic restructuing program. The measures included in the existing IMF Agreement are nearly comprehensive and, for the most part, stand alone. A.I.D. assistance, therefore, is not tied to, or dependent upon implementation of the IMF measures, per se. However, independent of the IMF Program, but included in the GOE's stabilization program are certain policy commitments which the Mission feels are particularly important to the economy and which form part of the Mission's on-going sectoral policy dialog with the GOE. These include: (1) achievement of market-determined interest rates, (2) reduction in tariff barriers, (3) reduction in domestic subsidies on petroleum derivitives, and (4) reduction and/or elimination of consumer price controls, particularly for agricultural products. Actions related to the first three of these form part of the policy dialogue and monitoring process which forms part of this Program. The third forms part of the FY 85 PL-480 Title I Program.

Given the notable progress of the GOE to date in implementing significant macroeconomic policy reforms and the urgency of the balance of payments financing requirement, the Mission proposes to disburse the FY 1985 assistance as soon as possible after authorization and obligation of funds without additional conditionality. As a covenant to the Program, the GOE will make a commitment to continue to take actions which will further institutionalize the GOE's policy reforms, as outlined in its letter of application for ESF assistance.

Upon each disbursement, the GOE will deposit an equivalent amount of sucres into a Special Account in the Central Bank of Ecuador. These sucres will be used for mutually agreed upon economic and social development purposes which are consistent with Sections 103 through 106 of the Foreign Assistance Act.

As part of the Program Agreement, the GOE will agree to make available an equivalent amount of dollars to the private sector for imports of raw materials and intermediate goods from the United States within a period of six months following disbursement of funds.

B. Dollar Financing.

1. Justification for cash transfer. In designing this Program, the Mission carefully weighed the advantages and disadvantages presented by the cash transfer vis-a-vis the commodity import program (CIP) as the dollar financing mechanism. Based on a careful analysis of LAC experience with both mechanisms and the appropriateness of each mechanism in light of the objectives of this Program, the Mission concluded that only by utilizing the cash transfer mechanism could the overall objectives and the specific purpose of the Program be achieved.

In terms of providing balance of payments support for CY 1985, it is most important that the assistance be disbursed rapidly. The CIP mechanism would not allow for the speed of disbursement required to have an impact on the 1985 balance of payments; in general, the mechanism does not allow for an infusion of foreign exchange into the economy when most needed.

Given the political and economic importance of this Program, it is imperative that disbursements be made efficiently, without costing either the Mission or the GOE excessive delays or staff time. Given previous Mission experience with credit funds in the Central Bank, including a modified CIP, it would require between six and nine months to set up the procedures for operating a CIP in Ecuador. Also, the CIP would require Mission staff time to administer, an additional burden on an already shrinking staff. Since the Mission has been informed by AID/W that there will be no additional staff in the foreseeable future, the Mission beleives that the cash transfer is the only practical mechanism for Program management.

The general advantage of the CIP mechanism is its accountability. The Mission beleives that, given the small size of the Program vis-a-vis the normal level of Ecuadorean imports from the U.S. each year, and given that the GOE has already instituted some of the most effective import monitoring procedures in the hemisphere, a modified import attribution system will be more than sufficient to account for the use of dollar resources. In sum, while the CIP theoretically could offer a marginal increase in the accountability of the Program, that increase is virtually irrelevant and does not justify the loss in control over the timing and impact of disbursements nor the additional load on Mission staff.

2. Utilization and management of dollar resources. A $25 million cash transfer to the Central Bank of Ecuador (BCE) is proposed. Disbursements will be made into one of the BCE's US bank accounts, in accordance with its instructions contained in the Financing Request. It is anticipated that an electronic transfer of funds to its account in the Federal Reserve Bank of New York will be employed.

During the six months following a disbursement, the BCE will make an equivalent amount of foreign exchange available to the private sector for the importation of goods from the United States which fall into the categories of raw materials and intermediate goods. Annual levels of imports of such goods into Ecuador average $305 million (FOB). Therefore, the GOE anticipates no problem in importing an equivalent portion of this, or a substantially higher level of goods during the period indicated. In fact, since the proposed level of ESF funding represents only about 8% of the annual value of eligible goods imported into Ecuador, the Mission does not believe that special mechanisms need be established to monitor the attributions. The Mission Controller will spot check data generated pursuant to the import monitoring procedures of the GOE, as recently revamped and instituted by the Societe General de Surveillance (SGS), to attribute the U.S. imports.

3. Justification for grant financing. The level of ESF assistance proposed for Ecuador is quite small given the size of the economy and the magnitude of the emerging balance of payments gap. Therefore, if the USG is to make a demonstrable contribution and achieve maximum political impact with a limited amount of assistance, it is essential that funds be provided to the maximum extent on the most concessional terms possible.

In spite of the fact that the balance of payments problem is a large and growing one, and in spite of the fact that the USG wishes to provide significant assistance to the politically supportive and friendly Febres Cordero administration, it is unlikely that funding availabilities will allow for the kind of cash transfer program that could literally fill the balance of payments gap. Therefore, to the extent that funds are available for Ecuador, they must perform the politically important task of demonstrating U.S. support for Ecuador and the kind of economic reforms it is undertaking without solving the economic problems. To this end, whatever funding the USG can provide will have much more impact both economically and politically if it can be provided if it is provided on the most concessional basis. In this regard, the Mission believes that preference should be given to grant financing this Program.

C. Local currency uses and procedures. In addition to its promise of strengthening a market-oriented approach to development that emphasizes the role of the private sector, the Febres Cordero government was elected on a populist platform of "Bread, Housing, and Employment." While the policy reforms enacted thus far during the four-year life of his administration have emphasized the first promise, the development investments initiated during the past year have been oriented toward both structural reform of the economy and the more populist platform. But progress on the latter has been unacceptably slow, and it is a political imperative that the GOE move more swiftly during its second year on its popular campaign promises. In light of this, the proposed local currency program will be oriented toward assisting the GOE to fulfill some of the most important of these pledges. Given its greater flexibility in both programming and disbursement, local currency is an appropriate vehicle for supporting such investments.

1. Public sector uses. Local currency to be utilized through the public sector falls into two general categories: public investment projects and A.I.D. counterpart. Unless the fiscal situation deteriorates radically, there will be a ceiling placed on financing GOE budgeted counterpart of the equivalent of $500,000 (disbursements) per calendar year. These funds will be programmed judiciously to support two kinds of activities.

The Mission is currently experiencing some difficulty in encouraging the GOE to continue to finance the counterpart for older projects, some of which do not fit into the new Administration's priorities, but are nearly completed; e.g., the IRD projects. Secondly, there are certain new project counterpart expenses that the Mission would like to encourage the GOE to finance in its budget as a means of fortifying the GOE's committment to finance the activities after the A.I.D. DA financing ends; e.g., malaria control, land titling.

In addition to counterpart funding, there are a variety of public investment projects that the GOE and the Mission would like to see continued. For example, international and GOE financing has been programmed to date to address about 70% of the first priority infrastructure rehabilitation works identified after the El Ni]o disaster of 1983. In many of the coastal areas, whole areas still remain isolated because of damaged bridges and roads. Part of the local currency will be utilized to address this continuing need. Follow-on activities to the Mission's successful rural water and sanitation, macroeconomic analysis and implementation, and drug awareness programs may be provided.

2. Private sector uses. Local currency will be utilized to support two general activities within the private sector: provision of investment credit for productive activities complementary to AID programs, and an expanded PVO program.

As discussed in the economic analysis above, there is a shortage of funds available within the formal financial system for long term investments. This affects the ability of the private sector to make significant investments in productive activities. In light of its employment generation platform, this is also troubling to the GOE. Local currency funds will, therefore, be made available for productive investments. Given the limited amount of funding available, these funds will be targeted to investment areas where on-going AID projects are actively providing complementary assistance; for example, small enterprises, non-traditional agricultural export development, and the coffee sector.

The AID program in Ecuador provides a large amount of assistance each year for both local and U.S. PVO projects. Many of these projects have produced benefits disproportionately large to the level of AID investment. Both the Mission and the GOE would like to see such small investments expanded, but the Mission lacks staff to support an expanded program. With local currency financing, the Mission will explore the possibility of creating a separate entity which would provide funding for an expanded program. Examples of on-going and new programs which could be partially or fully financed through this facility include: a technical skills training program, the graduate management school to be established in Guayaquil, a variety of on-going programs in the health and population fields, and institutional development activities of the Instituto Nacional del Nino y la Familia (INFAA), a major actor in the A.I.D.-sponsored Child Survival Initiative.

3. A.I.D. Trust Fund. Pursuant to AID/W guidance, as agreed during the Mission Program Week, a Trust Fund for A.I.D. operating expenses will be established with local currency resources.

4. Local Currency Programming and Disbursement Procedures. Prior to disbursement of the dollar resources, A.I.D. and the GOE will jointly program the uses of the resources to be made available. Upon disbursement of the dollar resources, the GOE will establish within the Central Bank of Ecuador a Special Account and deposit an equivalent amount of local currency therein.

It is anticipated that all funds will subsequently be transferred to A.I.D. in accordance to the terms and conditions of a Resource Administration Agreement (Trust Fund for Program Uses) except that portion programmed for AID operating expenses, which will be subject to a separate Trust Fund Agreement.

Subsequent changes in the local currency programming will be subject to joint agreement of A.I.D. and the GOE, as will certain specific disbursements of funds. A.I.D. will disburse funds directly for private sector activities with prior notification to the GOE.

5. Summary of Programming. To summarize, local currency uses are oriented toward employment generating, popular investments that emphasize increasing production. A summary table of anticipated local currency uses is presented below:

Purpose/Activity	Funding ($000)
Public Development Activities	9,500
a. Ag. Credit Mobilization	
b. Rural and Secondary City Infrastructure Rehab/Reconstruction	
c. Economic Policy Analysis/Implementation	
d. Narcotics Awareness	
Counterpart to A.I.D. Projects	500
a. Malaria Control	
b. Forestry Development	
c. IRD/Agriculture	
d. IRD/Health	
e. Land Titling	

Purpose/Activity	Funding ($000)
Private Sector Programs	14,000
a. Private Sector Investments (Complementary to other AID assistance)	
b. PVO Projects	
A.I.D. Operating Expense Trust Fund	1,000
TOTAL LOCAL CURRENCY RESOURCES	25,000

D. Conditions, Covenants and Negotiating Status

1. Program Strategy. As discussed above and presented in detail in Annex D, the GOE has made significant progress in restructuring and reorienting its economic policies. The reforms which have taken place to date have included some of the politically most difficult to achieve; e.g., substantial increases in domestic petroleum prices and unificiation of exchange rates. At the same time, some of the measures passed have been steps towards implementing new policies rather than complete reform in and of themselves. For example, in the area of interest rate policy, the GOE made considerable progress toward liberalizing interest rates on both lending and saving when, in January 1985, it created the certificates of deposit and freed the certificates, as well as the lending of resources thus generated, from interest rate ceilings. However, interest rate ceilings still are in effect for most savings and lending instruments. The GOE's stated policy is to gradually introduce market-determined interest rates on both savings and lending.

In the area of petroleum subsidies, the GOE's stated policy is to align domestic prices with international prices, thereby reducing subsidies. Again, much progress has been made, but the price still is less than the generally accepted definition of "world market price."

In the area of tariff reform, the GOE is committed to reducing trade barriers. In its informal discussions, the economic cabinet has discussed reductions in the highest tariff rates from an average of 250% to a standard tariff of 100%. While this would appear to be an obvious benefit for the greatest majority of Ecuadoreans, it caused the industrial sector to denounce the administration. Opposition became less vocal when the GOE launched a campaign to educate the private sector interest groups on the benefits of tarriff reform, and the GOE still wishes to move forward in instituting a revised tariff schedule as soon as possible. However, it is currently taking time to debat the least disruptive means of achieving significant reform without causing significant problems for the international reserve situation on the one hand, and without resparking opposition on the other.

Finally, in the area of price controls, the GOE eliminated a large number of consumer price controls upon taking office. A few, however, are still in place, and some of the most important of these are in the agricultural sector. While the stated policy of the GOE is to minimize the number of such controls, this has proven particularly difficult for the GOE to implement for a series of reasons. First among these has been the weakness of the public sector to analyze the economy-wide impacts of reductions in price controls and, subsequently, to devise a politically acceptable plan for the gradual elimination of price controls. The reason for this is that virtually all of the public sector's economic expertise has been employed analyzing and devising the strategy for the macroeconomic reforms and debt renegotiations that have taken place. In relation to the FY 1985 PL-480 Title I program and as part of the Agriculture Sector Reorientation Project, the Mission is providing assistance to the GOE to analyze its policies related both to consumer price controls and minimum producer prices. Through these two mechanisms, the Mission expects the GOE to address its price control policies in the agricultural sector.

The provision of ESF assistance will encourage the GOE to continue to implement its economic recovery strategy, including further reforms of basic economic structures. Through its policy dialogue with the GOE, the Mission will continue to focus its efforts on the interest rate issue as it effects long-term lending operations, tariff reform, and domestic petroleum subsidies. Assistance required by the GOE in analyzing and designing policies in these areas may be financed under the Mission's on-going Macroeconomic Policy Analysis Project.

2. Conditions Precedent to Disbursement.

a. Fiscal Year 1985 Funding. The Program Agreement which obligates FY 1985 funds will contain the following Conditions Precedent to Disbursement:

(1) Prior to any disbursement of the Assistance, the GOE will present to A.I.D., in form and substance acceptable to A.I.D.: (a) an opinion of legal counsel acceptable to A.I.D. stating that the Agreement has been duly authorized or ratified by and executed on behalf of the Government of Ecuador, and that it constitutes a valid and legally binding obligation of the Government of Ecuador in accordance with all of its terms and conditions; and, (b) a statement of the name of the person holding or acting in the office of the Minister of Finance of the Government of Ecuador, and of any additional representatives, together with a specimen signature of each authorized person specified in such statement.

(2) Prior to any disbursement of the Assistance, the GOE will present to A.I.D., in form and substance acceptable to A.I.D., a program for the use of local currency resources generated pursuant to the disbursement of the U.S. Dollars.

b. Fiscal Year 1986 Funding. The Amendatory Agreement which obligates FY 1986 funds will include the following Conditions Precedent to Disbursement:

(1) Prior to any disbursement of the additional Assistance provided pursuant to Amendatory Agreement No. 1, the GOE will present to A.I.D., in form and substance acceptable to A.I.D.: (a) an opinion of legal counsel acceptable to A.I.D. stating that the Agreement has been duly authorized or ratified by and executed on behalf of the Government of Ecuador, and that it constitutes a valid and legally binding obligation of the Government of Ecuador in accordance with all of its terms and conditions; and, (b) a statement of the name of the person holding or acting in the office of the Minister of Finance of the Government of Ecuador, and of any additional representatives, together with a specimen signature of each authorized person specified in such statement.

(2) Prior to any disbursement of the additional Assistance provided pursuant to Amendatory Agreement No. 1, the GOE will present to A.I.D., in form and substance acceptable to A.I.D., a program for the use of local currency resources generated pursuant to the disbursement of the U.S. Dollars.

3. Program Covenants. In addition to the above conditions, the Program Agreement will include the following covenants related to program implementation:

(a) that the GOE assure the allocation of an amount of foreign exchange equal to the amount obligated under the Agreement, or any amendment thereto, within a period of six (6) months from the date of the disbursement of the Assistance under the Agreement, or any amendment thereto, for the importation of raw materials and intermediate goods from the United States of America.

(b) that, upon disbursement of the dollar resources, the GOE deposit in a Special Account in the Central Bank of Ecuador the amount of sucres equivalent to the dollar disbursement, the uses of which will support development activities that meet the criteria for funding as outlined in Sections 103 through 106 of the Foreign Assistance Act of 1961, as amended, and which will be jointly accorded by A.I.D. and the GOE.

(c) that the GOE maintain steady progress in the implementation of its stabilization and recovery program in the areas outlined in its Letter of Application to A.I.D., reporting on such progress in those areas of special interest to A.I.D. on a regular basis.

4. Program Implementation Schedule. The following table outlines the proposed implementation actions for the Economic Stabilization and Recovery Program.

	ACTIVITY	ANTICIPATED DATE
1.	Sign Program Agreement	September 30, 1985
2.	(CP)Legal Opinion/Signatures	October 30, 1985
3.	(CP)Local Currency Programming	October 30, 1985
4.	Disburse FY 85 Funds/Deposit Local Currency Equivalent	October 31, 1985
5.	Sign Amendatory Agreement	December 2, 1985
6.	(CP)Legal Opinion/Signature	December 16, 1985
7.	(CP)Local Currency Programmin	December 30, 1985
8.	Disburse FY 86 Funds/Deposit Local Currency Equivalent	December 31, 1985
9.	Attribute FY 85 Funding Imports	March 30, 1986
10.	Attribute FY 86 Funding Imports	June 30, 1985
11.	Report on progress implementing petroleum pricing plan, market-determined interest rates and tariff reform	June 30, 1985

5. Negotiating Status. The essential terms and conditions of this Program have been discussed with the Minister of Finance, the Economic Advisor to the President of the Republic, and the Economic Advisor to the President of the Central Bank. All are in agreement that the conditions and terms of the assistance are appropriate. It is likely, however, that the Government of Ecuador will continue to negotiate for increased ESF funding levels.

REPUBLICA DEL ECUADOR
MINISTERIO DE FINANZAS

OFICIO No. 3639

Quito, a 29 AGO. 1985

Señor
Orlando Llenza
DIRECTOR DE LA AGENCIA INTERNACIONAL
PARA EL DESARROLLO
En su Despacho

Estimado señor Llenza:

A nombre del Gobierno del Ecuador, tengo a bien solicitar financiamiento por la cantidad de 75'000.000 de dólares para un Programa de Estabilización y Recuperación Económica, que servirá para apoyar el Programa de Ajuste Económico del Ecuador para los años 1985 y 1986.

Durante los dos años anteriores, Ecuador ha enfrentado grandes dificultades económicas. Las fuertes inundaciones de 1983 causaron graves daños a la producción agrícola, incluyendo los productos de exportación. Se dañó o destruyó millones de dólares de infraestructura física básica. Además, las relaciones comerciales del Ecuador continuaron deteriorándose, debido principalmente a la continua declinación de los precios de las principales exportaciones ecuatorianas a nivel mundial. Estos factores condujeron a una declinación del 7.0% del PNB per capita en 1983. No obstante, la República inició un esfuerzo de ajuste financiero durante el período y llevó a cabo exitosamente un programa de estabilización económica apoyado por una operación stand by del FMI, en el período 1983-1984.

El Gobierno, democráticamente electo, del Presidente León Febres Cordero, que se posesionó el 10 de Agosto de 1984, está interesado en realizar un programa económico que conducirá a un equilibrio interno y externo y a la consecución de la estabilidad financiera del País. Estos factores, a su vez, crearán un ambiente más favorable para que el sector privado desempeñe una función importante en el desarrollo de la economía, conduciendo así a una mejora en los niveles de vida de los ecuatorianos.

Apenas posesionadas las nuevas autoriades económicas en la nueva administración gubernamental, incrementaron y consolidaron el esfuerzo de estabilización monetaria, y nuestros logros -

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han sido considerables. Una de las principales metas ha sido la reducción del déficit en el sector público. Las cifras preliminares indican que el déficit del sector público para 1984 se redujo a menos del 1%, si se compara con el 6.8% del PNB en 1982. Aspiramos que en 1985 el PNB mostrará un excedente de alrededor del 2.0%. La declinación del 7% del PNB per capita en 1983 se convirtió en un 1.2% positivo en 1984, aunque el PNB total aún no ha regresado a su nivel de 1978.

La comunidad bancaria internacional, en reconocimiento a los esfuerzos ecuatorianos de ajuste económico, autorizó un convenio multi-anual que reprograma 4.6 billones de dólares. A ésto siguió una exitosa reprogramación multi-anual con el Club de Paris, aunque no en términos tan favorables como los que nuestro Gobierno había esperado. El 11 de marzo de 1985, la Junta Ejecutiva del FMI aprobó un Convenio Stand by de doce meses para el Ecuador. Bajo este programa, podremos girar 105.5 millones de DEG. Considerado en conjunto, este paquete permitirá al Ecuador reducir las deficiencias de su balanza de pagos anual proyectada para el período 1985-1989, y reducir la relación del servicio de la deuda para las exportaciones de bienes y servicios, de aproximadamente 70% a 32%.

Adicionalmente, y a fin de conseguir un ajuste estructural a un plazo más largo, al que se hace referencia anteriormente, nuestro Gobierno:

a. Ha continuado trabajando hacia la unificación del tipo de cambio, moviendo todas las transacciones del mercado oficial al mercado de intervención del Banco Central;

b. Ha retirado todas las prohibiciones a las importaciones y reducido los períodos de financiamiento mínimos a 120 días;

c. Ha incrementado los precios del petróleo doméstico en un promedio del 78%;

d. Ha incrementado la flexibilidad de las tasas de interés doméstico permitiendo la emisión de pólizas de acumulación a un tipo de interés determinado libremente;

e. Ha reducido la intervención del Gobierno en la economía, rebajando la cantidad de bienes esenciales sujetos a control de precios; y,

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f. Ha abierto la economía a la inversión de los Estados Unidos, firmando un convenio con la OPIC.

Durante el curso de los siguientes 12 meses, nuestro Gobierno espera hacer un progreso substancial en:

a. El incremento de la influencia de las fuerzas de mercado en la determinación de las tasas de interés, especialmente para operaciones de préstamos a largo plazo;

b. La reducción de los niveles de protección efectiva a través de las modificaciones de los programas arancelarios; y,

c. La reducción de los subsidios sobre el consumo doméstico del petróleo.

Las consideraciones basado en las cuales se solicita este programa de asistencia económica, son las siguientes:

a. Las proyecciones de la balanza de pagos para el período 1985-1989 muestra claramente la necesidad de alivio financiero de todas las fuentes;

b. El proceso de ajuste económico que se inició en 1983 y continuó durante el período 1984-1985 ha conseguido ya una mejora substancial en los sectores externo e interno de la economía; y,

c. Uno de los principales objetivos de las políticas económicas y financieras promovidas por nuestro gobierno es volver tan rápidamente como sea posible a las relaciones normales con nuestros socios comerciales, fomentando así el incremento de la actividad de comercio e inversión.

A nombre de la República del Ecuador, espero que esta solicitud recibirá el apoyo total del Gobierno de los Estados Unidos, con el cual mi País mantiene importantes relaciones políticas, financieras, y comerciales de beneficio mutuo.

Atentamente,
DIOS, PATRIA Y LIBERTAD,

Francisco X. Swett M.,
MINISTRO DE FINANZAS Y CREDITO PUBLICO.

COUNTRY CHECKLIST

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FAA Sec. 481; FY 1984 Continuing Resolution. Has it been determined or certified to the Congress by the President that the Government of the recipient country has failed to take adequate measures or steps to prevent narcotic and psychotropic drugs or other controlled substances (as listed in the schedules in section 202 of the Comprehensive Drug Abuse and Prevention Control Act of 1971) 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?

   It has not been determined. The GOE has an active narcotics program with USG support.

2. FAA Sec. 620(c). If assistance is to a government, is the government liable as debtor or unconditional guarantor of any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) the debt is not denied or contested by such government?

   No such case is known.

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3. FAA Sec. 620(e)(1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?	No.
4. FAA Sec. 532(c), 620(a), 620(f), 620D; FY 1982 Appropriation Act Secs. 512 and 513. Is recipient country a communist country? Will assistance be provided to Angola, Cambodia, Cuba, Laos, Vietnam, Syria, Libya, Iraq, or South Yemen? Will assistance be provided to Afghanistan or Mozambique without a waiver?	No.
5. ISDCA of 1981 Secs. 724, 727 and 730. For specific restrictions on assistance to Nicaragua, see Sec. 724 of the ISDCA of 1981. For specific restrictions on assistance to El Salvador, see Secs. 727 and 730 of the ISDCA of 1981.	N/A
6. FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action of U.S. property?	No.
7. FAA Sec. 620(l). Has the country failed to enter into an agreement with OPIC?	Ecuador signed an OPIC Agreement in November 1984.

8. FAA Sec. 620(o); Fishermen's Protective Act of 1967, as amended, Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters?

   Yes, taken into account by the Administrator at the time of approval of Agency OYB.

   (b) If so, has any deduction required by the Fishermen's Protective Act been made?

   N/A

9. FAA Sec. 620(q); FY 1982 Appropriation Act Sec. 517. (a) Has the government of the recipient country been in default for more than six months on interest or principal of any AID loan to the country?

   No.

   (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the appropriation bill appropriates funds?

   No.

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

    Yes, taken into account by the Administrator at the time of approval of Agency OYB.

11. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?

No.

12. FAA Sec. 620(u). What is the payment status of the country's 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.)

Payment status is current.

13. FAA Sec. 620A; FY 1982 Appropriation Act Sec 520. Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed an act of international terrorism? Has the country aided or abetted, by granting sanctuary from prosecution to, any individual or group which has committed a war crime?

No.

14. FAA Sec. 666. Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?

No.

15. FAA Sec. 669, 670. Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards?

No.

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, after August 3, 1977? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.)

16. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Session of the U.N. of Sept. 25 and 28, 1981, and failed to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the Taking into Consideration memo.)	Yes. Yes. Yes, taken into account by the Administrator at the time of approval of Agency OYB.
17. ISDCA of 1981 Sec. 721. See special requirements for assistance to Haiti.	N/A.
18. FY 1984 Continuing Resolution. Has the recipient country been determined by the President to have engaged in a consistent pattern of opposition to the foreign policy of the United States?	No such determination has been issued.

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria

a. 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?	The Department of State has not determined that Ecuador is a violator of human rights.

2. Economic Support Fund Country Criteria

a. FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can the country made such significant improvements in its human rights record that furnishing such assistance is in the national interest?

No such determination has been made.

b. ISDCA of 1981, Sec. 725(b). If ESF is to be furnished to Argentina, has the President certified that (1) the Govt. of Argentina has made significant progress in human rights; and (2) that the provision of such assistance is in the national interests of the U.S.?

N/A

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

N/A

STANDARD ITEM LIST

A. Procurement

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

6	FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per cent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent that such vessels are available at fair and reasonable rates.?	No, shipping is not excluded from these requirements.
7.	FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? If the facilities of other Federal agencies will be utilized, are they particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs?	No technical assistance is contemplated.
8.	International Air Transport. Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available?	No such financing is contemplated.
9.	FY 1982 Appropriation Act Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States?	No such procurements are contemplated.

B. Construction

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

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

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

C. Other Restrictions

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

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

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

4. Will arrangements preclude use of financing:

a. FAA Sec. 104(f); FY 1982 Appropriation Act. Sec. 525: (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion?	Arrangements preclude the use of funds for this purpose.
b. FAA Sec. 620(g). To compensate owners for expropriated nationalized property?	Arrangements preclude the use of funds for this purpose.
c. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?	Arrangements preclude the use of funds for this purpose.
d. FAA Sec. 662. For CIA activities?	Arrangements preclude the use of funds for this purpose.
e. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?	Arrangements preclude the use of funds for this purpose.
f. FY 1982 Appropriation Act, Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for military personnel?	Arrangements preclude the use of funds for this purpose.

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g. <u>FY 1982 Appropriation Act, Sec. 505.</u> To pay U.N. assessments arrearages or dues?	Arrangements preclude the use of funds for this purpose.
h. <u>FY 1982 Appropriation Act, Sec. 506.</u> To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)?	Arrangements preclude the use of funds for this purpose.
i. <u>FY 1982 Appropriation Act, Sec. 510.</u> To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields?	Arrangements preclude the use of funds for this purpose.
j. <u>FY 1982 Appropriation Act, Sec. 511.</u> Will assistance be provided for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights.?	Arrangements preclude the use of funds for this purpose.
k. <u>FY 1982 Appropriation Act, Sec. 515.</u> To be used for publicity or propaganda purposes within U.S. not authorized by Congress?	Arrangements preclude the use of funds for this purpose.

NONPROJECT ASSISTANCE CHECKLIST

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1. App. Unnumbered; FAA Sec-653-(b)

(a) Describe how Committees on appropriations of Senate and House havebeen or will be notified concerning the nonproject assistance.	(a) Congress was notified by normal Congressional Notification procedures
(b) Is assistance within (Operational Year Budget)country or international organization allocation reported to the Congress (or not more than $1 million over that figure plus 10%)?	(b) No, Congress has been notified of Agency's intent to increase OYB for this purpose.
2. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of this assistance?	N/A
3. FAA Sec. 209, 619. Is assistance more efficiently and effectively given through regional or multilateral organizations? If so why is assistance not so given? Information and conclusion whether assistance will encourage regional development programs. If assistance is for newly independent country, is it furnished through multilateral organizations or in accordance withmultilateral plans to the maximum extent appropriate?	No

4. FAA Sec. 601(a); (and Sec.-201(f) for Development Loans). Information and conclusions whether asistance 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.

Assistance is being provided because and in support of the private sector orientation of the GOE and will fortify a policy environment aimed at strengthening private initiative and competition. Dollars will be provided to private importers for trade, and local currency will be used to support development efforts of coops., credit unions, and savings/loan associations.

5. FAA Sec. 601(b). Information and conclusion 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 enterprise).

Dollars to be provided will be used to finance private imports from the U.S.

6. FAA Sec. 612(b); Sec. 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 United States are utilized to meet the cost of contractual and other services.

Local currency will help finance Ecuador's public investment program.

7. FAA Sec. 612(d). Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?

N/A

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Funding

a. FAA Sec. 531. How will this assistance support promote economic or political stability? Is the country among the 12 countries in which Supporting Assistance may be provided in this fiscal year.

The Program will promote economic and political stability by providing urgently needed BOP assistance which in turn will: (1) help maintain economic growth, (2) allow the GOE the time necessary for recently instituted economic reforms to take effect, (3) quiet domestic opposition to GOE support for U.S. foreign policies. In addition, local currency to be generated will be used to fund investment efforts which will generate employment and improve living conditions.

2. Nonproject Criteria for Development Assistance

a. FAA Sec. 102(c); Sec. 111; Sec. 281a. Extent to which activity will (1) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production, spreading investment out from cities to small towns and rural areas; and (2) help develop cooperatives, assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local government institutions?

N/A

b. FAA Sec. 103, 103A, 104, 105, 106, 107. Is assistance being made available: (include only applicable paragraph -- e.g., a, b, etc. -- which corresponds to sources of funds used. If more than one fund sources is used for assistance, include relevant paragraph for each fund source.)

N/A

c. FAA Sec. 207; Sec. 113. Extent to which assistance reflects appropriate emphasis on: (1) encouraging development of democratic, economic, political, and social institutions; (2) self-help in meeting the country's food needs; (3) improving availability of trained worker-power in the country; (4) programs designed to meet the country's health needs; (5) other important areas of economic, political, and social development, including industry, free labor unions, cooperatives, and Voluntary Agencies; transportation and communication; planning and public administration; urban development and modernization of existing laws; or (6) integrating women into the recipient country's national economy. — N/A

d. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government. — N/A

e. FAA Sec. 201(b)(2)-(4) and -(8); Sec.201(e); Sec. 211-(a)(1)-(3) and -(8). Does the activity give reasonable promise of contributing to the development of economic resources or to the increase of productive capacities and self-sustaining economic growth; or of educational or other institutions directed toward social progress? It is realted to and consistent with other development activities, and will it contribute to reliable long-range objectives — N/A

f. FAA Sec. 201(b)(6); Sec. 211(a)(5), (6). Information and conclusion on possible effects of the assistance on U.S. economy, with special reference to areas of substantial labor surplus, and extent to which U.S. commodities and assistance are furnished in a manner consistent with improving or safeguarding the U.S. balance-of-payment position. — N/A

3. Nonproject Criteria for Development Assistance (Loans only)

(a) FAA Sec. 201(b)(1). Information and conclusions on availability of financing from other free-world sources, including private sources within the United States — N/A

(1) 103 for agriculture, rural development or nutrition; if so, extent to which activity isspecifically designed to increase productivity and income of rural poor; (103A) if for agricultural research, is full account taken of needs of small farmers; — N/A

(2) (104) for population planning or health; if so, extent to which activity extends low-cost, integrated delivery systems to provide health and family planning services, especially to rural areas and poor; extent to which assistance gives attention to interrelationship between (A) population growth and (B) development and over-all improvement and over-all improvement in living standards in developing countries. Is activity designed to build motivation for small families in programs such as education in an out of school, maternal and child healthservices, agriculture production, rural development, and assistance to urban poor? — N/A

(3) (105 for education public administration, or human resources development, if so, extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, or strengthens management capability of institutions enabling the poor to participate in development.	N/A
(4) (106) for technical assistance, energy, research reconstruction, and selected development problems; if so, extent activity is:	N/A
(a) to help alleviate energy problem;	N/A
(b) reconstruction after natural or manmade disaster;	N/A
(c) for special development problem, and to enable proper utilization of earlier U.S. infrastructure, etc., assistance;	N/A
(d) for programs of urban development, especially small labor-intensive enterprises, marketing systems, and financial or other institutions to help urban poor participate in economic and social development.	N/A
(5) (107) by grants for coordinate private effort to develop and disseminate intermediate technologies appropiate for developing countries.	N/A

b. FAA Sec. 201(b)(2); 201-(d). Information and conclusion on (1) capacity of the country to repay the loan, including reasonableness of repayment prospects, and (2) reasonableness and legality (under laws of country and United States) of lending and relending terms of the loan.	N/A
c. FAA Sec. 201(e). If loan is not made pursuant to a multilateral plan, and the amount of the loan exceeds $100,000, has country submitted to A.I.D. an application for such funds together with assurance to indicate that funds will be used in an economically and technically sound manner?	N/A
d. FAA Sec. 202(a). Total amount of money under loan which is going directly to private enterprise, is going to intermediate credit institutions or other borrowers for use by private enterprise, is being used to finance imports from private sources, or is otherwise being used to finance procurements from private sources?	N/A

STATISTICAL TABLES

ANNEX C

TABLE C-1

EXPENDITURE ON GROSS DOMESTIC PRODUCT
(Million 1975 Sucres)

Item	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	Preliminary 1982	Preliminary 1983
Gross Domestic Product	62,912	66,852	76,493	95,867	102,046	107,740	117,679	125,369	133,632	140,718	147,622	153,443	156,136	150,931
Terms of Trade Effect	4,535	3,302	-1,590	-8,280	4,338	0	1,806	6,747	2,813	10,856	14,444	11,189	8,361	7,183
Gross Domestic Income	67,447	70,154	74,903	87,587	106,384	107,740	119,485	132,116	136,445	151,574	162,066	164,632	164,497	158,114
Resource Gap	4,170	7,960	3,207	-3,121	-4,986	6,979	1,720	4,333	8,673	-905	447	-1,983	-1,590	-11,242
Imports (G+NFS)	17,038	20,555	19,911	20,969	30,189	35,221	34,155	40,175	41,518	41,485	45,683	41,453	38,513	29,264
Capacity to Import	12,868	12,595	16,704	24,090	35,175	28,242	32,435	35,842	32,845	42,390	45,236	43,436	40,103	40,506
Exports (G+NFS)	8,333	9,293	18,294	32,370	30,837	28,242	30,629	29,095	30,002	31,534	30,792	32,247	31,742	33,323
Total Expenditures	71,617	78,114	78,110	84,466	101,398	114,719	121,205	136,449	145,118	150,669	162,513	162,649	162,907	146,872
Consumption	57,068	59,715	62,076	66,717	76,824	85,922	93,908	103,296	108,021	114,619	123,297	128,696	131,715	124,498
General Government	7,600	7,429	7,853	8,590	13,158	15,624	17,098	20,572	20,613	21,658	23,611	24,185	23,856	21,587
Private	49,468	52,286	54,223	56,127	63,666	70,298	76,810	82,724	87,408	92,961	99,686	104,511	107,863	102,911
Investment	14,549	18,399	16,034	17,749	24,574	28,797	27,297	33,153	37,097	36,050	39,216	33,953	31,188	22,374
Fixed Investment	13,576	17,190	14,102	15,952	20,194	24,907	25,268	29,181	33,058	32,955	34,975	32,442	29,545	21,001
Change in Stocks	973	1,209	1,932	1,797	4,380	3,890	2,029	3,972	4,039	3,095	4,241	1,511	1,643	1,373
Domestic Savings	10,379	10,439	12,827	20,870	29,560	21,818	25,577	28,820	26,424	36,955	38,769	35,936	32,778	33,616
Net Factor Income	-1,195	-1,595	-2,639	-4,846	-5,787	-1,678	-3,236	-3,903	-5,008	-5,758	-7,249	-8,507	-10,020	-9,241
Current Transfers	315	352	314	291	452	338	178	8	215	6	0	0.	237	295
National Savings	9,499	9,196	10,502	16,315	24,225	20,478	22,518	24,924	23,632	31,203	31,519	27,429	22,995	24,670

Source: Central Bank of Ecuador, Cuentas Nacionales Nos. 2, 5, and 6, and Statistical Appendix Table No. 3.1, mission estimates.

Table C-2
Sectoral Origin of GDP
(million 1975 sucres)

	1980	1981	1982	1983 prel	1984 prel	1985 proj.
Gross Domestic Prod.	147,622	153,443	155,265	150,529	156,630	160,858
Agriculture & Livestock	21,198	22,647	23,101	19,721	21,048	22,942
Petrol & Mining	15,070	15,992	15,527	19,711	22,063	23,618
Manufacturing	26,807	29,159	29,584	29,541	28,909	29,486
Construction	6,906	7,239	7,285	6,638	6,469	6,501
Commerce	24,789	25,032	25,562	22,468	23,743	24,052
Transport & Comm.	10,038	10,517	10,687	10,539	10,852	10,827
Elect., Gas & Water	1,115	1,117	1,241	1,443	1,729	1,788
Pub. Admin.	13,709	14,000	14,224	14,423	14,610	14,787
Other	27,990	27,740	28,054	26,045	27,207	26,856
			(percent of GDP)			
GDP at Market Prices	100.00	100.00	100.00	100.00	100.00	100.00
Agriculture & Livestock	14.36	14.76	14.88	13.10	13.44	14.26
Petrol & Mining	10.21	10.42	10.00	13.09	14.09	14.68
Manufacturing	18.16	19.00	19.05	19.62	18.46	18.33
Construction	4.68	4.72	4.69	4.41	4.13	4.04
Commerce	16.79	16.31	16.46	14.93	15.16	14.95
Transport & Comm.	6.80	6.85	6.88	7.00	6.93	6.73
Elect., Gas & Water	0.76	0.73	0.80	0.96	1.10	1.11
Pub. Admin.	9.29	9.12	9.16	9.58	9.33	9.19
Other	18.96	18.08	18.07	17.30	17.37	16.70
			(percent change)			
GDP at Market Prices		3.94	1.19	-3.05	4.05	2.70
Agriculture & Livestock		6.84	2.00	-14.63	6.73	9.00
Petrol & Mining		6.12	-2.91	26.95	11.93	7.05
Manufacturing		8.77	1.46	-0.15	-2.14	2.00
Construction		4.82	0.64	-8.88	-2.55	0.50
Commerce		0.98	2.12	-12.10	5.67	1.30
Transport & Comm.		4.77	1.62	-1.38	2.97	-0.23
Elect., Gas, & Water er		0.18	11.10	16.28	19.82	3.44
Pub. Admin.		2.12	1.60	1.40	1.30	1.21
Other		-0.89	1.13	-7.16	4.46	-1.29

Source: The Central Bank of Ecuador, unpublished data, and Mission Estimates

TABLE C-3
CENTRAL GOVERNMENT BUDGETARY OPERATIONS
(million sucres)

	1983	1984 PREL	1985 PROJ
TOTAL REVENUE	60,186	100,601	154,619
Petroleum Revenue	27,834	48,027	88,000
Income Tax	6,767	9,541	11,400
Property Tax	377	152	170
Taxes on Goods & Services	13,007	19,635	22,536
Sales Tax	7,381	11,000	12,680
Excise Taxes	5,626	8,635	9,856
Taxes in Int'l Trade	11,477	18,867	29,987
Import Duties	10,589	17,179	27,911
Export Duties	54	78	128
Exchange Profits Tax	834	1,610	1,948
Other Taxes	19	610	650
Export Incentives	(664)	(70)	0
Non-tax Revenue	1,369	2,000	1,500
Transfers	0	1,839	376
TOTAL CURRENT EXPEND	59,848	86,632	107,138
Wages & Salaries	16,550	20,290	24,348
Goods & Services	2,780	4,073	4,890
Interest Payments	14,426	23,572	31,938
External	12,219	19,965	27,028
Internal	2,207	3,607	4,910
Current Transfers	19,427	28,453	34,370
Other Current Expend.	6,665	10,244	11,592
CAPITAL EXPENDITURES	14,409	17,532	26,583
Fixed Capital Formation	5,778	9,957	15,785
Capital Transfers	7,185	7,433	10,573
Other	1,446	142	225
CENTRAL GOV'T BUDGET SAVING	338	13,969	47,482
OVERALL SURPLUS/DEFICIT	(14,071)	(3,563)	20,899
FINANCING	14,071	3,564	(20,899)
External (net)	(2,266)	(2,787)	(5,329)
Disbursement			
Amortization	2,266	2,787	5,329
Domestic (net)	16,337	6,351	(15,570)
Central Bank	11,810	3,924	(16,630)
Bonds	4,527	2,427	1,060

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CENTRAL GOVERNMENT BUDGETARY OPERATIONS
(percent of GDP)

	1983	1984 PREL	1985 PROJ
TOTAL REVENUE	10.64	13.49	16.58
Petroleum Revenue	4.92	6.44	9.43
Income Tax	1.20	1.28	1.22
Property Tax	0.07	0.02	0.02
Taxes on Goods & Services	2.30	2.63	2.42
Sales Tax	1.30	1.47	1.36
Excise Taxes	0.99	1.16	1.06
Taxes in Int'l Trade	2.03	2.53	3.21
Import Duties	1.87	2.30	2.99
Export Duties	0.01	0.01	0.01
Exchange Profits Tax	0.15	0.22	0.21
Other Taxes	.00	0.08	0.07
Export Incentives	-0.12	-0.01	0.00
Non-tax Revenue	0.24	0.27	0.16
Transfers	0.00	0.25	0.04
TOTAL CURRENT EXPEND	10.58	11.61	11.49
Wages & Salaries	2.93	2.72	2.61
Goods & Services	0.49	0.55	0.52
Interest Payments	2.55	3.16	3.42
External	2.16	2.68	2.90
Internal	0.39	0.48	0.53
Current Transfers	3.43	3.81	3.68
Other Current Expend	1.18	1.37	1.24
CAPITAL EXPENDITURES	2.55	2.35	2.85
Fixed Capital Formation	1.02	1.33	1.69
Capital Transfers	1.27	1.00	1.13
Other	0.26	0.02	0.02
CENTRAL GOV'T BUDGET SAVING	0.06	1.87	5.09
OVERALL SURPLUS/DEFICIT	-2.49	-0.48	2.24
FINANCING	2.49	0.48	-2.24
External (net)	-0.40	-0.37	-0.57
Disbursement	0.00	0.00	0.00
Amortization	0.40	0.37	0.57
Domestic (net)	2.89	0.85	-1.67
Central Bank	2.09	0.53	-1.78
Bonds	0.80	0.33	0.11

Source:The Ecuadorean Economy: Recent Developments and Prospects, Quito, March 1985, Table 6 and mission estimates

TABLE C-4
BALANCE OF PAYMENTS
(Million US$)

Item	1970	1971	1972	1973	1974	1975	1976	1977	1976	1979	1980	1981 Preliminary	1982 Preliminary	1983 Preliminary
Exports (GNFS)	256.6	265.0	364.9	627.0	1307.9	1109.7	1418.6	1592.5	1703.5	2410.8	2666.5	2913.1	2690.0	2643.0
Merchandise	234.9	238.0	323.2	584.7	1225.4	1012.8	1307.2	1400.8	1529.2	2150.5	2544.2	2543.8	2343.0	2365.0
Non-factor Services	23.7	27.0	41.7	42.3	82.5	96.9	111.4	191.7	174.3	260.3	322.3	369.3	347.0	278.0
Imports (GNFS)	359.3	401.2	391.9	509.1	1100.3	1294.9	1311.7	1774.0	2166.7	2709.6	3013.6	3217.5	3058.0	2019.0
Merchandise	249.6	306.8	284.1	397.5	875.2	1006.3	1047.8	1360.5	1704.0	2096.8	2241.8	2361.2	2181.0	1408.0
Non-factor Services	109.7	94.4	107.8	111.6	225.1	288.6	263.9	413.5	462.7	612.8	771.8	856.3	877.0	611.0
Resource Balance	-100.7	-136.2	-27.0	117.9	207.6	-185.2	106.9	-181.5	-463.2	-298.8	-147.1	-304.4	-368.0	624.0
Net Factor Income	-29.2	-35.8	-65.6	-138.2	-200.9	-67.1	-143.9	-196.1	-279.0	-355.7	-524.7	-722.2	-847.0	-752.0
(Receipts)	0.3	0.7	2.1	6.0	25.4	17.0	13.3	25.5	36.9	67.7	109.1	86.9	44.0	45.0
(Payments)	29.5	36.5	67.7	144.2	226.3	84.1	157.2	221.6	315.9	423.4	633.8	809.1	891.0	797.0
(MLT Interest paid, DRS) a/	7.3	8.1	10.9	15.7	16.9	17.6	25.4	45.2	98.0	208.5	286.5	441.2	562.1	365.3
Net Current Transfers	7.7	7.9	7.8	8.3	15.7	13.5	7.9	0.4	12.0	0.4	0.0	0.0	20.0	24.0
(Receipts)	7.7	7.9	7.8	8.3	15.7	13.5	8.0	0.5	12.0	0.4	0.0	0.0	20.0	24.0
(Payments)	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Balance on Current Account	-122.2	-164.1	-84.8	-12.0	22.4	-238.6	-29.1	-377.2	-730.2	-654.1	-671.8	-1026.6	-1195.0	-104.0
MLT Capital Inflow														
Direct Investment	86.6	162.1	80.8	52.3	76.8	95.3	-19.9	34.5	48.6	63.4	70.0	60.0	40.0	50.0
Official Grant Aid	9.2	7.8	7.5	18.5	15.3	18.8	22.8	35.8	28.9	29.3	30.2	25.0	0.0	0.0
Net MLT Loans (DRS) b/	25.9	16.0	73.6	22.0	-6.8	133.3	160.0	507.2	423.8	339.8	702.8	930.8	-262.3	236.6
Disbursements	42.2	40.8	101.2	53.3	71.0	166.4	216.6	579.7	534.1	1080.4	972.9	1412.5	277.2	744.9
Amortizations	16.3	24.8	27.6	31.3	77.8	33.1	56.6	72.5	110.4	740.6	270.1	481.7	539.5	508.3
Other MLT (net)	2.5	3.3	9.5	6.1	36.0	-28.1	19.7	54.7	264.5	231.2	3.5	222.3	409.2	205.9
Net Credit from IMF	1.5	-8.3	3.0	9.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	213.8
Net Short-term Capital c/	10.0	20.3	-39.0	-2.0	-4.4	1.9	57.7	-145.0	-74.5	31.7	204.0	-496.4	546.1	-446.5
Errors and Omissions	-6.3	-58.6	26.7	1.2	-36.0	-35.6	13.4	9.8	8.0	36.6	-18.4	-11.0	.0	.0
Change in net Reserves (-=increase)	-7.7	13.2	-74.3	-86.1	-103.3	53.2	-224.6	-119.8	30.9	-77.9	-320.3	295.9	460.0	58.0
Memorandum Items:														
Medium & Long-term External Debt Outstanding:														
Public Sector b/	217.5	235.0	309.5	336.0	331.6	461.6	623.0	1144.6	2251.4	2630.2	3329.0	4220.5	3919.0	6264.7 d/
Private Sector e/	12.2	12.8	19.3	14.2	32.8	56.2	57.3	89.9	496.2	706.3	1121.5	1452.3	1628.5	669.7

a/ DRS stands for Debt Reporting System of the World Bank
b/ Includes only public and publicly guaranteed medium and long-term debt.
c/ In 1982 and 1983 this item includes errors and omissions.
d/ Includes short-term and non-guaranteed debt converted to medium term, publicly guaranteed debt, as a result of rescheduling arrangements.
e/ Includes short-term debt after 1977.

Sources: Central Bank of Ecuador; IMF Balance of Payments Statistics, 1983 Yearbook; mission estimates.

Economic Policy Reforms
Accomplishments of the Febres Cordero Administration

The administration of President Leon Febres Cordero has organized an exceptionally well-qualified team of private enterprise-oriented economists. This group, with limited assistance from A.I.D., has put together a package of economic measures that are designed to stabilize and reorient the economy in the immediate to short term, and lead to recovery in the medium term. Among those steps already taken are the following:

1. August 1984: To reduce energy subsides, the GOE resolved to continue the 2% per month increase in electricity rates.

2. September 4, 1984: To align exchange rates, the GOE:

   a. created the official intervention market;
   b. moved all transactions except public sector transactions, selected imports, and debt servicing on external loans contracted prior to 9/4/84 to the intervention and parallel markets;
   c. reduced the minimum financing period from 360 days and 180 days to 120 days for the majority of imports;
   d. lowered certain import duties; and,
   e. removed most import prohibitions.

3. September 11, 1984: To free the market, the GOE eliminated price controls on 48 of the 55 commodities subject to control.

4. November 6, 1984: To slow the rate of growth of Central Bank credit, the GOE raised the reserve requirement on sight deposits by 2 percentage points to 22 percent.

5. November 1984: To foster foreign investment, the GOE successfully negotiated and signed an OPIC Agreement.

6. December 1984: To stabilize the economy, the GOE successfully completed negotiations for a MYRA (1985-1989) debt rescheduling with foreign commercial banks.

7. December 28, 1984: To increase government revenues and decrease petroleum subsidies, the GOE:

   a. increased domestic gasoline prices by about 65 percent (regular and high octane);
   b. increased the domestic diesel price by 100 percent; and
   c. intends to further adjust prices in the future.

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8. January 1985: To make interest rates more flexible, the GOE:

    a. raised the interest rates on commercial lending to 23 percent;
    b. raised the interest on deposits to 20 percent; and,
    c) allowed the banking system to issue term deposit certificates at market-determined interest rates and to determine freely the interest rate applied on loans funded with the proceeds from the placement of such certificates.

By August 1985 this mechanism had become so popular that about $20 million had been generated, up to $5 million of which is capital returned from abroad.

9. January 1985: To stabilize the economy in the immediate term and restore economic growth over the medium term, the GOE successfully completed negotiations with the IMF for an SDR 105.5 million Stand-by Agreement. The following measures were identified for implementation during 1985 as part of the IMF Stand-by Agreement:

    a. unification of the official and Central Bank intervention exchange rates;
    b. transfer of foreign exchange transactions for services from the parallel market to the unified market;
    c. ultimate implementation of a flexible exchange rate policy;
    d. achievement of an official fiscal surplus through increased revenues from domestic petroleum sales and traditional taxes and expenditure constraints;
    e. limitation of wage increases to the rate of inflation;
    f. elimination of the requirement for advance payments for imports;
    g. ceilings on external debt; and,
    h. limits on expansion of domestic credit.

10. April 1985: To further open the economy, the GOE officially eliminated all remaining import prohibitions.

11. April 1985: To stabilize the economy, the GOE successfully completed negotiations for a MYRA for official debt at the Paris Club.

12. August 28, 1985: To unify exchange rates, all import/export transactions were moved to the Central Bank intervention exchange rate. Prior to this date, the GOE had been gradually transferring specific tranactions from the official to the Central Bank rate. On August 28, the only transactions which continued to take place at the official rate were pharmaceutical imports and Texaco exports. With the transfer of these transactions to the Central Bank rate, the official market has been virtually eliminated. Tight monetary policy has resulted in strengthening the free market sucre from a low of S/125:$1.00 in February 1985 to S/100:$1.00 at the first of August 1985. Since the Central Bank intervention rate has remained constant at S/97:$1.00 and the official rate has been virtually abolished, a de facto exchange rate unification is taking place.

DATED: August 30, 1985
(2697G)

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FISCAL AND MONETARY BACKGROUND

1. The Fiscal Situation. GOE fiscal performance has had a major impact on monetary policy and consequently on the balance of payments. The initiation of major new petroleum producion in the early 1970s substantially incrased the resources available to the GOE. Two factors, however, led to a steady and serious deterioration in the fiscal accounts. First, legislation earmarked petroleum revenues for a wide variety of domestic expenditures, encouraging an expansion of expenditures in the earmarked categories which, in fact, considerably exceeded the growth in petroleum revenues. Between 1973 and 1981, revenues from taxes on petroleum increased from 3.9 to 7.9 percent of GDP. Over the same period, current expenditures, excluding interest, increased from 14.8 to 19.5 percent of GDP, while capital expenditures incrased from 7.3 to 10.3 percent of GDP.

The second factor which contributed to fiscal deterioration was the decline in tax effort. Revenues from non-petroleum taxes declined from 17.0 pervent of GDP in 1973 to 11.5 percent in 1981. Thus a public sector surplus which equaled 3.1 percent of GDP in 1973 was quickly converted to a deficit which steadily expanded, equaling 5.8 percent of GDP by 1981.

The method used to finance these growing deficits eventually turned this deterioration into a crisis. Throughout the 1970s, the GOE sought to expand domestic credit by borrowing from abroad and lending to the domestic financial system. Thus, in 1973, despite the existence of a public sector surplus equal to 3.1 percent of GDP, the GOE borrowed an amount equal to 3.1 percent of GDP abroad, lending the equivalent of 6.2 percent of GDP to the financial system in that year. Throughout the 1970s, the GOE continued the practice of financing its entire financial requirements, and more, externally. The resulting expansion of domestic private sector credit was a substantial contributor to the very rapid growth of output during that period.

The combination of a deteriorating public sector fiscal position and a steadily growing burden of debt service obligations eventually proved unsustainable. The crisis occurred in 1982. Largely as a result of major increases in international interest rates, Ecuador's public sector deficit jumped from 5.8% of GDP in 1981 to 7.9% in 1982. Increasing nervousness on the part of foreign lenders made it impossible to finance a deficit of this magnitude externally. For the first time in over a decade, the GOE made substantial demands on the supply of domestic credit in financing an amount equal to 3.4 percent of GDP. In attempting to supply this

Table E-1a

CENTRAL GOVERNMENT BUDGETARY OPERATIONS

(million sucres)

	1983	1984 prel.	1985 proj.
TOTAL REVENUE	60,186	100,601	154,619
Petroleum Revenue	27,834	48,027	88,000
Other Tax Revenue	32,352	52,574	66,619
EXPENDITURES	74,257	104,164	133,721
Non-Interest Current Expenditures	45,422	63,060	75,200
Interest	14,426	23,572	31,938
Capital Expenditures	14,409	17,532	26,583
CENTRAL GOVERNMENT BUDGETARY SAVING	338	13,969	47,482
OVERALL SURPLUS/DEFICIT	-14,071	-3,563	20,899
FINANCING	14,071	3,563	-20.899
External	-2,266	-2,787	-5,329
Disbursements	0	0	0
Amortization	2,266	2,787	5,329
Domestic (net)	16,377	6,351	-15,570
Central Bank	11,810	3,924	-16,630
Bonds	4,527	2,427	1,060

(percent of GDP)

	1983	1984 prel.	1985 proj.
TOTAL REVENUE	10.64	13.49	16.58
Petroleum Revenue	4.92	6.44	9.43
Other Tax Revenue	5.72	7.05	7.14
EXPENDITURES	13.12	13.96	14.34
Non-Interest Current Expenditures	8.03	8.45	8.06
Interest	2.55	3.16	3.42
Capital Expenditures	2.55	2.35	2.85
CENTRAL GOVERNMENT BUDGETARY SAVING	0.06	1.87	5.09
OVERALL SURPLUS/DEFICIT	-2.49	-0.48	2.24
FINANCING	2.49	0.48	2.24
External	-0.40	-0.37	-0.57
Disbursements	0.00	0.00	0.00
Amortization	0.40	0.37	0.57
Domestic (net)	2.89	0.85	-1.67
Central Bank	2.09	0.53	-1.78
Bonds	0.80	0.33	0.11

Table E-1b
NATIONAL PARTICIPATION FUND
(million sucres)

	1983	1984 prel.	1985 proj.
TOTAL REVENUE	6,917	8,580	9,191
Petroleum Revenue	2,458	2,656	2,297
Other Tax Revenue	4,459	5,924	6,894
EXPENDITURES	9,495	9,560	9,500
OVERALL SURPLUS/DEFICIT	-2,578	-980	-309

(percent of GDP)

	1983	1984 prel.	1985 proj.
TOTAL REVENUE	1.22	1.15	0.99
Petroleum Revenue	0.43	0.36	0.25
Other Tax Revenue	0.79	0.79	0.74
EXPENDITURES	1.68	1.28	1.02
OVERALL SURPLUS/DEFICIT	-0.46	-0.13	-0.03

Table E-1c
REST OF PUBLIC SECTOR
(million sucres)

	1983	1984 prel.	1985 proj.
TOTAL REVENUE	96,411	122,602	144,577
Petroleum Revenue	29,440	54,510	60,129
Other Tax Revenue	66,971	68,092	84,448
EXPENDITURES	80,401	118,058	144,916
Current Expenditures	53,333	78,452	93,800
Capital Expenditures	27,068	39,606	51,116
SAVINGS: REST OF PUBLIC SECTOR	43,078	44,150	50,777
OVERALL SURPLUS/DEFICIT	16,010	4,544	-339

(percent of GDP)

	1983	1984 prel.	1985 proj.
TOTAL REVENUE	17.04	16.44	15.50
Petroleum Revenue	5.20	7.31	6.45
Other Tax Revenue	11.84	9.13	9.05
EXPENDITURES	14.21	15.83	15.84
Current Expenditures	9.43	10.52	10.06
Capital Expenditures	4.78	5.31	5.48
SAVING: REST OF PUBLIC SECTOR	7.61	5.92	5.44
OVERALL SURPLUS/DEFICIT	2.83	0.61	-0.04

ANNEX E
Table E-1d
SUMMARY: CONSOLIDATED PUBLIC SECTOR
(billion sucres)

	1983	1984 prel.	1985 proj.
TOTAL REVENUE	152.4	217.8	295.5
Petroleum Revenue	59.7	105.2	150.4
Other Tax Revenue	92.8	112.6	145.1
EXPENDITURES	153.1	217.8	276.6
Current Expenditures	111.7	162.2	198.9
Capital Expenditures	41.4	55.6	77.7
PUBLIC SECTOR SAVING	40.8	55.6	96.6
OVERALL SURPLUS/DEFICIT	-0.6	0.0	18.9
FINANCING	0.6	0.0	-18.9
External	3.4	4.1	0.0
Disbursements	8.5	11.9	14.5
Amortization	5.1	7.8	14.5
Domestic (net)	-2.8	-4.1	-18.9

(percent of GDP)

	1983	1984 prel.	1985 proj.
TOTAL REVENUE	26.95	29.20	31.68
Petroleum Revenue	10.55	14.10	16.13
Other Tax Revenue	16.40	15.10	15.56
EXPENDITURES	27.06	29.20	29.65
Current Expenditures	19.74	21.74	21.32
Capital Expenditures	7.32	7.45	8.33
PUBLIC SECTOR SAVING	7.21	7.45	10.36
OVERALL SURPLUS/DEFICIT	-0.11	0.00	2.03
FINANCING	0.11	0.00	2.03
External	0.60	0.55	0.00
Disbursements	1.50	1.60	1.55
Amortization	0.90	1.05	1.55
Domestic (net)	-0.49	-0.55	-2.03

public sector financing while maintaining the flow of credit to the private sector, the GOE greatly expanded domestic credit and the monetary aggregates, leading to a substantial acceleration in inflation.

The government of the day responded quickly and skillfully to this crisis by drastically cutting expenditures. Non-interest current expenditures were reduced from 19.1 percent of GDP to 15.4 percent, while capital expenditures were reduced from 10.1 percent of GDP to 7.2 percent. As a result of these drastic reductions, the consolidated public sector deficit was reduced to essentially zero in 1983.

Good fiscal performance continued through 1984, despite some relaxation of expenditure constraints. The adjustment of certain petroleum product prices in 1984, as well as an effective devaluation of the sucre in the first eight months of 1984, contributed to a substantial increase in budgetary revenues from petroleum. As shown on Table E-1d, consolidated public sector revenues from petroleum production rose from 10.55 percent of GDP to 14.1 percent. Deteriorating price performance by state enterprises and lags in tax collection by the social security system offset significantly increased tax collection by the central government so that non-petroleum revenues of the public sector fell from 16.4 to 15.1 percent of GDP.

On the expenditure side, overall current expenditure increased by 2 percent of GDP. Approximately one half of this increase was accounted for by the central government, of which the largest single component was increased interest on external debt. In large part, this increase was a result of exchange rate adjustments. Capital expenditure also increased slightly, primarily in the state enterprises.

2. The Monetary situation.

During the course of the 1970s, Ecuador experienced a period of very rapid economic growth. During the period 1973-80, real GDP grew by an average of 8.6 percent per year. In other countries which have experienced similarly rapid growth, the process has been accompanied by a considerable financial deepening. That is, the ratio of banking system domestic liabilities to GDP increases as domestic residents choose to hold an increasing level of their assets as domestic banking system deposits. This financial deepening has helped to finance the domestic investment necessary to sustain high growth.

In the case of Ecuador, however, although there was some financial deepening, the increase in the real size of the financial system was much smaller than would have been expected. As illustrated in Table E-2, banking system liabilities to the private sector measured as a percentage of GDP* increased from 21.72 percent in 1973 to 26.39 percent in 1977, before declining to 23.78 percent in 1979.

* Since banking system assets and liabilities are a stock measured at year end, there is a potential for some distortion if those year-end stocks are compared with current year GDP. This is particularly a problem in periods of high growth or high inflation. Consequently, in the comparisons with GDP in this section, an average of current year and following year GDP is employed.

The primary explanation for this relatively poor performance of the financial system lies in interest rate policies which held deposit rates well below current rates of inflation. As a consequence of the very rapid real growth experienced in the early 1970s, fueled by petroleum revenues and heavy external borrowing, and the presence of certain domestic supply constraints, inflation accelerated sharply, despite an appreciating real exchange rate and steadily increasing import levels. Inflation, which had averaged less than 5 percent per year in the previous two decades, accelerated sharply. The CPI increased 12.1 percent in 1973, 22.7 percent in 1974, 14.3 percent in 1975, then settled within a range of 10-13 percent for the remainder of the decade. Throughout this period, interest rates on domestic savings deposits were limited to 6 percent, while time deposits could earn no more than 8-9 percent. As a result, Ecuadorean residents found foreign assets and a variety of domestic real assets more attactive investments than domestic financial instruments.

Two factors helped to compensate for the relative lack of domestic financial resources during this period. First, as noted in the previous section, the public sector throughout this period was a net supplier of funds to the financial system. As a result, domestic financial system credit to the private sector grew significantly more rapidly than financial system deposits. During the period 1973-1979, while currency and bank deposits (M2) grew by 272.6 percent (and net domestic assets of the financial system grew by a similar amount, 299.6 percent), banking system credit to the private sector (including credit to non-bank financial intermediaries) grew by 378.2 percent.

This source of additional credit proved to be inadequate to meet domestic credit demand, however, and increasingly in the latter part of the 1970s, Ecuadorean firms began to borrow directly from foreign banks. From a level equal to one-half percent of GDP in 1973, external private sector borrowing grew to 6.7 percent of GDP by 1979, fully one-third of domestic financial system credit. While the dangers from exchange risk inherent in this type of borrowing are clear in retrospect, the long period of exchange rate stability apparently led domestic borrowers to ignore the financial consequences of devaluation.

That the financial situation existing at the end of the 1970s was unsustainable is clear in retrospect. What precipitated a financial crisis was a drastically deteriorating fiscal position which both converted the public sector from a net lender to a net borrower from the financial system by 1982. In an attempt to both meet the emerging financing needs of the public sector and sustain the flow of credit to the private sector, the monetary authorities significantly increased net domestic credit of the central bank, by 59.3 percent in 1981 and 63.7 percent in 1982. This in turn led to an increase in banking system credit of 28.9 percent in 1981 and 48.3 percent in 1982. This monetary expansion would have led to an unsustainable balance of payments deterioration except that the GOE responded to a clearly overvalued exchange rate by a series of exchange rate adjustments which, however, substantially increased the sucres burden of the private external debt. The adverse effects of these devaluations on the financial position of

Table E-2a

Development of the Banking System 1973-1979
(billion sucres)

	1973	1974	1975	1976	1977	1978	1979
Net Int'l Res.	5.72	8.56	6.43	11.41	15.3	16.2	16.6
Net Med & L.T. Foreign Liab.	0.04	0.30	0.44	0.52	1.0	0.6	0.6
Net Domestic Assets	13.24	16.57	23.62	30.76	36.1	41.7	52.9
Credit to Priv. Sector (incl. Non-Bank Fin Int.)	11.46	16.45	22.20	29.14	37.1	44.7	54.8
Liabilities to Private Sector	16.83	22.37	26.87	38.32	47.2	52.8	62.7
Other & Capital	2.09	2.36	2.74	3.33	3.2	4.5	6.2
Memorandum: External Private Sector Debt Outstanding (in sucres)	0.36	0.82	1.41	1.43	2.3	12.4	17.7

Table E-2b
(percent of GDP)

	1973	1974	1975	1976	1977	1978	1979
Net Int'l Reserve	7.38	8.54	5.34	7.62	8.55	7,62	6.30
Net Med & L.T. Foreign Liab.	0.05	0.30	0.37	0.35	0.56	0.28	0.23
Net Domestic Assets	17.08	16.53	19.63	20.56	20.18	19.61	20.06
Credit to Priv. Sector (incl. Non-Bank Fin Int.)	14.79	16.41	18.45	19.47	20.74	21.02	20.79
Liabilities to Private Sector	21.72	22.31	22.33	25.61	26.39	24.83	23.78
Other & Capital	2.70	2.45	2.28	2.23	1.79	2.12	2.35
Memorandum: External Private Sector Debt Outstanding (in sucres)	0.46	0.82	1.17	0.96	1.26	5.83	6.70

Source: IBRD, Ecuador: An Agenda for Recovery and Sustained Growth, Oct. 5, 1984.

private Ecuadorean firms would have been sufficient to make further foreign financing impractical, even if world credit markets had been more willing, in general, to supply additional funds.

In addition to external developments, the acceleration of inflation in 1982 and 1983, combined with lagging adjustments of interest rate ceilings, led to some contraction of the real domestic deposit base (i.e.

Table E-3a

Accounts of the Consolidated Banking System: 1980-1984

(million sucres)

	1980	1981	1982	1983	1984
Net Intl Reserves	21413	14072	6930	8194	11349
Other Int'l Assets	261	-866	-5195	-7708	-9739
of which sucretization				(-13800)	(-52300)
Net Domestic Credit	68481	88239	130842	183432	242555
Central Government	-658	-2968	-694	1569	-3679
Rest of Public Sector (net)	-11583	-17265	-24268	-40365	-45883
Private Financial Organ.	1294	2681	4290	15080	34927
Private Sector	66434	85641	107535	171582	228997
of which sucretization				(13800)	(52300)
other private sector	(66434)	(85641)	(107535)	(157782)	(176697)
Other Assets	12994	20150	43979	35566	28193
Float	938	1801	1550	-6645	13166
Obligations to the Priv. Sector	77251	86573	114707	154147	227898
Money	44790	50048	60167	78450	111530
Currency in Circulation	(14885)	(16907)	(20024)	(24918)	(34621)
Demand Deposits	(29905)	(33141)	(40143)	(53532)	(76909)
Quasi-Money	32461	36525	54540	75697	116368
Counterpart to SDRs	826	930	1172	1866	2188
Capital and Reserves	13016	15743	18248	21260	27245
	(percent of GDP)				
Net Intl Reserves	7.30	4.04	1.66	1.45	1.52
Other Int'l Assets	0.09	-0.25	-1.25	-1.36	-1.31
of which sucretization				(-2.44)	(-7.01)
Net Domestic Credit	23.25	25.31	31.38	32.42	32.52
Central Government	-0.22	-0.85	-0.17	0.28	-0.49
Rest of Public Sector (net)	-3.95	-4.95	-5.82	-7.13	-6,15
Private Financial Organ.	0.44	0.77	1.03	2.67	4.68
Private Sector	22.65	24.56	25.79	30.33	30.70
of which sucretization				(2.44)	(7.01)
other private sector	(22.65)	(24.56)	(25.79)	(27.89)	(23.69)
Other Assets	4.43	5.78	10.55	6.29	3.78
Float	0.32	0.52	0.37	-1.17	1.77
Obligations to the Priv. Sector	26.34	24.83	27.51	27.24	30.55
Money	15.27	14.35	14.43	13.87	14.95
Currency in Circulation	(5.07)	(4.85)	(4.80)	(4.40)	(4.64)
Demand Deposits	(10.19)	(9.51)	(9.63)	(9.46)	(10.31)
Quasi-Money	11.07	10.48	13.08	13.38	15.60
Counterpart to SDRs	0.28	0.27	0.28	0.33	0.29
Capital and Reserves	4.44	4.52	4.38	3.76	3.65

Source: Central Bank of Ecuador, unpublished data.

an increase in velocity). The ratio of money to GDP declined from 24.1 percent in 1980 to 23.3 percent in 1982 and remained essentially constant in 1983. As a result, real domestic credit to the private sector (including non-bank financial intermediaries) declined from 23.1 percent of GDP to 22.8 percent. The chief point to be emphasized here is that this relatively modest decline occurred at a time when external financing was drying up.

The elimination of the public sector deficit in 1983 and repeated interest rate adjustments, combined with a decline in domestic inflation from its 1983 peak of 52 percent, have greatly improved the condition of the Ecuadorean financial system. The elimination of public sector domestic borrowing in 1983 permitted an expansion of private sector credit (including non-bank financial intermediaries and apart from the credit due solely to the credit arising from the central bank's assumption of the private sector foreign debt--the "sucretization credits") from 22.8 percent of GDP to 26.4 percent.

Developments during 1984 are complex. Banking system liabilities expanded sharply, for reasons which appear to be largely technical. M1 inceased by 42.2 percent and M2 by 47.8 percent in a year in which the CPI increased by only 24 percent on a December to December basis. At the same time, banking system credit to the private sector, excluding sucretization credits and including credit to non-bank financial intermediaries, increased by 22.4 percent, slightly less than the rate of inflation. Net credit to the public sector remained essentially constant. The explanation for the substantial rise in deposits seems to lie in the reversal of interbank float from a negative 6.6 billion sucres at the end of 1983 to a positive 13.2 billion sucres at the end of 1984.

FOREIGN EXCHANGE ALLOCATION AND IMPORT PROCESSING PROCEDURES

The procedural steps for requesting and acquiring foreign exchange through the Central Bank of Ecuador (BCE) and for importing goods through customs are described in detail below. Where newly initiated import monitoring procedures are operating, they are so identified:

1. The importer fills out an import license application form and presents it with accompanying documents (proforma invoice) at the Central Bank of Ecuador (BCE).

2. The BCE initiates the approval process and requests payment from the importer of the following fees and taxes:

    a. the monetary stabilization fee (5.8% or 15% of the value of the goods, depending on their classification);
    b. 80% of the estimated import duties on the goods; and,
    c. a 1% service charge.

3. If the import license is approved, the importer is given an importer code. La Societé Générale de Surveillance (SGS) then receives a copy of all documents submitted by the importer which it reviews and sends to its office located at the port of embarkation.

4. The importer may send the import approval documents (import license and back-up) directly to the exporter when sufficient confidence exists between the importer and the exporter and terms of the sale have been previously negotiated. If not, the importer presents approved import documents to his local bank in conjunction with his application for letter of credit. If accepted, the local bank approves the letter of credit and confirms it to a correspondent bank, which in turn communicates the approval to the exporter.

5. Meanwhile, the SGS reviews the invoice, checking unit prices and recording the quantity of merchandise to be shipped. If all is in order, it approves the shipment. (Note: the BCE engaged the SGS and established the scope of its duties late in 1984.) The SGS provides the notices which importers must pass on to exporters, giving instructions about inspections before embarkation of the goods.

6. The exporter receives all of the various documents and ships the merchandise. He presents appropriate documentation (i.e. invoices, certificate of origin, bill of lading, etc.) to the correspondent bank, based upon which he is paid. Original documents are then sent by the correspondent bank to the local bank for reimbursement. The exporter may also ship merchandise and send all documents directly to the importer for reimbursement if the transaction is being financed directly.

7. An application for reimbursement of foreign exchange is then filed with the BCE, Reimbursement Department, supported by other documents (i.e., the import license, invoice, bill of lading, receipt, etc.). This is done either by the local bank or directly by the importer. This is first reviewed and then processed; that is, the import license data is compared with invoice amounts and the information contained on the bill of lading (type of goods, price, quantity, weight, etc.) The importer must also pay the SGS inspection fee of 2% when he files for reimbursement.

8. Assuming the BCE approves the transaction, it authorizes the importer to take his merchandise out of Customs by stamping the reimbursement document. The BCE maintains copies of the transaction documents in a special "hold" file until the importer returns to present the receipts from Customs (customs charges and payment of duties) before it authorizes the foreign exchange payment to the exporter or the local or correspondent bank.

9. The importer clears the merchandise through Customs at port of entry (where it may be subject a second SGS inspection), and pays the remaining 20% of duty, taxes and other Customs or service charges.

10. The importer presents the receipts from Customs and the Customs clearance documents to the BCE.

11. The BCE, Reimbursement Dept., receives these clearance documents, pulls the documents in the "hold" file, authorizes the total transaction, and instructs the Department for Foreign Payments (Departmento de Giros del Exterior) to pay the correspondent bank, the local bank, or the importer.

With the initiation of SGS monitoring procedures, the most common infraction in the import process that has been detected is over-invoicing of imports. When this is detected, an additional penalty is added to the charges to be paid by the importer. Once paid, the importer, may clear his merchandise through Customs.

Attachment 1

BANCO CENTRAL DEL ECUADOR

REQUISITOS PARA INSCRIBIRSE COMO IMPORTADOR EN EL BANCO CENTRAL

COMERCIANTES:

PERSONAS NATURALES:

1.- MATRICULA DE COMERCIO DEL CANTON Y REGISTRO MERCANTIL
2.- AFILIACION A LA CAMARA DE COMERCIO
3.- COMPROBANTE DEL PAGO DEL IMPUESTO AL CAPITAL EN GIRO
4.- REGISTRO UNICO DE CONTRIBUYENTES
5.- CEDULA DE IDENTIDAD ECUATORIANA
6.- CEDULA TRIBUTARIA

PERSONAS JURIDICAS:

1.- ESCRITURA PUBLICA DE CONSTITUCION Y REGISTRO MERCANTIL
2.- AFILIACION A LA CAMARA DE COMERCIO
3.- PAGO DEL IMPUESTO AL CAPITAL EN GIRO
4.- REGISTRO UNICO DE CONTRIBUYENTES
5.- NOMBRAMIENTO DEL REPRESENTANTE DE LA COMPAÑIA
6.- CEDULA DE IDENTIDAD ECUATORIANA DEL REPRESENTANTE DE LA COMPAÑIA
7.- CEDULA TRIBUTARIA DEL REPRESENTANTE DE LA COMPAÑIA

INDUSTRIALES, ARTESANOS, CONSTRUCTORES, AGRICULTORES, ETC.

PERSONAS NATURALES:

1.- MATRICULA DE COMERCIO DEL CANTON Y REGISTRO MERCANTIL
2.- AFILIACION A UNA DE LAS CAMARAS DE LA PRODUCCION
3.- REGISTRO UNICO DE CONTRIBUYENTES
4.- CEDULA DE IDENTIDAD ECUATORIANA
5.- CEDULA TRIBUTARIA

PERSONAS JURIDICAS:

1.- ESCRITURA PUBLICA DE CONSTITUCION Y REGISTRO MERCANTIL
2.- AFILIACION A UNA DE LAS CAMARAS DE LA PRODUCCION
3.- REGISTRO UNICO DE CONTRIBUYENTES
4.- CEDULA TRIBUTARIA DE LA COMPAÑIA
5.- NOMBRAMIENTO DEL REPRESENTANTE DE LA COMPAÑIA
6.- CEDULA DE IDENTIDAD ECUATORIANA DEL REPRESENTANTE DE LA COMPAÑIA
7.- CEDULA TRIBUTARIA DEL REPRESENTANTE DE LA COMPAÑIA

Attachment 2

CAMARA DE INDUSTRIALES DE PICHINCHA

CIRCULAR N° 0038

13 MAR. 1985

PRESIDENCIA

Estimado Consocio:

La Junta Monetaria en sesión del 28 de febrero de 1.985, expidió la Regulación N° 230-85, relativa al mecanismo de operación para la inspección a las importaciones y exportaciones, de acuerdo con el convenio celebrado con la Firma - Société Générale de Surveillance S.A.; la misma que por considerar de trascendental importancia para todas las empresas, le estamos remitiendo adjunto a la presente.

Atentamente,

Ing. Pedro Kohn T,
PRESIDENTE.

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No. 230-85

LA JUNTA MONETARIA

En uso de las atribuciones que le confiere el Artículo 12 de la Ley sobre Cambios Internacionales,

RESUELVE:

Artículo Primero.- En la Codificación de las Regulaciones de esta Corporación, efectúense las siguiente modificaciones:

I. Al Artículo 1, Sección II, Capítulo I, Título Octavo (Comisiones y Tasas por Servicios), Libro I (Política Monetaria-Crediticia), de la Codificación de Regulaciones de la Junta Monetaria (Página 69.0), añádase el siguiente literal:

"r) Comisión para inspecciones

Importación.- Sobre el valor FOB	2%	2%
Exportación.- Sobre el valor FOB	1%	1%

La comisión estará a cargo de los importadores o exportadores, según el caso, y será depositada al ingreso de las respectivas solicitudes de importación o exportación, ampliaciones y autorizaciones de embarque. (Liquidable en sucres al tipo de venta de mercado libre de intervención del Banco Central del Ecuador, vigente a la fecha de depósito).

En el caso de mercaderías destinadas a Depósitos Comerciales, el cobro de la comisión se efectuará en base a las autorizaciones previas expedidas por los mencionados Depósitos".

II. Al Título Segundo (Importaciones), Libro II (Política Cambiaria) (Página 92.2), añádase el siguiente Capítulo:

"CAPITULO III. INSPECCIONES DE IMPORTACION
Sección I. Inspecciones
Artículo 1. La Société Générale de Surveillance S.A. efectuará las inspecciones de importación a que se encuentra obligada según lo establecido en el Contrato de Prestación de Servicios suscrito con el Banco Central del Ecuador, el 31 de octubre de 1984.

BANCO CENTRAL DEL ECUADOR

JUNTA MONETARIA

Las inspecciones se efectuarán de manera previa al embarque de las mercaderías en base a los permisos de importación concedidos por el Banco Central del Ecuador;), previo al desaduanamiento de las mismas, cuando dicho banco lo estime necesario.

Artículo 2. La Société Générale de Surveillance S.A. enviará diariamente un delegado a las Oficinas de Cambios Internacionales a fin de que retire las órdenes de inspección.

Artículo 3. En el caso de mercaderías llegadas a Ferias o Exposiciones Internacionales, debidamente autorizadas, para la nacionalización de las mercaderías la Société Générale de Surveillance S.A. efectuará las inspecciones respectivas en el Recinto Ferial, en base a los permisos de importación concedidos por el Banco Central del Ecuador y a la respectiva Nota de Pedido.

Sección II. Del Banco Central del Ecuador

Artículo 1. Previo al embarque de las mercaderías las Oficinas de Cambios Internacionales del Banco Central del Ecuador procederán a sellar los permisos de importación, las ampliaciones o prórrogas y las autorizaciones de embarque con la siguiente leyenda: "Importación sujeta a inspección de calidad, cantidad y precios por parte de la Société Générale de Surveillance S.A.".

En caso de importaciones destinadas a Depósitos Comerciales, el sello mencionado en el inciso anterior deberá ser aplicado en las copias de las Autorizaciones Previas expedidas por dichos Depósitos.

Se exceptúan de estas disposiciones las importaciones de petróleo y sus derivados (combustibles), objetos de arte, animales vivos, armas, periódicos, revistas, efectos personales y de menaje, paquetes postales, así como aquellas a las que se refieren los literales b) y c) del Artículo 1, Sección II, Capítulo I, de este Título.

Artículo 2. En los permisos de importación se admitirá solamente la declaración de un país de origen.

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Cualquier cambio relacionado con esta disposición deberá efectuarse mediante la respectiva ampliación, antes del embarque de la mercadería.

Artículo 3. Los originales del permiso de importación, ampliaciones y prórrogas, así como una copia de las autorizaciones de embarque, y la correspondiente nota de pedido, serán entregados diariamente a la persona designada por la Société Générale de Surveillance S.A.

Artículo 4. Las Oficinas de Cambios Internacionales del Banco Central del Ecuador exigirán el pago de la comisión de inspección, según lo dispuesto en el literal r), Artículo I, Sección II, Capítulo 1, Título Octavo, del Libro 1 de esta Codificación.

Artículo 5. Si en la liquidación de los reembolsos se estableceríen excesos en el valor, las Oficinas de Cambios Internacionales procederán al cobro de la diferencia de la comisión de inspección, de la misma forma dispuesta para los permisos de importación.

Artículo 6. El Banco Central del Ecuador solamente devolverá al interesado el valor pagado por la comisión, cuando se anularen los permisos de importación, y la Société Générale de Surveillance S.A. no hubiere efectuado la inspección correspondiente.

Artículo 7. Cuando la Société Générale de Surveillance S.A. emita Avisos de No Conformidad, como consecuencia de las divergencias que puedan establecerse en las inspecciones, las Oficinas de Cambios Internacionales notificarán inmediatamente al importador, a efectos de la apelación a que tiene derecho de conformidad con los Artículos 17 de la Ley sobre Cambios Internacionales y 49 de su Reglamento.

Artículo 8. El Banco Central del Ecuador venderá divisas, en el mercado que corresponda, para el pago de las importaciones, en base a los valores establecidos en los Avisos de Conformidad que emita la Société Générale de Surveillance S.A., o por los valores que constaren en las Resoluciones expedidas por la Gerencia General del Banco Central del Ecuador o por la Junta Monetaria, en caso de apelaciones.

DISPOSICIONES TRANSITORIAS

PRIMERA: Las Oficinas de Cambios Internacionales del Banco Central del Ecuador no someterán al sistema de inspección a las mercaderías llegadas a Depósitos Comerciales que hubieren sido embarcadas con anterioridad al 1° de marzo de 1985.

SEGUNDA: Para la aprobación de solicitudes de ampliación a permisos de importación concedidos por el Banco Central del Ecuador con anterioridad al 1° de marzo de 1985, que impliquen modificación de valor, cantidad o calidad, deberá exigirse el pago de la comisión de inspección sobre el valor FOB de las mercaderías no embarcadas a la fecha de la ampliación, debiendo dichas mercaderías sujetarse a la inspección correspondiente.

Sección III. De los importadores

Artículo 1. Los importadores deberán adjuntar a las solicitudes de importación, ampliaciones y autorizaciones de embarque, el formulario de depósito de la comisión de inspección, así como el valor correspondiente. Este pago se consignará de manera independiente a los otros pagos que, para la obtención de los permisos de importación, deben efectuar los importadores.

Artículo 2. En el caso de las importaciones destinadas a Depósitos Comerciales, el importador, previo al embarque de la mercadería, entregará a las Oficinas de Cambios Internacionales, tres copias de la autorización previa conferida por los mencionados Depósitos, e igual número de notas de pedido y efectuará el pago de la comisión de inspección.

Artículo 3. En todos los casos las importaciones estarán sujetas al requisito de inspección previa, particular que deberá ser comunicado por los importadores a sus proveedores, a fin de que presten las facilidades necesarias a la Société Générale de Surveillance S.A., notificando, por lo menos con siete días hábiles de anticipación, la fecha propuesta para la inspección y presentando las mercaderías en condiciones de ser inspeccionadas. Se exceptúan de esta disposición aquellos casos mencionados en el inciso tercero, del Artículo [illegible], de la Sección II del presente Capítulo.

Sección IV. De los bancos y compañías financieras

Artículo 1. Para el pago de las Cartas de Crédito por importaciones, los bancos y las compañías financieras exigirán la presentación de una copia del permiso de importación concedido por el Banco Central del Ecuador y una copia del Aviso de Conformidad emitido por la Société Générale de Surveillance S.A. Esta condición deberá constar en los mencionados documentos.

En el caso de importaciones destinadas a Depósitos Comerciales, la Autorización Previa que emitan dichos Depósitos sustituirá a la copia del permiso de importación concedido por el Banco Central del Ecuador.

El valor de los documentos definitivos para el pago de la Carta de Crédito será aquel que conste en el Aviso de Conformidad. Sin embargo, la Gerencia General del Banco Central del Ecuador o la Junta Monetaria, según el caso, en uso de las facultades que les confieren los Artículos 17 de la Ley sobre Cambios Internacionales y 49 de su Reglamento, podrán expedir las Resoluciones que consideren convenientes, a fin de autorizar pagos por valores distintos a los establecidos por la Société Générale de Surveillance S.A.

Artículo 2. A la solicitud de reembolso o visto bueno, para el pago al exterior del valor a plazo de las mercaderías, deberá adjuntarse en todos los casos una copia del Aviso de Conformidad, emitido por la Société Générale de Surveillance S.A. o de la Resolución de la Gerencia General o de la Junta Monetaria, según el caso".

III. Sustitúyanse los Artículos 1, 2 y 3 de la Sección I, Capítulo I, Título Tercero (Exportaciones), Libro II (Política Cambiaria) (Página 94.0) por los siguientes:

"Artículo 1. El permiso de exportación provisional tendrá un plazo de validez de 10 días; excepto para los permisos provisionales globales de exportación, a que se refiere el Artículo 1°, Capítulo VIII de este Título.

Para la tramitación del permiso provisional, será requisito indispensable la presentación de la factura comercial pormenorizada, en la que deberá constar en forma clara la cantidad, calidad y valor unitario de los productos a ex-

Cuando el permiso no hubiere sido utilizado, será devuelto de inmediato al Banco Central del Ecuador, dentro del plazo máximo de cinco días hábiles desde la fecha de su caducidad, o se deberá presentar una certificación de que no se realizó la exportación, cuando las Aduanas de la República se nieguen a restituirlo al exportador.

Cuando hubiere sido utilizado, los exportadores deberán presentar en el Banco Central del Ecuador los respectivos documentos para la tramitación del permiso definitivo, dentro del plazo máximo de veinte días, contados a partir de la fecha de embarque o despacho de las mercaderías por cualquier medio de transporte.

Artículo 2. Los arreglos con el Banco Central del Ecuador para la negociación de las divisas provenientes de la exportación, deberán efectuarse como requisito previo a la obtención del permiso provisional.

Artículo 3. Cuando existiere demora en la entrega de documentos para la obtención del permiso definitivo, el exportador será sancionado con una multa del 0,50 por mil sobre el valor FOB del permiso definitivo, por cada día de retraso, contado a partir del vigésimo primer día desde la fecha de embarque o despacho de la mercadería por cualquier medio de transporte.

Para el cálculo de la multa se tomará en cuenta la cotización de venta del mercado libre de intervención, que rija a la fecha del pago en el Banco Central del Ecuador".

IV Sustitúyase el literal a), Artículo 1, Capítulo II (Compensación y Trueque), Título Tercero (Exportaciones), Libro II (Política Cambiaria) (Página 95.0) por el siguiente:

"a) La operación deberá iniciarse con la exportación de productos ecuatorianos; en consecuencia, las licencias de importación que constituyan la respectiva compensación y/o trueque, se las podrá expedir dentro de un plazo no mayor de 1[illegible]0 días contados a partir de la fecha de otorgamiento del permiso provisional de exportación".

V. Sustitúyase el literal d), Artículo 3, Capítulo II (Compensación y Trueque), Título Tercero (Exportaciones), Libro II (Política Cambiaria) (Página 95.1) por el siguiente:

"d) El exportador deberá presentar al Banco Central del Ecuador una garantía de bancos o de compañías financieras, en divisas, por el valor FOB total de la exportación, la misma que se hará efectiva en caso de no efectuarse la importación en el plazo señalado en el respectivo contrato de trueque, o si el Banco Central del Ecuador estableciere diferencias en los valores reales de la importación o exportación; en este caso, el débito se efectuará por el valor de la diferencia".

VI. Sustitúyase el Artículo 1, Capítulo VI (Comprobación de Precios), Título Tercero (Exportaciones), Libro II (Política Cambiaria) (Página 103.0), por el siguiente:

"Artículo 1. La comprobación de la entrega de divisas provenientes de las exportaciones, se efectuará en base a los valores establecidos en los Avisos de Conformidad emitidos por la Société Générale de Surveillance S.A."

VII. Sustitúyase el primer inciso del Artículo 3, Capítulo VI (Comprobación de Precios), Título Tercero (Exportaciones), Libro II (Política Cambiaria) (Página 104.0), por los siguientes:

"Artículo 3. Los exportadores están obligados a entregar al Banco Central del Ecuador las divisas correspondientes al valor real de las exportaciones. Para seguridad de dicha entrega, el Instituto Emisor exigirá una garantía de bancos o de compañías financieras, en divisas, por el equivalente del valor FOB de la exportación. El Banco Central del Ecuador podrá hacer efectiva la garantía en cualquier tiempo, a partir de la fecha en que el exportador debió entregar las divisas, si éste no hubiere cumplido con su obligación.

En caso de que las instituciones garantes, a la fecha en que el Banco Central del Ecuador debite los valores de las garantías, no dispusieren de fondos suficientes en sus cuentas divisas, el Instituto Emisor debitará los valores correspondientes en las cuentas sucres de dichas instituciones, aplicando para el efecto la cotización de venta de mercado libre, que no sea del Banco Central del Ecuador, vigente a la fecha del débito."

BANCO CENTRAL DEL ECUADOR [illegible]
JUNTA MONETARIA

Best Available Document

ANNEX F
Attachment 2

VIII. Elimínese el Artículo 4 de los propios Capítulo, Título y Libro. (Página 105.0)

IX. Al Título Tercero (Exportaciones) Libro II (Política Cambiaria) (Página 107.0), añádase el siguiente Capítulo:

"CAPITULO IX. INSPECCIONES DE EXPORTACION

Sección I. Inspecciones

Artículo 1. La Société Générale de Surveillance S.A. efectuará las inspecciones de exportación a que se encuentra obligada según lo establecido en el Contrato de Prestación de Servicios, suscrito con el Banco Central del Ecuador, el 31 de octubre de 1984.

Las inspecciones se efectuarán de manera previa al embarque de las mercaderías en base a los permisos de exportación concedidos por el Banco Central del Ecuador; y, en los puertos o aeropuerto de desembarque en el exterior cuando dicho Banco lo estime conveniente.

Artículo 2. La Société Générale de Surveillance S.A. enviará diariamente un delegado a las Oficinas de Cambios Internacionales, a fin de que retire las órdenes de inspección.

Sección II. Del Banco Central del Ecuador

Artículo 1. Las Oficinas de Cambios Internacionales del Banco Central del Ecuador procederán a sellar los permisos de exportación provisionales, con la siguiente leyenda: "Exportación sujeta a inspección de calidad, cantidad y precios por parte de la Société Générale de Surveillance S.A.".

Se exceptúan de esta disposición las exportaciones de petróleo y sus derivados (combustibles), objetos de arte, animales vivos, armas, periódicos, revistas, efectos personales y de menaje y paquetes postales.

Artículo 2. En los permisos de exportación no se admitirá la declaración de más de un puerto o aeropuerto de embarque y de un puerto o aeropuerto de desembarque. Sin embargo, [illegible] embarque, debiera [illegible] final de la mercadería, el [illegible] la respectiva [illegible] por lo menos [illegible] días antes de la [illegible] lugar de destino. [illegible] podrá [illegible].

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Artículo 3. La copia "Banco Central del Ecuador - Efecto Negociación de Divisas" de los permisos provisionales de exportación y una copia de la factura comercial correspondiente serán entregadas diariamente a la persona designada por la Société Générale de Surveillance S.A.

Artículo 4. Las Oficinas de Cambios Internacionales del Banco Central del Ecuador exigirán el pago de la comisión de inspección, según lo dispuesto en el literal r), Artículo 1, Sección II, Capítulo [illegible], Título Octavo del Libro I de esta Codificación.

Artículo 5. Si en los permisos de exportación definitivos se establecieren excesos respecto de los valores declarados en los permisos de exportación provisionales, las Oficinas de Cambios Internacionales procederán al cobro de la diferencia de la comisión de inspección, por el valor del exceso registrado.

Artículo 6. El Banco Central del Ecuador solamente devolverá al interesado el valor pagado por la comisión, cuando fueren anulados los permisos de exportación y la Société Générale de Surveillance S.A. no hubiere efectuado la inspección correspondiente.

Artículo 7. El Banco Central del Ecuador exigirá la venta de divisas por exportaciones efectuadas, en base a los valores establecidos en los Avisos de Conformidad que emita la Société Générale de Surveillance S.A., o por los valores que constaren en las Resoluciones expedidas por la Gerencia General o por la Junta Monetaria, en caso de apelaciones.

Artículo 8. Cuando la Société Générale de Surveillance S.A. emitiere Avisos de No Conformidad como consecuencia de las divergencias que puedan establecerse en las inspecciones, las Oficinas de Cambios Internacionales notificarán inmediatamente al exportador a efectos de la apelación a que tiene derecho de conformidad con los Artículos 1? de la Ley sobre Cambios Internacionales y [illegible] del Reglamento a dicha Ley.

Sección III. De los exportadores

Artículo 1. Los exportadores [illegible] adjuntar a las solicitudes de exporte[illegible] formulario de [illegible] de la comisión [illegible] con el [illegible] correspondiente.

Este pago se consignará de manera independiente a los otros pagos que, para la obtención de los permisos de exportación, deben efectuar los exportadores.

Artículo 2. En todos los casos las exportaciones estarán sujetas al requisito de inspección previa, excepto en aquellos mencionados en el Artículo 1, Sección II de este Capítulo. Para el cumplimiento de esta disposición, los exportadores están obligados a prestar las facilidades del caso a la Société Générale de Surveillance S.A.

Artículo 3. El Exportador deberá comunicar a la Société Générale de Surveillance S.A., por lo menos tres días hábiles antes del embarque de las mercaderías, a efectos de programar la inspección correspondiente.

Artículo 4. Cuando el Banco Central del Ecuador solicitare la inspección de las exportaciones en el puerto o aeropuerto de desembarque, el exportador notificará al comprador sobre el particular, a fin de que facilite a la Société Générale de Surveillance S.A. la mencionada inspección, presentado las mercaderías en condiciones de ser inspeccionadas.

Sección IV. De los bancos y compañías financieras

Artículo 1. Para la aceptación de Cartas de Crédito por exportaciones, los bancos y compañías financieras exigirán la presentación de una copia del permiso de exportación concedido por el Banco Central del Ecuador y una copia del Aviso de Conformidad emitido por la Société Générale de Surveillance S.A. Esta condición deberá constar en los mencionados documentos.

El valor de los documentos definitivos para el pago de la Carta de Crédito será aquel que conste en el Aviso de Conformidad. Sin embargo, la Gerencia General del Banco Central del Ecuador o la Junta Monetaria, según el caso, en uso de las facultades que les confieren los Artículos [illegible] de la Ley sobre Cambios Internacionales y 49 de su Reglamento, podrán expedir las Resoluciones que consideren convenientes, para autorizar liquidaciones de divisas por valores distintos a los establecidos por la Société Générale de Surveillance S.A."

X. Sustitúyase el Artículo 1°, Capítulo VIII, Título Tercero del Libro II, (Página 107.0) por el siguiente:

"Artículo 1. Facúltase al Banco Central del Ecuador conceder permisos provisionales globales de exportación, válidos por 90 días, con cargo a los cuales podrán realizar exportaciones parciales de los productos perecibles, en estado natural, determinados por el Ministrio de Industrias, Comercio e Integración.

Para el embarque de las mercaderías será requisito indispensable la inspección previa por parte de la Société Générale de Surveillance S.A."

Artículo Segundo.- La presente Regulación entrará en vigencia a partir del 1° de marzo de 1985, sin perjuicio de su publicación en el Registro Oficial.

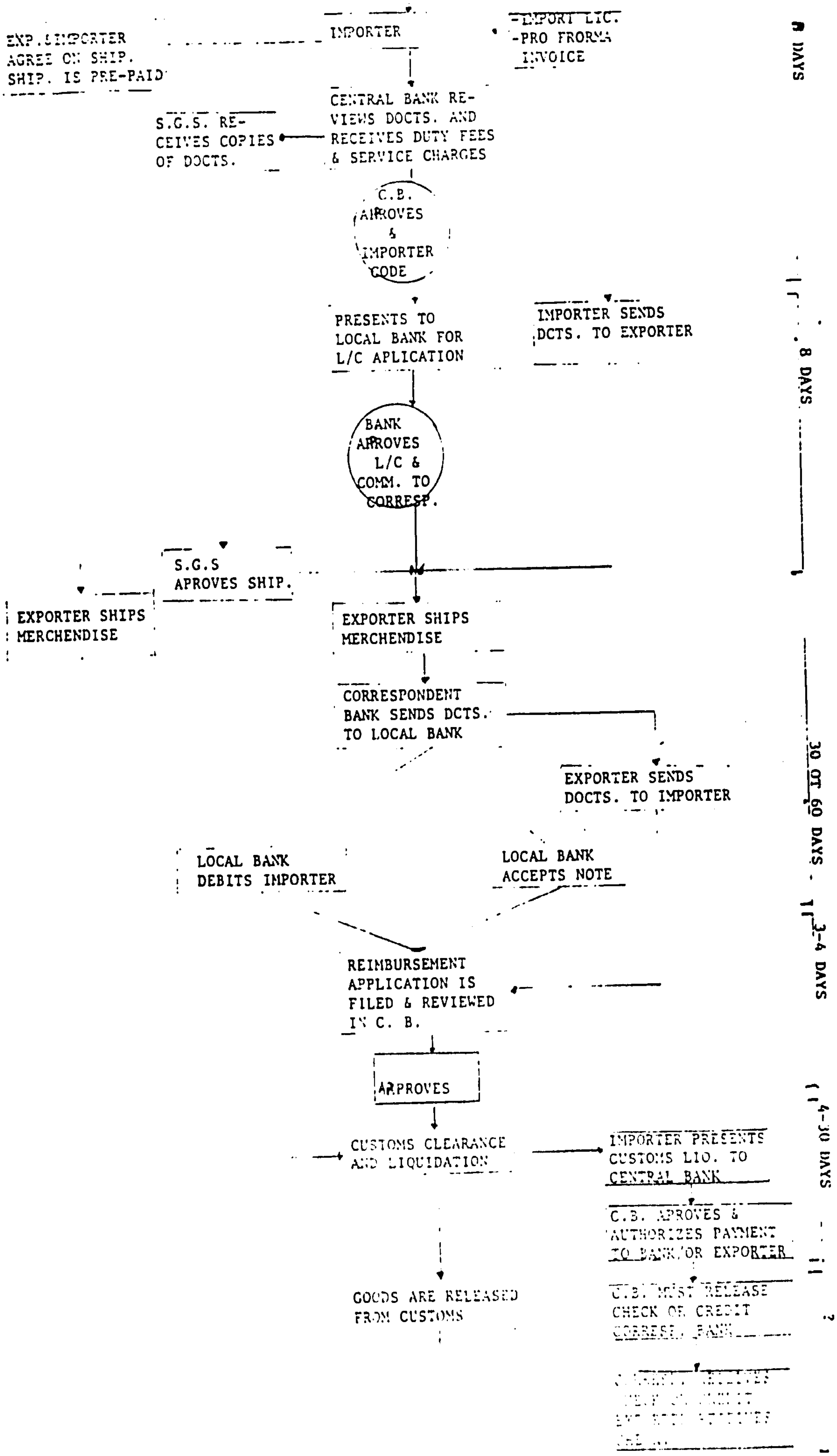
DAD, en Quito a 26 de febrero de 1985

EL PRESIDENTE,

f) Dr. Raúl Clemente Huerta

EL SECRETARIO,

f) Dr. Galo Recalde Fdez. E.



EXP.&IMPORTER AGREE ON SHIP. SHIP. IS PRE-PAID
IMPORTER
-IMPORT LIC. -PRO FROMA INVOICE
CENTRAL BANK RE-VIEWS DOCTS. AND RECEIVES DUTY FEES & SERVICE CHARGES
S.G.S. RE-CEIVES COPIES OF DOCTS.
C.B. APROVES & IMPORTER CODE
PRESENTS TO LOCAL BANK FOR L/C APLICATION
IMPORTER SENDS DCTS. TO EXPORTER
BANK APROVES L/C & COMM. TO CORRESP.
S.G.S APROVES SHIP.
EXPORTER SHIPS MERCHENDISE
EXPORTER SHIPS MERCHENDISE
CORRESPONDENT BANK SENDS DCTS. TO LOCAL BANK
EXPORTER SENDS DOCTS. TO IMPORTER
LOCAL BANK DEBITS IMPORTER
LOCAL BANK ACCEPTS NOTE
REIMBURSEMENT APPLICATION IS FILED & REVIEWED IN C. B.
APROVES
CUSTOMS CLEARANCE AND LIQUIDATION
IMPORTER PRESENTS CUSTOMS LIQ. TO CENTRAL BANK
C.B. APROVES & AUTHORIZES PAYMENT TO BANK/OR EXPORTER
C.B. MUST RELEASE CHECK OR CREDIT CORRESP. BANK
GOODS ARE RELEASED FROM CUSTOMS
DAYS
8 DAYS
30 OT 60 DAYS
3-4 DAYS
4-30 DAYS

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