

Report No. 21825

Ecuador Country Assistance Evaluation

January 25, 2001

Operations Evaluation Department



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Abbreviations and Acronyms

CAE	Country Assistance Evaluation
CAS	Country Assistance Strategy
CASPR	CAS Progress Report
CONAM	State Modernization Council
CPPR	Country Portfolio Performance Review
DDSR	Debt and Debt Service Reduction
DEI	Development Effectiveness Indicators
EMETEL	Ecuadorian Telecommunications Company
ESAF	Extended Structural Adjustment Facility
ESW	Economic Sector Work
FIAS	Foreign Investment Advisory Service
FISE	Emergency Social Investment Fund
FPSI	Finance, Private Sector and Infrastructure Network
GDP	Gross Domestic Product
GOE	Government of Ecuador
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion Report
IDA	International Development Association
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IMF	International Monetary Fund
INECEL	Ecuadorian Electrification Institute
MDBs	Multilateral Development Banks
MIGA	Multilateral Investment Guarantee Agency
MOSTA	Modernization of the State Technical Assistance Loan
NGOs/POs	Non-Governmental Organizations, Private Organizations
OED	Operations Evaluation Department
PAR	Performance Audit Report
PERTAL	Public Enterprise Reform Technical Assistance Loan
PFPs	Policy Framework Papers
PMEAC	Public Manufacturing Enterprise Adjustment Credit
SAL	Structural Adjustment Loan
UNDP	United Nations Development Program
USAID	United States Agency for International Development

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MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

Ecuador: Country Assistance Evaluation

The discovery of large oil and natural gas deposits in the 1960s transformed Ecuador's economy, bringing rapid growth, new social benefits and entitlements. Once oil prices collapsed in the early 1980s, Ecuador sank into a profound macroeconomic and structural crisis which has strained its society. In the 1990s, the economic situation worsened further. Real international oil prices declined to levels not seen since the 1930s, while natural disasters including El Nino-related floods, an earthquake, and a drought inflicted widespread devastation. During 1998, real growth ground virtually to a halt, inflation exceeded 50 percent, the fiscal and current account deficits widened, the banking system came under severe strain, and Ecuador's external debt burden remained one of the heaviest in Latin America. A draft of this evaluation was distributed to CODE in June 1999. This report is now being re-issued for the purpose of public disclosure.

The reduction of poverty remains Ecuador's main development challenge. Meeting it will require faster, labor-intensive output growth, inclusion of the poor (especially women) in the development process and more effective targeting of social services.

Given that the bulk of the Bank's lending is recent, the CAE focuses on the experience of the 1990s relative to strategic objectives embedded in the 1993 CAS. Although the objectives were highly relevant to Ecuador's key development requirements, the CAS underestimated the risks associated with society's weak commitment to reform.

During the CAS implementation period (FY94-98), the Bank moved too strongly and too quickly into a high lending scenario, notwithstanding the abortive reform experience of the 1980s. The CAS triggers relied excessively on measures which could easily be watered down or reversed. Of the main CAS objectives, only one—renegotiating Ecuador's external debt—was substantially achieved. Progress on the other three—poverty alleviation, public sector reform, and private sector-led development—was meager. Thus, the efficacy of the strategy fell short of satisfactory standards.

With respect to efficiency, standard benchmarks place the Ecuador program within Bankwide averages. Staff time invested per unit of new lending was about twice the LCR average. But, when compared to other Bank programs in small, low-income countries, where economies of scale were less likely to be achieved, unit lending costs were in line with the Region and Bank averages. Processing times to completion were also average.

OED has rated 45 completed projects in Ecuador, roughly half in the agricultural and financial sectors. Ratings on outcomes and institutional development impact were average. But comparatively few projects (42 percent) had sustainable benefits. Investment projects did far better than adjustment operations, only half of which had satisfactory outcomes.

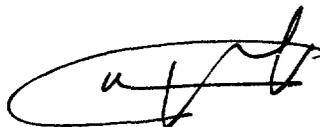
With respect to ongoing projects, QAG found that, after several years of sharp decline, performance improved dramatically during the second half of 1998. The main factors behind this improvement are believed to be early actions by the new administration to cancel troublesome operations, GOE success in diversifying its sources of counterpart funding, and increased *pari passu* disbursements from international donors.

Overall, OED rates the outcome for the Bank assistance program over the last CAS period (FY94-98) as **unsatisfactory**, sustainability as **unlikely**, and institutional development impact as **modest**. External shocks clearly played a major role in blunting the effectiveness of Bank assistance. But, so did a lack of commitment at different levels of Ecuador's society, and the Bank's willingness to lend, even when the necessary conditions for sustainability were not present.

The newly-elected Mahuad Administration has negotiated a landmark peace agreement, ending 55 years of border conflict, opening new vistas of increased trade and economic integration with Peru, and helping reduce military expenditures. The Administration now faces simultaneous crises, including alleviation of widespread poverty, reconstruction of the Coastal Region severely damaged by *El Nino*, stabilizing the currency and the economy, shoring up the banking system, restoring confidence in public institutions, and reigniting economic growth. Initial policy measures have included devaluation, sharp increases in petroleum taxes, reductions in consumer subsidies, an increase in the minimum wage, higher transfers for the poor and aged, a new legal framework for the banking system, and a financial transaction tax to replace suspended personal and income taxes. Negotiations with the IMF and the MDBs for substantially-increased technical and financial assistance are underway.

The Bank's new assistance strategy will need to provide effective help to Ecuador in dealing with these crises. The experience of the past 16 years suggests the need for a new approach. A revised strategy might incorporate: continued restructuring of the existing portfolio; timely and high-quality non-lending services designed to build wider societal support for reform; diminished reliance on quick-disbursing assistance to solve long-term institutional and policy problems; small-scale, flexible lending targeted at grass-roots poverty and gender-oriented initiatives; Adaptable Program Lending Loans (APLs) for poverty-oriented and sectoral reforms where strong borrower commitment has been demonstrated; strengthened coordination with the IDB and the CAF; and reduced turnover among Bank managers and staff to enhance project continuity.

This CAE was shared with the Government. Its findings and recommendations were discussed with the Minister of Finance during the May 1999 Spring Meetings. On June 2, OED received a letter from the Minister of Finance (see Appendix), which agreed generally with the findings of the CAE, and did not object significantly to its recommendations.

A handwritten signature in black ink, consisting of a large, stylized initial 'A' followed by several loops and a final vertical stroke.

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This report was prepared by John H. Johnson, Task Manager. Betty Casely-Hayford provided administrative support.

1. The Setting: An Economy Transformed by Petroleum

1.1 The discovery of large oil and natural gas deposits in the 1960s transformed Ecuador's economy. Initially, the boom brought rapid growth, new social programs, and added entitlements. But oil prices collapsed in the early 1980s, triggering an economic crisis. Since then, Ecuador's struggle to restore macroeconomic equilibrium and reform its institutions has strained its social and political structures. Growth has been low by the standards of Latin American comparators, while the burden of its external indebtedness and the incidence of poverty have been high (Table 1.1).

Table 1.1 Ecuador- Socioeconomic Indicators and Comparators¹

SERIES NAME	ECUADOR			COLOMBIA			PARAGUAY			PERU			Latin America & Caribbean		
	1	2	3	1	2	3	1	2	3	1	2	3	1	2	3
Economic Indicators															
GNP per capita growth (%/yr)	0.8	0.6	0.8	1.2	3.7	2.1	-1.4	-0.5	0.3	-0.4	3.0	2.4	-0.5	2.3	1.2
General govt. consumption (% of GDP)	8.5	8.1	13.0	9.3	9.9	9.9	6.5	8.3	9.5	8.2	6.8	8.2	10.9	11.4	11.9
GDP deflator, (%/yr)	56.0	39.4	30.7	26.5	24.1	20.8	30.8	18.3	14.2	31.4	43.0	21.7	n.a	n.a	n.a
Current revenue, ex. Grants (% of GDP)	16.6	15.9	n.a	13.1	14.8	n.a	11.8	14.2	n.a	9.2	13.4	15.7	17.7	19.5	n.a
Expenditure, total (% of GDP)	14.3	11.7	16.9	12.5	15.1	17.9	10.1	13.3	n.a	13.7	15.8	16.8	22.2	23.0	n.a
Financing from abroad (% of GDP)	-1.8	1.7	1.6	0.8	-1.1	0.7	-0.3	-0.3	n.a	2.9	2.5	1.4	0.4	-0.4	n.a
Total debt service (% of GNP)	10.8	7.1	8.0	10.0	7.9	6.1	4.5	5.8	2.9	2.5	3.9	3.6	4.6	4.3	5.6
Social Indicators															
National headcount index (% of pop.)	n.a	n.a	35.0	n.a	n.a	17.7	n.a	n.a	21.8	n.a	n.a	54.0	n.a	n.a	n.a
GNP per capita (U\$000s)	610	1460	1500	570	1190	2140	600	1140	1850	1090	950	2420	n.a	3710	n.a
Health (% of GDP)	n.a	n.a	2.0	n.a	n.a	3.0	n.a	n.a	1.0	n.a	n.a	2.6	n.a	3.0	n.a
Education (% of GNP)	n.a	3.7	3.0	n.a	2.9	3.7	n.a	1.5	2.9	n.a	2.9	n.a	n.a	3.9	n.a
Life expectancy	59	61	70	62	68	70	66	66	71	56	57	68	n.a	70	n.a

n.a - Not available
Source: WDI, Unified Survey.

1.2 Poverty affects more than half the population, and its reduction is the main development challenge for Ecuador (Table 1.2). Close to four million Ecuadorians, about 35 percent of the population, live in poverty, while another two million, or seventeen percent of the population, are vulnerable to poverty. One-and-one-half million of the poor could not meet their nutritional requirements, even if they spent all their income on food. Women and the indigenous population, with limited access to formal labor, land, credit, and technology markets, are particularly vulnerable.

¹ 1=1989-91; 2=1992-94; 3=1995-97; 4=1970-75; 5=1980-85; 6=1990-95.

Table 1.2: Characteristics of Poverty

	<i>Urban</i>		<i>Rural</i>	
	<i>Poor</i>	<i>Non-Poor</i>	<i>Poor</i>	<i>Non-Poor</i>
Education of household head, years	5.2	9.1	3.2	4.7
Diseases treated informally (%)	24.8	14.8	32.7	24.1
Basic Services Access (%)				
Electricity	97.8	99.5	62.0	75.8
Sewerage connection	57.3	83.4	12.4	28.2
Water from public net	61.2	78.8	18.3	23.0
Waste collection	59.7	76.7	1.1	5.6

Source: World Bank, *Poverty Report on Ecuador*, 1995.

1.3 Alleviating poverty will require faster, labor-intensive output growth, with emphasis on employment opportunities for poor women, improved targeting of social services,² and improved infrastructure in low-income areas. Faster growth will require improvements in the investment climate through privatization, deregulation, and transparent rules for competition.

1.4 Corruption has also hampered the climate for growth, distorting incentives, depriving the Government of badly-needed revenues, and undermining public security. Among 85 countries surveyed by Transparency International, Ecuador is currently ranked fifteenth for corruption.

1.5 Finally, the sustainability of growth has been endangered by the degradation of natural resources and increased pollution. Hydrocarbons are the single largest source of pollution. Exploration and production have resulted in large-scale destruction of the Amazon forest. Spills and effluent treatment have caused serious pollution around drilling sites and refineries. And access roads to open exploration sites have attracted large-scale colonization, damaging the natural habitat and the social fabric of indigenous communities. Elsewhere, the rich lands and waters surrounding the Guayaquil Gulf have been damaged by pollutants and toxins from agroindustrial, mining and industrial effluents, and from improper solid waste disposal. As poverty has worsened, the poor have increased their reliance on wood for cooking, accelerating deforestation, and on unregulated mining for a livelihood, with detrimental effects on water and land resources.

² Ninety percent of the poor have little or no access to basic health services. Malnutrition affects 45 percent of children under five, while water and sanitation services are virtually unknown in poor rural and urban areas. Schooling, averaging seven years, is two years below the average schooling in comparable low-income countries. In rural areas, the average schooling is barely three years, exacerbated by high repetition and drop-out rates and a poor quality of education. Public and private spending on health care (about US\$70 per capita, or 5 percent of GDP) is the lowest in Latin America, and benefits primarily middle and upper-income groups.

2. The Bank's Response: CAS 1993 And 1997 CASPR

2.1 The Bank's portfolio in Ecuador is young. In 1988, there were only 5 loans, while today there are more than three times that number. Therefore, the CAE focuses on what happened during the 1990s.

Relevance

2.2 The 1993 CAS objectives (Box 2.1) were well-attuned to Ecuador's key development requirements, and supported by a rich menu of ESW reports. The only significant omissions were a lack of gender perspective and the Bank's indirect approach on governance. The first study on gender issues was not started until mid-1998, although two loans approved during this period (the Rural Development and Health and Nutrition Loans) contained small gender components. Corruption was not part of the Bank's formal CAS agenda, but was indirectly addressed by operations encouraging greater transparency of economic incentives (the SAL and the DDSR Loans) and reform of public sector management (the Public Enterprise and Modernization of the State Technical Assistance Loans). Although environmental issues were underplayed in the CAS, in practice, all projects were subject to environmental review during this period, and nine of them incorporated significant environmental components.

2.3 But the 1993 CAS devoted inadequate attention to how the Bank should adapt its strategy to the risks of a lack of societal commitment to reform and of inability on the part of the Government to deliver on reform. For example, in the early 1980s, the Bank had lent heavily to support the stabilization and reform program of the Febres-Cordero Administration. From a promising beginning, this program was sidetracked in less than three years, largely by opposition from the Legislature, the bureaucracy, and the general public. Much the same situation confronted the Bank in 1993: a modernizing, well-educated core of Executive Branch policymakers faced widespread indifference, and in some cases hostility, to reform. While the CAS warned that opposition from Congress and interest groups could derail the Duran-Ballen program, the Bank decided to support heavily the President and his economic team. Duran-Ballen lost the political battle, and reforms were once again derailed.

2.4 Given the historical antecedents, such heavy reliance on the core Executive Branch economic team to carry forward the banner of reform may have been unduly risky. Other measures to hedge this risk were needed, such as a more participatory approach in elaborating and implementing the CAS. To be fair, the concept of participatory strategic planning did not exist within the Bank at the time the CAS was being prepared. In any event, this omission meant that, from the outset, the CAS objectives were only moderately relevant to the way Ecuador actually operated.

Efficacy

2.5 The Bank assistance efforts during the CAS implementation period (FY94-98) fell short of their stated goals. Positive results were achieved in certain areas, such as the Bank's advice to the Constituent Assembly leading to the adoption of an independent Central Bank; the Bank's advocacy for better targeting of subsidies, which recently culminated in GOE approval in September 1998 of an improved system; the Bank's assistance in building an improved public sector financial management system; and rationalization of the regulatory framework for the energy and telecommunications sectors. But, given the magnitude of Bank lending and non-lending services, the development benefits have been disappointing. Only two of the five triggers identified as prerequisites for a high-case Bank lending scenario—liberalization of domestic petroleum prices and re-negotiation of the external debt—were met.

The other critical reforms—sustained macroeconomic stabilization, privatization, and public sector modernization—were not completed, and, between 1995 and 1998, were largely reversed.

Box 2.1: 1993 CAS Objectives and Bank Assistance

CAS preparation received solid underpinning from high-quality economic and sector studies and policy notes prepared during the preceding four years. The main objectives of the assistance strategy were four-fold: (a) to improve basic services targeted to the poor; (b) to promote reform of the public sector; (c) to strengthen the basis for private sector-led growth; and (d) to assist in the resolution of Ecuador's external debt difficulties.

Social services for the poor—basic education, primary health care, and nutrition—were to be complemented by increased investment in water and sanitation, rural transport, and other infrastructure requirements of the rural poor. Small farmers were to be switched from reliance on public banks slated for restructuring to specialized commercial lines of credit. An emergency social fund was created to meet the short-term investment needs of the poor, who were to be identified through poverty assessment, transport, and water studies. The CAS emphasized that a stable macroeconomic framework; a reduced, more focused role for the public sector; and job-creating, private-sector growth were the best vehicles for alleviating poverty. Hence, adjustment operations were to be scrutinized for their impact on lower-income groups.

The triggers for “high scenario” lending were four-fold: (a) GOE approval of a budgetary reform law; (b) strong progress toward stabilization during 1993-94; (c) acceptance of Bank proposals for improving draft legislation on public sector modernization; and (d) preparation of two large state enterprises for privatization. If progress was satisfactory in all these areas, the Bank planned three operations yearly, totaling as much as US\$800 million over the five-year (1993-97) planning period. SALs and SECALs for privatization, public sector reform, and debt reduction were to be reinforced with technical assistance loans for budgetary reforms and capacity-building. Investment operations in agriculture, housing, and social services were also to have a poverty focus. If progress was unsatisfactory, the “low scenario” called for reduced lending of around US\$350 million, with postponement of all adjustment operations. In this eventuality, roughly two investment operations yearly were to focus on poverty-oriented social services and infrastructure in agriculture, roads, irrigation and flood control, and mining.

Source: 1993 CAS.

2.6 The origins for these policy failures were both **external** and **internal**. On the external side, the devastation of natural disasters, including *El Nino*-related floods, an earthquake, and a drought, was compounded by the terms of trade shock stemming from a sharp decline in international oil prices. Together, the losses from these external shocks were equivalent to about 15 percent of 1998 GDP, and made it difficult for officials to maintain their focus on the process of structural reforms. Ecuador also experienced a costly border conflict in 1995. Internal factors included the departure of the Vice President of the Republic (who had been in charge of economic policy) by order of the Congress, the early removal of the Bucaram Government in 1997, and the installation of a caretaker Interim Government in 1997. The corrosive effects of corruption and chronic institutional fragility have posed additional obstacles.

2.7 The record of progress toward the CAS's main objectives was meager:

- (a) **Poverty alleviation.** Since 1993, unemployment has risen, and real per capita incomes have barely improved. In absolute terms, the poor lost ground during 1989-95, and probably

also during 1996-98, although data are sketchy for this latter period.³ Targeted loans represented a small proportion (roughly one-tenth) of Bank lending during the period, and the Borrower was neither able nor willing to invest the political and institutional resources to build a meaningful social safety net. Indeed, the quality of basic services available to the poor deteriorated during this period.

(b) **Public sector reform.** The promised restructuring of public agencies, improvements in tax expenditure, tightening of expenditure controls, and rationalization of public investment planning largely failed to take place. The civil service remains overmanned, no large public enterprise has been privatized, the delivery of social services has deteriorated, and the structural fiscal deficit has worsened.

(c) **Private Sector-Led Development.** A modern legal framework for the development of capital markets and new kinds of financial institutions was passed, but remains largely on paper. Three state-owned banks were restructured, and restrictions on private mining eased. However, formal labor markets remain highly regulated, and private investors remain uninterested in increasing their commitment, so long as the macroeconomic and political climates remain uncertain. Real private investment has grown by less than 2 percent annually and the stock of foreign private investment, at around 4 percent of GDP, remains at about half the norm for all of Latin America.

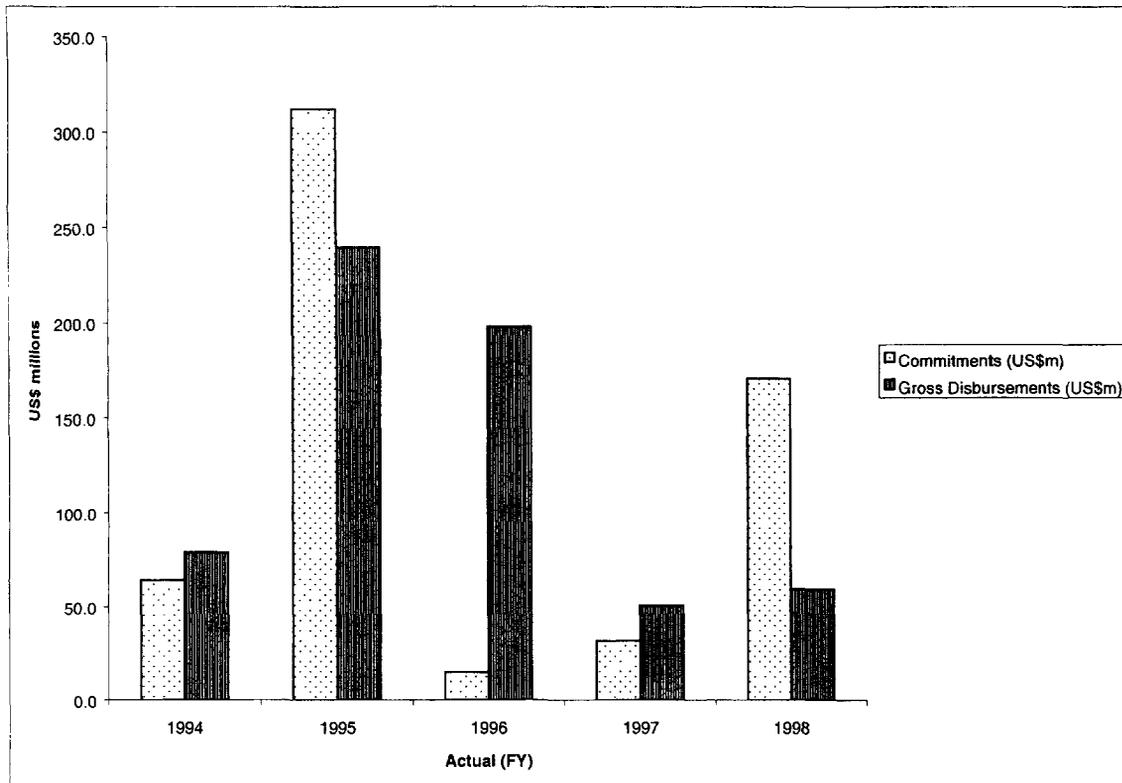
(d) **Debt-Service Reduction.** In 1995, the Bank assisted Ecuador to renegotiate softened terms on its external debt with the help of a SAL and a DDSR Loan. However, the benefits of this achievement have been undermined by the lack of macroeconomic and financial stability. Ecuador's public external debt, at 63 percent of GDP, remains among the highest in Latin America, and is currently trending upward.

2.8 The Bank committed too much lending too quickly to Ecuador -- US\$568 million of the US\$800 million contemplated under the high-case scenario. To hedge against the political risk, the Bank backloaded the disbursements of the SAL, whose US\$100 million second tranche was cancelled in October 1997 after three frustrating years of renegotiations. The Bank expected that built-in conditionality would act as a brake on lending in the event of poor policy performance, forgetting perhaps that the ensuing crises generated new pressures on the Bank to "buy time" and "fill critical financing gaps". Whatever the case, Bank lending slowed only briefly, maintaining overall a high rate of expansion. The Bank's exposure nearly tripled, from US\$300 million in 1993 to US\$850 million in FY98, despite negligible structural reform or stabilization. Commitments peaked at US\$312 million in FY95, before coming to a virtual halt during FY96-97, reflecting Bank dissatisfaction with the deteriorating economic policy environment and delays in implementing key structural reforms (Figure 2.1).⁴

³ See "How Should We Assess Poverty Using Data from Different Surveys", *Poverty Lines*, No. 3, World Bank, September 1966; and "Poverty in Latin America and the Caribbean: An Inventory, 1980-95", *INDES Working Paper Series 1-4*, Inter-American Development Bank, November 1997. Three Living Standards Measurement Surveys (LSMSs) have been conducted, in 1994, 1995, and 1997. Results of the 1997 LSMS are not yet available.

⁴ In its comments on this point, the Region noted: "In FY95, the Bank decided to provide substantial support to the Duran Ballen Government. From the time it took office in August 1992, this Government had taken significant structural reform initiatives and had persuaded Congress to approve progressive legislation. On the basis of this track record, Bank staff decided to provide support for accelerated structural reform through a coordinated package of operations, comprising an US\$80 million Debt and Debt Service Reduction Loan (DDSR), a US\$200 million Structural Adjustment Loan (SAL), a Public Enterprise Reform Technical Assistance Loan (PERTAL), and a Modernization of the State Technical Assistance (MOSTA) Loan. Aware of the high risks in Ecuador, Bank staff structured this package of operations, first, so that the technical assistance loans would help work through the singular complexities of Ecuador's reform process, and second -- in the particular case of the SAL -- so that

Figure 2.1: IBRD/IDA Lending in ECUADOR, Fiscal Years 1993-1998



Sources: Ecuador Country Assistance Strategy-Progress Report, March 6, 1997 and the Ecuador Country Team

2.9 What is most surprising is the pace of Bank lending during FY98, a period of deep constitutional and economic crisis in Ecuador. From November 1997 to June 1998, Management brought five loans to the Board, valued at US\$171 million, which was more than triple the amount the Region had told the Board it planned to lend in FY98 during discussions of the (March 1997) CAS Progress Report. The Region explained that it would have remained within the ceiling, were it not for the unexpected destruction caused by *El Niño*, which justified a US\$60 million emergency loan outside the approved program, and a one-month acceleration of the Board presentation of two other loans (International Trade and Integration and Health Modernization), so that they would be up-and-running in the shortest possible time.⁵ Two observations are pertinent here. First, Ecuador was virtually insolvent during 1997-98, and

the Bank would disburse only against achievement of specific program targets. During FY95, however, the Duran Ballen Government was losing effectiveness. The Bucaram Government, which lasted only from August 1996 through February 1997, was short-lived and widely perceived to be corrupt. The Interim Government that followed had a limited term and was generally perceived as of limited effectiveness. Neither of these two governments was able to advance a serious economic program, particularly in the face of the economic shocks that struck the country. For these reasons, the Bank slowed new commitments sharply in FY96 and FY97.”

⁵ In commenting on this point, the Region noted: “The assertion that lending ran at a ‘high pace’ in FY98 (noting that there was an emergency operation in that FY) needs to be qualified and placed in proper perspective. Presentation of new operations to the Board was “bunched” in FY98 because one loan - the Agricultural Census - was delayed from FY97 and two loans - the Health Modernization and Export Development - were prepared more rapidly than expected and brought forward. The Indigenous Peoples Loan went to the Board as scheduled, while a Rural Water project has been delayed to FY99. Four of the five operations brought to the Board during FY98 were specifically anticipated in the March 1997 CAS Progress Report. The fifth was the emergency lending operation for *El Niño*. The loans in question were not closely dependent for [their] implementation on the adoption of broad structural reform (or on election outcomes). If the *El Niño* Emergency Recovery Loan is excluded, the annual average lending volume in FY96-98 was only US\$53 million, which was in line with the low case scenario of the CAS Progress Report. FY98 flows, leaving aside the *El Niño* operation, show three years of substantially diminished activity. In addition, it is important to note that Bank management had decided to allow the Structural Adjustment Loan to close October 31, 1997 without

not creditworthy for new borrowing. Nonetheless, the Bank accelerated lending, knowing that the IDB and the CAF were doing the same. Secondly, in its review of the CASPR, the Board was of the general opinion that Ecuador's disappointing record on reform was sufficient, in and of itself, to curtail new lending until the Bank obtained a clearer reading of intentions from the newly-elected Administration in early FY99.

Box 2.2: The 1997 CAS Progress Report

In 1996, a new CAS was withdrawn before Board discussion, so that the Region could reformulate it in consultation with the incoming Bucaram Government. Preparation of the new CAS included a valuable participatory session with various representatives of the Civil Society. While the new CAS was in preparation, however, the Bucaram Government was deposed. Under the circumstances, the Bank concluded that the only alternative was to present a CAS progress report (CASPR) to the Board in March 1997, since the Interim Government was not then in a position to conclude a new CAS.

The CASPR acknowledged that Ecuador's commitment to reform had begun to wane from 1996 onward, exacerbated by institutional shortcomings, public opposition, drought, and a border conflict. In light of this impasse, the CASPR proposed refocusing the Bank's assistance strategy during FY98-99 on: (a) implementation of ongoing projects, including the SAL, the Public Enterprise Reform Technical Assistance Loan (PERTAL), and the Social Development Loans I and II; (b) limited amounts of new lending — about US\$50 million in FY98 — for two to three projects promoting poverty objectives, such as land titling and basic services for indigenous peoples, and rural and small cities water development; and (c) non-lending services focussed on dissemination and discussion of reform options with NGOs, labor unions, private businessmen, and the Government.

Source: 1993 CAS

2.10 One explanation for the rapid transition in 1994 to a high-case scenario may reside in how the triggers were defined. The measures sought — GOE approval of a budgetary reform law, strong progress on stabilization during 1993-94, incorporation of Bank proposals into draft legislation on public sector modernization, and preparation of two large state enterprises for privatization — were easily blocked and/or reversed. For example, a budgetary law was approved in 1993, but included no hard spending constraints and suffered from other flaws that rendered it ineffective.

2.11 Another problem may have been a lending culture affecting all three major donors—the IDB, the CAF, and the Bank. Currently, these three donors account for more than 60 ongoing operations in Ecuador, valued at over US\$3.4 billion. In comparative terms, the Bank's Ecuador portfolio is the smallest -- around 85 percent of CAF's and half of the IDB's. This rising tide of new lending may have sent a misleading signal to an underperforming Borrower, and overwhelmed its weak implementation capacity.⁶

disbursing the US\$100 million third tranche, since the Interim Government appeared unlikely to meet the third-tranche conditionality within a reasonable time frame. This cancellation also allowed the Bank to accommodate the emergency loan and the other operations within the limits of lending scenarios set out in the CAS Progress Report. If the US\$60 million *El Niño* operation is excluded, net lending in FY98 would be just US\$111 million, comprising three social development loans totaling US\$90 million and a modest-size export development loan of US\$21 million."

⁶ The Region comments: "We have been working on several key operations in close coordination with the IDB and the CAF (for example, the El Niño emergency operation was prepared in close coordination with the IDB and CAF). In any case, we intend to ensure adequate policy conditionally and assessment of implementation capacities and risks, with a view to counteracting any tendencies to an "approval culture."

Table 2.2: Comparative Data on the Efficiency of Bank Assistance Programs, FY88-98

Country	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Total SYs	Lending SYs	No. of projects	Commitments (US\$ million)	(1)/(3)	(2)/(3)	(1)/(4) ^a
Bankwide	24,663.6	8,518.4	2,612	241,792	9.4	3.3	10.2
South Asia	3,724.2	1,231.3	269	36,311	13.8	4.6	10.3
Europe And Central Asia	3,548.0	1,409.4	397	37,847	8.9	3.6	9.4
Middle East And North Africa	2,101.8	705.6	202	14,984	10.4	3.5	14.0
East Asia And Pacific	3,583.7	1,390.9	455	59,251	7.9	3.1	6.0
Africa	7,498.7	2,295.7	755	33,414	9.9	3.0	22.4
Latin America And Caribbean	4,207.2	1,485.4	534	59,985	7.9	2.8	7.0
Peru	164.3	63.2	20	3,004	8.2	3.2	5.5
Colombia	248.5	96.5	33	3,017	7.5	2.9	8.2
<i>Ecuador</i>	<i>190.9</i>	<i>66.5</i>	<i>25</i>	<i>1,330</i>	<i>7.6</i>	<i>2.7</i>	<i>14.4</i>
Chile	133.2	49.6	19	1,711	7.0	2.6	7.8
Bolivia	225.5	77.1	36	1,127	6.3	2.1	20.0

a. Column (7) displays Total SYs (staff years) per \$100 million of commitment.

Note: Lending SYs are recorded from identification to Board presentation. Total SYs include lending SYs, supervision, and economic and sector work.

Sources: PBD, Financial Database.

Efficiency

2.12 The average processing costs for Bank lending to Ecuador do not appear unusual, when viewed on a per-project basis (Table 2.2). On a commitments basis, lending to Ecuador since FY98 has absorbed on average about twice the staff resources absorbed by the average LCR loan (14.4 staff years/US\$100 million of commitments in Ecuador, compared to 7.0 staff years for all LCR borrowers). However, these costs are in line with other small, low-income borrowers, such as Bolivia. Processing times for loans to Ecuador are about average relative to the LCR Region and the Bank as a whole (Table 2.3). On this basis, efficiency is rated as **moderate**.⁷

Table 2.3: Average Elapsed Time in Months for FY92-98 Approvals

<i>Country</i>	<i>Average, IEPS- Appraisal</i>	<i>Average, Appraisal- Board</i>	<i>Average, IEPS- Board</i>
All Regions	16.5	8.6	25.2
South Asia	21.5	10.7	32.2
Africa	22.0	9.1	31.1
East Asia and Pacific	16.3	8.6	25.0
Middle East and North Africa	15.1	7.5	22.6
Latin America and the Caribbean	13.3	8.6	21.9
Colombia	19.8	14.6	34.3
<i>Ecuador</i>	13.9	9.9	23.8
Bolivia	12.3	7	19.3
Peru	10.5	7.4	17.9
Europe and Central Asia	11.0	7.4	18.3

Note: IEPS = Initial Executive Project Summary

Source: PBD

⁷ The Region comments: "We have a concern about the efficiency measures the CAE discusses...Loan preparation has a substantial fixed cost, and, since Ecuador's loan sizes are relatively small, such efficiency measures as the ratio of preparation staff weeks to commitment size are likely to show a relatively high cost of loan preparation. Preparation efficiency ratios for Ecuador should be compared with countries of similar per capita income and institutional development, like Bolivia or certain African economies. In fact, even though Ecuador's difficult institutional circumstances often make loan preparation and supervision costly, actual efficiency indicators for Ecuador's loans compare favorably with Bolivia, Africa, and are about the same as those for MENA Region. Ecuador's overall efficiency is roughly on par with the average for the Latin America region when measured by staff weeks per project."

3. Projected Development Impact Of Completed And On-Going Portfolios

3.1 OED has evaluated or reviewed ICRs for 45 completed projects in Ecuador, valued at US\$1.3 billion (Annex Table A.1). Roughly half were in the finance and agricultural sectors (Annex Table A.2). Seventy-eight percent of all projects had satisfactory outcomes, which was in line with Bank averages, and 48 percent had substantial institutional impact, which was well above average (Annex Table 4.3).

3.2 However, in two areas, the Ecuador portfolio displays performance weaknesses. First, a low proportion of completed projects—42 percent—had sustainable benefits, compared to 46 percent in LCR, and 57 percent Bankwide.⁸ This concern was highlighted in a recent OED impact evaluation of three small-scale enterprise projects implemented between 1979 and 1990.⁹ The evaluation's key findings were that: (a) none of the projects achieved lasting development benefits due to the highly distorted economic environment prevailing during most of the implementation period, including highly negative real interest rates, regulated wages, and a heavily-protected industrial sector; (b) the projects provided large subsidies at a high cost to a comparatively small number of sub-borrowers and furnished almost no incentive for lenders and borrowers to treat the projects as financially-sustainable transactions; (c) the continued disbursement of funds on subsidized terms exacerbated financial instability; (d) the Bank incorrectly assumed that lending to small and medium enterprises would generate efficient, labor-intensive growth, whereas in reality beneficiary firms produced fewer jobs than control group firms and failed at a higher rate; and (e) the Bank needed to exercise more caution in designing projects whose success hinged on politically-controversial reforms, particularly in periods preceding elections.

3.3 Secondly, the performance of the four adjustment operations lagged well behind the rest of the portfolio. Two of the 4 adjustment loans had unsatisfactory outcomes; 3 of 4 had benefits unlikely to be sustained; and 2 had negligible institutional development impact. Recurrent themes in OED evaluations have been: (a) the Bank needs to pay greater attention to macroeconomic and policy risks, particularly for economies, like Ecuador's, which depend heavily on exports of a single commodity; (b) up-front, hard-to-reverse reforms provide the only assured basis for effective policy-based lending; and (c) quick-disbursing assistance has not been effective in supporting the type of long-term structural reforms Ecuador most requires.

3.4 As for the ongoing portfolio, after a three-year period of deteriorating risk characteristics, there appears to have been a sharp improvement since July 1998. The share of projects rated by QAG as "at risk" rose from 8 percent at end-FY96 to 23 percent at end-FY98 (Table 3.1 and Annex Table A.4), but have now declined to 4 percent as of end-November 1998. Key to this improving portfolio performance, according to the Region, has been high-level GOE ownership of the results. Rather than restructuring the overall portfolio, the Region and the GOE have implemented corrective measures on individual projects. For example, the GOE has diversified its sources of counterpart funds, tapping local and community services (Health Services Modernization Project), funds from other donors (Indigenous and Afro-Ecuadorian Peoples Project), and the private sector (International Trade Project). These actions reduced the likelihood of a shortage of counterpart funds, which remains the most significant problem affecting

⁸ The 1998 *Annual Review of Development Effectiveness (ARDE)*, OED, November 1998, Report No. 18630, Annex 1, pp. 47-50, discusses a new Development Effectiveness Indicator (DEI), which integrates OED measures of outcomes, sustainability, and institutional development impact at the project level. Based on a commitment-weighted average of evaluated projects approved over the past decade, the DEI for completed loans to Ecuador portfolio is 6.15, which places it in the satisfactory range. However, because the component ratings required to compute the DEI were available for only 4 of 45 projects, the estimate is subject to a wide margin of error.

⁹ *World Bank Support for Small-Scale Enterprises in Ecuador: An Impact Evaluation*, July 1998.

project implementation. As of November 30, 1998, only two projects remained classified as "at risk", one of which is rated as a problem project.

Table 3.1: FY96-98 Portfolio Performance & Disbursements of Ongoing Projects (as of 6/30/98)

	FY96	FY97	FY98
Portfolio Performance			
Number of Projects under Implementation	15	16	19
Percent of Projects Rated Unsatisfactory			
Development Objectives	6	6	n.a.
Implementation Progress	6	6	n.a.
Percent of Projects at Risk			
By Number of Projects	27	32	15
By Commitment Amount	7	20	22
Disbursements			
Disbursement Ratio	37	19	24

Source: LCR

3.5 The outcome of the Bank's country assistance efforts during the CAS implementation period (FY94-98) is rated unsatisfactory and of unlikely sustainability. Progress in meeting the main CAS objectives, relative to their high lending and non-lending service costs, was meager. This does not signify that the Bank's presence was not needed in Ecuador, only that the impact of that presence was blocked by a variety of external and domestic factors. With respect to institutional development impact, progress in preparing two public enterprises for privatization and reforms in certain economic clauses of the new Constitution were sufficient for a rating of modest.

3.6 Exogenous factors contributed to the unsatisfactory outcome, but Bank and Borrower performance also played a major role. The Bank's excellent policy advice made key contributions to the design of the Duran-Ballen reform program. But the constructive impact of the Bank's policy advice and of other non-lending services was offset by flaws in the design and execution of the lending strategy. The design of the CAS took insufficient measures to hedge the risk that Ecuador's core reformers would be stymied by opposition from the Legislature and major interest groups. By the time the program went off-track, the Bank had already committed a large proportion of its planned lending, relying on triggers which were watered down and too easily reversed. Cancellation of one tranche of the SAL did not obviate the fact that large volumes of Bank resources were disbursed against promises of reform which, from a distance of six years, have nearly all been broken. A decade of political instability and resistance to reform should have forewarned the Bank by 1993 that large-scale, quick-disbursing lending was not a suitable instrument for Ecuador. Now, the country must begin anew, farther behind most of its Latin American neighbors than at any time in modern history.

4. How Can The Bank Help Ecuador More Effectively?

Assistance Strategy

4.1 A newly-elected administration took office in August 1998. In his acceptance speech, President Jamil Mahuad Witt unveiled the main components of his Government's agenda. On the political front, a peace agreement with Peru was concluded and ratified in October-November 1998, after more than 55 years of border conflict. The agreement is expected to facilitate trade and integration between the economies of the two countries, and a reduction in military expenditure. On the social and economic development front, President Mahuad has emphasized accelerated reconstruction of the coastal area damaged by *El Nino*, an improved social safety net, reform of public sector institutions, improved governance, and accelerated economic growth. Tough and unpopular measures have been adopted, including exchange rate devaluation, a tightened monetary policy, a targeting of the electricity subsidy to benefit only low-income consumers, and termination of the cooking gas subsidy. Other measures include increased cash transfers for mothers of poor families and persons past working age, an increase in the minimum wage, a financial transactions tax replacing taxes on personal and corporate income, and a new legal and institutional framework for dealing with a deepening banking crisis. Negotiations on an IMF Stand-by arrangement have been started, and the authorities have requested the Bank's technical and financial support.

4.2 The lessons of the past 16 years provide useful insights for the new CAS:

(a) Restructuring the ongoing existing portfolio through cancellations, reallocations, etc., has proven useful, furnishing immediate support for an incoming Administration facing a difficult economic environment, while buying time for the Borrower to identify and act upon reforms the Bank can later support¹⁰

(b) Historically, adjustment lending has not been a successful instrument in Ecuador. This suggests that, at a minimum, further quick-disbursing lending should be extended only when major reforms have reached the "sticky", hard-to-reverse stage.

(c) A modest initial level of lending -- focussed on poverty-alleviation, environmental remediation, and reconstruction of the damaged infrastructure -- might offer a constructive alternative to the approach the Bank has tried in the past. It might better match Ecuador's limited capacity to service additional debt, increase the probability of achieving core Bank development priorities in Ecuador, and better shield projects from the uncertainties of the economic climate.

¹⁰ The Region comments: "We have appointed a portfolio restructuring task force for Ecuador, that is developing bold restructuring recommendations, including partial or total cancellation of projects that are unsatisfactory or inconsistent with the present Government's priorities. An action plan, including measures to be taken by the GOE regarding counterpart funds, creation of a coordinating agency within the Finance Ministry to deal with multilaterals, and other measures will be discussed with the new authorities as part of our dialogue on portfolio performance and pipeline." The Region indicated that, at the Borrower's request, one project has been partially cancelled, and another reallocated to *El Nino* reconstruction. In addition, a strict policy of not extending closing dates is expected to result in closure of eleven of the seventeen ongoing projects by the end of FY2000. This is expected to free administrative resources to prepare new projects and non-lending activities in support of the new administration's development program.

- (d) One option would be small-scale, flexible Lending Innovation Loans (LILs) targeted to high-priority development activities.
- (e) Another possibility would be Adaptable Program Lending (APL), supporting defined milestones, performance indicators, policy requirements, etc. in areas such as poverty alleviation, health, population, education, nutrition, social infrastructure, and urban development.
- (f) Non-lending services, such as the Bank's excellent policy advice on public sector modernization and Constitutional economic reform, have had a greater impact than the Bank's adjustment lending, and at a lower cost to the Borrower. The Bank's high-quality ESW, promotional activities with opinion leaders, seminars, and training have been cost-effective, and should continue at a high rate as an aid toward illuminating Ecuador's best options for overcoming the crises.¹¹
- (g) The Bank has commendably intensified coordination of its assistance strategy with the IDB and the CAF, an effort which, based on past experience, will remain indispensable.
- (h) Less frequent reorganizations and turnover among Bank managers and staff would significantly improve the continuity of Bank assistance in Ecuador.
- (i) Increased resources for project supervision and monitoring are needed to cope with rapidly-changing local conditions affecting project performance.

¹¹ The Region notes: "Your recommendations for the future coincide very much with our approach in our CAS, currently in preparation. Mr. Mahuad's Administration represents a window of opportunity to advance on various reforms which, as stated above, have taken longer than expected. In terms of lending, our strategy is to restrain the pace of new lending according to the country's absorption and implementation capacity, including its capacity to provide counterpart funds. Portfolio monitoring will continue to be a high priority, especially since we aim to sustain the progress attained over the past 12-18 months. In terms of highlights of new elements of our strategy, corruption has become high priority. We are advancing work in this area with the Government at the highest level (President Mahuad) as well as the Carter Center and Transparency International. We are conducting work on gender issues with particular emphasis on the portfolio. A strong emphasis on restructuring and institutional strengthening of the financial sector will play an important role in our strategy. We are working on an Integrated Social Review that will update the poverty assessment and conduct a diagnosis of the social situation in Ecuador, broadening the social objectives of the development strategy to include poverty, inequality, inclusion of the indigenous population, and extend and integrate the instruments of social policy and mechanisms for participatory design and implementation of these policies."



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Quito, junio 1 de 1999

Señor
Murilo Portugal
Director Ejecutivo
Banco Mundial
Presente.-

De mi consideración:

En relación al documento "Ecuador: Country Assistance Note - OED" y su Anexo C, del 18 de mayo de 1999, me permito enviarle mis comentarios y observaciones.

El documento inicia con un resumen del entorno en el que se ha desenvuelto el país y los principales puntos relativos a la gestión del Banco Mundial en este entorno. Se menciona correctamente que la crisis macroeconómica y estructural que sufre el Ecuador desde los años 80, a causa de la disminución de los precios del petróleo, se ha agravado fuertemente durante los años 90. Esto ha provocado en los últimos años el incremento de la inflación y el apareamiento de saldos negativos en las cuentas externas y fiscales; a lo cual se suma un sistema financiero que afronta enormes dificultades.

Frente a estas realidades, el documento afirma que si bien la estrategia del Banco fue relevante, la misma subestimó los riesgos derivados de la falta de compromiso de la sociedad civil con las reformas. En efecto, la imposibilidad de lograr consensos políticos en la sociedad ecuatoriana alrededor de los más básicos principios u objetivos, ha constituido un gran obstáculo para el progreso de nuestro país. Sin embargo, considero que la existencia misma de estos obstáculos, permite valorar aún más los esfuerzos realizados para implementar algunos cambios y reformas importantes durante los últimos años.

A partir de Agosto de 1998, el gobierno ecuatoriano ha conseguido importantes logros. La firma definitiva de la paz con el Perú, luego de 55 años de conflicto, no sólo ha permitido poner fin a una historia muy triste y dura para nuestro país, sino que ha conseguido una drástica reducción en los gastos militares y el inicio de acciones tendientes a facilitar la integración y el comercio entre los dos países. Por otro lado, medidas duras han sido tomadas en cuanto a la eliminación de los subsidios al gas de uso doméstico y a las tarifas eléctricas, sistema que ha sido reemplazado por un subsidio directo que llega mensualmente a 1'400.000 ainas de casa, ancianos y discapacitados de los hogares más



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pobres del Ecuador. Finalmente, la aprobación de una reforma tributaria, que incluyó el retorno al impuesto a la renta, la eliminación de los escudos fiscales del mismo, y la disminución de las exenciones del IVA, buscan, junto a la aplicación de una austera política fiscal, el cumplimiento de las metas macroeconómicas establecidas.

Sin embargo, con el propósito de ayudar al Ecuador de manera más efectiva, el documento del Banco Mundial propone algunas sugerencias. El diseño de una nueva estrategia que tenga en cuenta las prioridades del gobierno es un paso importante y necesario. A esto, se añaden sugerencias como no extender las fechas finales de utilización de los empréstitos, optar preferiblemente por préstamos pequeños y más flexibles y por los programas denominados "adaptables" dirigidos a las áreas sociales. De forma complementaria se aconseja mantener una estrecha coordinación con los otros organismos de desarrollo, mantener la estabilidad en el personal a cargo de los proyectos e incrementar la supervisión y el monitoreo de los mismos

Comparto en términos generales las observaciones presentadas por el documento, sobre las cuales me permito indicar que puesto que el Banco debe privilegiar con sus recursos, la atención a la pobreza, debe darse prioridad a programas que impulsen la conformación de una verdadera red social que al momento no existe. En este sentido es necesario una evaluación y un monitoreo pormenorizado de programas como el del FISE y los de desarrollo rural. Esto debe ser complementado con un enfoque más participativo, que tenga en cuenta sobre todo a los gobiernos seccionales y a la sociedad civil. En cuanto a la coordinación con otros organismos de desarrollo, mi opinión es que ésta debe tener un carácter permanente a fin de lograr coordinación en las acciones, procedimientos y requerimientos, evitando así duplicaciones de esfuerzos y mejor utilización de los recursos humanos e institucionales de que dispone el país. Debemos fomentar la austeridad y la optimización de los recursos foráneos.

Una evaluación más detallada de los diferentes programas vigentes nos permitirá encontrar las falencias de algunos de ellos que han sido calificados como no satisfactorios y de dudosa sostenibilidad. Estas evaluaciones, deben además servir para que el país aprenda de estas experiencias, tanto para los nuevos diseños como para la implementación de los actuales.

Debo añadir que el congelamiento de fondos del sistema bancario alcanza, al 31 de mayo, aproximadamente el 54% del total de depósitos lo que ha permitido que el tipo de cambio real registre una relativa estabilidad, con lo cual se protege la producción exportable del país; las tasas de interés han mostrado una tendencia a la baja, lo que permitirá evitar un mayor deterioro de la actividad económica y la inflación del mes de mayo fue de 0.87%, lo que contribuye a revertir la tendencia ascendente de la variación anual del índice de precios al consumidor, el cual alcanza el 54.7%. Las Reservas Internacionales al 31 de mayo



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ascienden a US\$ 1300 millones mostrando una recuperación, frente a marzo de 1999, necesaria para mantener la solvencia externa del país.

Adicionalmente, debo informar que con el apoyo de los Organismos Internacionales, incluido el Banco Mundial, hemos preparado una estrategia financiera para enfrentar la crisis bancaria, que será parte importante del programa económico del país que está siendo negociado con el Fondo Monetario Internacional.

Atentamente,

A handwritten signature in black ink, appearing to read 'Ana Lucía Armijos', written in a cursive style.

Ana Lucía Armijos
MINISTRA DE FINANZAS Y CREDITO PUBLICO

ANNEXES

Annex A: Portfolio Performance Data

- Table A.1 OED Satisfactory Outcome Ratings by Period
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- Table A.4 Projects Under Implementation or Recently Closed in Ecuador
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Annex C: Recent Ecuadorian Policy Reform Initiatives

ANNEX A
Table A.1

Ecuador: OED Satisfactory Outcome Ratings by Period

	<i>Loans Rated</i>	<i>% Satisfact.</i>	<i>Value \$m</i>	<i>% Satisfact.</i>
1954-1982				
Adjustment Loans	0		0.0	
Non-Adjustment Loans	31	77	509.2	75
Period Total	31	77	509.2	75
1983-1986				
Adjustment Loans	1	0	98.6	0
Non-Adjustment Loans	5	80	194.9	85
Period Total	6	67	293.5	56
1987-1990				
Adjustment Loans	1	100	100.0	100
Non-Adjustment Loans	5	100	232.9	100
Period Total	6	100	332.9	100
1991-1999				
Adjustment Loans	2	50	179.8	44
Non-Adjustment Loans	0		0.0	
Period Total	2	50	179.8	44
All: 1954-1999				
Adjustment Loans	4	50	378.4	48
Non-Adjustment Loans	41	80	937.1	83
TOTAL RATED	45	78	1315.4	73

Source: OED Database

Ecuador: Evaluated Operations through October 31, 1998
(US\$ Millions)

<i>Sector</i>	<i>Data</i>	<i>Total</i>
Agriculture	Number of Evaluated Projects	13
	Commitments	232.9
Education	Number of Evaluated Projects	3
	Commitments	24.7
Elec. Power & Other Energy	Number of Evaluated Projects	3
	Commitments	13.6
Finance	Number of Evaluated Projects	10
	Commitments	453.7
Industry	Number of Evaluated Projects	1
	Commitments	50
Multisector	Number of Evaluated Projects	2
	Commitments	179.8
Oil & Gas	Number of Evaluated Projects	1
	Commitments	79.2
Public Sector Management	Number of Evaluated Projects	2
	Commitments	17
Telecommunications	Number of Evaluated Projects	1
	Commitments	0
Transportation	Number of Evaluated Projects	5
	Commitments	122.1
Urban Development	Number of Evaluated Projects	3
	Commitments	119.3
Water Supply & Sanitation	Number of Evaluated Projects	1
	Commitments	23.2
Total Number of Evaluated Projects		45
Total Commitments		1315.4

ANNEX A
Table A. 3**Outcome of OED Ratings for Ecuador Portfolio**

<i>Outcome</i>	<i>Number</i>	<i>Percent</i>	<i>Value \$m</i>	<i>Percent</i>
Satisfactory Outcome				
Adjustment Loans	2	50	179.8	48
Non-Adjustment Loans	33	80	778.2	83
Subtotal	35	80	958.0	73
Unsatisfactory Outcome				
Adjustment Loans	2	50	199.0	52
Non-Adjustment Loans	8	20	158.9	17
Subtotal	9	20	357.5	27
Total Rated	45		1315.4	
<i>Sustainability</i>	<i>Number</i>	<i>Percent</i>	<i>Value \$m</i>	<i>Percent</i>
Likely Sustainability				
Adjustment Loans	1	25	100.0	21
Non-Adjustment Loans	10	45	254.4	36
Subtotal	11	42	354.4	33
Uncertain Sustainability				
Adjustment Loans	0	0	0	0
Non-Adjustment Loans	10	45	410.1	58
Subtotal	10	38	410.1	38
Unlikely Sustainability				
Adjustment Loans	3	75	278.0	79
Non-Adjustment Loans	2	9	39.7	6
Subtotal	5	20	318.1	29
Total Rated	26	100	1082.6	100
<i>Institutional Development</i>	<i>Number</i>	<i>Percent</i>	<i>Value \$m</i>	<i>Percent</i>
Substantial ID				
Adjustment Loans	1	33	100.0	33
Non-Adjustment Loans	11	50	255.8	36
Subtotal	12	48	355.8	35
Moderate ID				
Adjustment Loans	0	0	0.0	0
Non-Adjustment Loans	7	32	317.3	45
Subtotal	7	28	317.3	32
Negligible ID				
Adjustment Loans	2	67	199.0	67
Non-Adjustment Loans	4	18	131.0	19
Subtotal	6	24	230.0	33
Total Rated	25	100	1002.8	100

Projects Under Implementation or Recently Closed in Ecuador

FY	Loan No.	Project	Loan	Disbursements			Undisbursed	Actual - Expected Disbursements	QAG's Rating**	
			Amount*	1996	1997	1998	Amount		07/97	04/98
Environmental, Social Sustainable Development										
1991	Ln 3276	Guayas Flood Control	59.00	16.6	15.2	4.7	3.88	5.13	N	N
1992	Ln 3390	Rural Development	84.00	9.1	5.0	4.6	18.00	15.94	N	R
1994	Ln 3730	Irrigation TA	20.00	1.5	1.3	0.8	11.00	6.67	P	R
1997	Ln 4075	Agricultural Research	21.00	0.0	0.0	0.2	15.29	25.00	N	N
1998	Ln 4259	El Niño Emergency Recovery	60.00	—	—	3.0	20.80		—	N
1998	Ln 4xxx	Agriculture Census & Information	20.00	—	—	—	57.00		—	N
1998	Ln 4xxx	Indigenous & Afro-Ecuadorian Peoples	25.00	—	—	—	20.00		—	N
<i>Subtotal</i>			289.00	27.3	21.5	13.3	160.08	511.18		
Poverty Reduction & Economic Management										
1995	Ln. 3819	SAL	99.84	50.0	0.0	0.0	0.00	100.16	N	Closed
1995	Ln. 3821	Public Enterprise Reform TA	12.00	3.9	1.5	3.2	3.39	3.88	N	N
1995	Ln. 3822	Modernization of StateTA	20.00	2.7	1.8	4.4	10.75	-1.95	P	P
1997	Ln. 4066	Judicial Reform TA	10.70	0.0	0.3	0.3	10.08	0.00	N	N
<i>Subtotal</i>			142.54	56.5	3.6	7.9	24.22	102.09		
Finance, Private Sector & Infrastructure										
1987	Ln. 2774	Guayaquil Water II	29.38	1.1	0.5	0.2	0.00	1.54	Closed	Closed
1991	Ln. 3285	Municipal Development I	104.00	22.2	6.8	8.6	28.22	35.45	N	N
1993	Ln. 3609	Private Sector Development	75.00	50.2	0.5	0.0	0.00		N	Closed
1994	Ln. 3655	Mining TA	14.00	1.2	1.6	1.6	8.61	6.56	R	R
1997	Ln. 3998	Environmental Management TA	15.00	0.0	0.9	1.1	13.01	0.39	N	N
<i>Subtotal</i>			237.38	74.7	10.0	11.5	49.84	43.94		
Human Development										
1992	Ln. 3425	Soc. Dev. I/Education & Training	89.00	12.8	7.5	2.9	38.85	18.16	P	R
1993	Ln. 3510	Soc. Dev. II/Health & Nutrition	70.00	14.7	7.2	9.3	28.03	15.73	N	N
1994	Ln. 3707	Social Investment Fund	30.00	2.7	0.8	0.4	0.00	-2.38	N	Closed
<i>Subtotal</i>			189.00	30.2	15.5	12.7	66.88	31.51		

* Net of Cancellation ** P - Problem Project; R - Project at Risk; N - Non Risky Project.
Source: Operations Information System

ANNEX A
Table A.5

Selected Indicators of Bank Portfolio Performance and Management

Indicator	FY94	FY95	FY96	FY97
Portfolio Performance				
Number of Projects under implementation	16	16	15	15
Average implementation period (years) ^{1/}	4.03	3.17	3.71	4.07
Percent of problem projects rated U or HU ^{2/} (for past years, rated 3 or 4)				
Development Objectives ^{3/}	18.75	6.25	6.67	6.25
Implementation Progress (or overall status for past years) ^{4/}	18.75	6.25	6.67	6.25
Canceled during FY in US\$m	49.78	4.84	0.00	0.00
Disbursement ratio (%) ^{5/}	14.55	22.16	37.49	26.00
Disbursement lag (%) ^{6/}	17.21	17.77	13.86	32.77
Memorandum item: % completed projects rated unsatisfactory by OED	30.77	28.13	26.47	n.a.
Portfolio Management				
Supervision resources (total US\$ thousands)	794.97	1,038.33	908.63	825.3
Average Supervision (US\$ thousands/project)	49.69	64.90	60.58	55.03
Supervision resources by location (in %) ^{7/}				
Percent headquarters	0.00	0.00	80.68	70.99
Percent resident mission	0.00	0.00	19.32	29.01
Supervision resources by rating category (US\$ thousands/project)				
Projects rated HS or S	53.13	66.98	62.28	56.25
Projects rated U or HU	34.78	33.63	36.72	47.00
Memorandum item: Date of last CPPR			Jun-97	

- Notes: 1. Average age of projects in the Bank's country portfolio.
2. Rating scale: "HS" denotes "Highly Satisfactory"; "S" denotes "Satisfactory"; "U" denotes "Unsatisfactory" and "HU" denotes "Highly Unsatisfactory".
3. Extent to which the project will meet its development objective (see OD 13.05, Annex D2, *Preparation of Implementation Summary* [Form 590]).
4. Assessment of overall performance of the project based on the ratings given to individual aspects of project implementation (e.g., management, availability of funds, compliance with legal covenants) and to development objectives (see OD 13.05, Annex D2, *Preparation of Implementation Summary* [Form 590]). The overall status is not given a Better rating than that given to project development objectives.
5. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: investment projects only.
6. For all projects comprising the Bank's country portfolio, the percentage difference between actual cumulative disbursements and the cumulative disbursement estimates as given in the "Original SAR/PR Forecast" or, if the loan amounts have been modified, in the "Revised Forecast". The country portfolio disbursement lag is effectively the weighted average of disbursement lags for projects comprising the Bank's country portfolio, where the weights used are the respective project shares in the total cumulative disbursement estimates.
7. Supervision resources data, by location, is only available starting in fiscal year 1996.

Source: Operations Information System

Other Macro, Demographic, and External Assistance Indicators

	Last Five Years ¹	Last Ten Years ²
A. Demographics		
Population (million)	11.5	10.9
Average annual growth		
Population (%)	2.1	2.2
Labor Force (%)	n/a	n/a
Urban population (% of total population)	58.9	57.0
Labor activities rates (% of total population)	35.2%(1990)	37.1%(1995)
B. Economic Indicators		
GNP at market prices (constant 1995 US\$)	16.9	15.7
GNP per capita (constant 1995 US\$)	1479.4	1447.9
GNP growth (annual %)	#N/A	#N/A
Gross domestic investment (% of GDP)	18.8	19.7
Gross domestic savings (% of GDP)	21.4	21.7
Exports of goods and services (% of GDP)	29.0	29.9
Imports of goods and services (% of GDP)	26.4	27.9
Resource balance (% of GDP)	2.6	2.0
Interest payments GDP	n/a	n/a
C. Foreign Trade (in US\$ millions)		
Exports of goods and services (constant 1995 US\$)	5301	4554
Imports of goods and services (constant 1995 US\$)	5078.0	4541.0
Resource balance (current US\$)	472.0	323.0
Net investment income		
Net current transfers (BoP, current US\$)	237.0	172.0
Current account balance (BoP, current US\$)	-545.0	-531.0
Financing from abroad (% of GDP)	#N/A	#N/A
Changes in net reserves (BoP, current US\$)	-230.0	-191.0
Reserves including gold (mill. US\$)	1,781	1,257
Official exchange rate (LCU per US\$, period average)	2773.6	1804.4
D. External Assistance		
I. Major donors in 1996 (net financial flow)		
<i>(in US\$ millions)</i>		
Regional Development Banks (both concessional & non-concessional)	103.9	36%
IBRD and IDA	-30.9	-11%
IMF (non-concessional)	-23.0	-8%
UN System (excl. IDA)	31.2	11%
Japan	47.5	16%
Germany	27.1	9%
USA	12.0	4%
France	11.4	4%
Netherlands	11.9	4%
Other DAC donors	97.1	34%
Total	288.2	
II. Aid and debt indicators		
	Last 5 Years	Last 10 Years
Aid (% of central government expenditures)	9.7	11.4
Aid (% of GNP)	1.5	1.7
Aid (% of gross domestic investment)	7.4	8.0
Aid per capita (current US\$)	21.0	21.6
Multilateral debt (% of total external debt)	18.8	18.3
Concessional debt (% of total external debt)	11.8	9.9

¹ 1993-97; ² 1988-97;

ANNEX B
Table B.2

OED SUMMARY RATINGS FOR ECUADOR FOR ALL YEARS

Totals All Approved Projects				
	<i>Number</i>	<i>Percent</i>	<i>Value \$m</i>	<i>Percent</i>
Adjustment Loans	4	9	378.4	29
Non-Adjustment Loans	41	91	937.1	71
Total	45	100	1315.5	100
OED Outcome Ratings				
	<i>Number</i>	<i>Percent</i>	<i>Value \$m</i>	<i>Percent</i>
<i>Satisfactory Outcome</i>				
Adjustment Loans	2	50	179.8	48
Non-Adjustment Loans	33	79	778.0	83
Total Satisfactory Outcome	35	78	957.8	73
OED Sustainability Ratings				
	<i>Number</i>	<i>Percent</i>	<i>Value \$m</i>	<i>Percent</i>
<i>Likely Sustainability</i>				
Adjustment Loans	1	25	100.0	26
Non-Adjustment Loans	10	45	254.0	36
Total Likely Sustainability	11	42	354.0	33
OED Institutional Development Ratings				
	<i>Number</i>	<i>Percent</i>	<i>Value \$m</i>	<i>Percent</i>
<i>Substantial ID</i>				
Adjustment Loans	1	25	100.0	26
Non-Adjustment Loans	11	48	255.0	27
Total Substantial ID	12	46	356.0	27
Total Approved projects, by Period(FY)				
<i>Period</i>	<i>Number</i>		<i>\$m Commit</i>	
Last 5 years	15		594.0	
Last 10 years	24		1230.0	
ARPP Ratings of Ongoing Projects				
	<i>Number</i>	<i>Percent</i>	<i>Value \$m</i>	<i>Percent</i>
<i>Development Objectives</i>				
Satisfactory	14	93	569.0	97
Unsatisfactory	1	7	15.0	3
Total	15	100	584.0	100
<i>Implementation Progress</i>				
Satisfactory	15	93	639.0	98
Unsatisfactory	1	7	15.0	2
Total	16	100	654.0	100
<i>Region</i>				
<i>Bank-wide or IDA</i>				
Disconnect for Ecuador				
<i>Number of projects</i>		<i>ARPP % Sat</i>	<i>OED % Sat</i>	<i>Net disc. exit¹</i>
45		94	78	16
Development Effectiveness Indicator				
	<i>Last 3 years</i>	<i>Last 5 years</i>	<i>Last 10 years²</i>	
Country			6.15	
Region				
Bank-wide or IDA				

¹ The disconnect is the difference between the share of projects rated satisfactory during the last supervision year and the share of projects rated satisfactory after completion. Thus it is an indication of the optimism in supervision ratings.

² Based on 4 evaluated projects, valued at US\$230 million, for which the underlying ratings were available.

WORLD BANK PROJECT RATINGS SORTED BY SECTOR, FY88 - FY98

PROJECT DESCRIPTION					OED RATINGS						QAG RATING	SUPERVISION RATINGS		OTHER RATINGS
Project ID #	Project Name	Commitment \$m	Approval FY	Closing Date	Outcome	Sustainability	ID	Development Effectiveness Indicator	Bank Performance	Borrower Performance	At risk Rating	Latest DO Rating	Latest IP rating	Percent Cancelled
AGRICULTURE														
7100	Guayas Ffd Cntl.	59.00	FY91	6/30/99	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	0
7105	Irrig. TA	20.00	FY94	6/30/00	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	0
7131	Ag. Research	21.00	FY97	12/31/03	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	0
7135	Agric. Census & Info.	20.00	FY98	9/30/02	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	0
Sub-total		120.00												0
EDUCATION														
7107	Soc. Devt. I/Ed. & Trg.	89.00	FY92	9/30/99	N/A	N/A	N/A		N/A	N/A	Non Risky	S	S	0
Sub-total		89.00												0
ENVIRONMENT														
7128	Env. Management Proj.	15.00	FY96	9/15/00	N/A	N/A	N/A	N/A	N/A	N/A	Actual	U	U	0
40086	Indigenous Peoples	25.00	FY98	9/30/02	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	0
Sub-total		40.00												0
FINANCE														
7098	Private Sector Development	75.00	FY93					6				S	S	0
7119	Small Scale Enterprise IV	50.00	FY90	6/30/95	Satisfactory	Uncertain	Modest	6	Unsatisfactory	Satisfactory		S	S	0
40106	Intl. Trade/Integration	21.00	FY98	6/30/02	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky			
Sub-total		146.00												0
MINING														
7129	TA Mining	14.00	FY94	6/30/99	N/A	N/A	N/A	N/A	N/A	N/A	Potential	S	S	0
Sub-total		14.00												0
MULTISECTOR														
36055	SAL	200.00	FY95									S	U	50
37046	DDSR	80.00	FY95	7/31/95	Satisfactory	Unlikely	N/R	N/A	Satisfactory	Satisfactory		S	S	0
Sub-total		280.00												50
POPULATION, HEALTH & NUTRITION														
7087	Soc. Devt. II/Health & Nut.	70.00	FY93	6/30/00	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	NA	HS	0
39084	Health Serv. Modern	45.00	FY98	12/31/04	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	0
Sub-total		115.00												0

WORLD BANK PROJECT RATINGS SORTED BY SECTOR, FY88 - FY98

PROJECT DESCRIPTION					OED RATINGS						QAG RATING	SUPERVISION RATINGS		OTHER RATINGS
Project ID #	Project Name	Commitment \$m	Approval FY	Closing Date	Outcome	Sustainability	ID	Development Effectiveness Indicator	Bank Performance	Borrower Performance	At risk Rating	Latest DO Rating	Latest IP rating	Percent Cancelled
PUBLIC SECTOR MANAGEMENT														
7132	Pub. Ent. Ref (TA)	12.00	FY95	7/31/99	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	0
7136	TA Mdrn Of State	20.00	FY95	6/30/00	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	0
36056	Judicial Reform	10.70	FY97	6/30/02	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	0
55571	El Nino	60.00	FY98	12/31/00	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	0
Sub-total		102.70												0
SOCIAL PROTECTION														
7106	Social Invest Fund	30.00	FY94		N/A	N/A	N/A	N/A	N/A	N/A		S	S	0
Sub-total		30.00												0
TELECOMMUNICATIONS														
7099	Telecomm	45.00	FY89	6/30/95	Satisfactory	Uncertain	Modest	6.75	Satisfactory	Unsatisfactory		U	U	100
Sub-total		45.00												100
TRANSPORTATION														
7115	Rural Development	84.00	FY92	6/30/99	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	0
Sub-total		84.00												0
URBAN DEVELOPMENT														
7097	National Housing II	60.00	FY88	4/3/00	Satisfactory	Uncertain	Modest	6	Satisfactory	Satisfactory		U	U	0
7123	Municipal Development I	104.00	FY91	6/30/00	N/A	N/A	N/A	N/A	N/A	N/A	Non Risky	S	S	15
Sub-total		164.00												14

Includes all projects that were effective between FY90 and FY98 and formal ESW completed since FY90.

Country Assistance Cost Indicators

<i>Period</i>	Average Completion Cost (\$000 per project)		Supervision Intensity* (\$000)		Average Elapsed Time from IEPS to Board Approval (months)**	
	<i>Last 5 years</i>	<i>Last 10 years</i>	<i>Last 5 years</i>	<i>Last 10 years</i>	<i>Last 5 years</i>	<i>Last 10 years</i>
Ecuador	301.16	340.66	37.14	44.61		23.8
Bank-wide/IDA	293.70	322.60		44.55		25.2
Africa	272.92	313.03	38.10	48.32		31.1
South Asia	350.96	415.62	36.14	46.28		32.2
East Asia & Pacific	303.00	336.92	30.40	38.40		25.0
Europe & Central Asia	362.64	362.58	39.76	53.28		18.3
Middle East & North Africa	314.96	331.31	32.56	40.27		22.6
Latin America & Caribbean	256.48	268.25	32.96	39.91		21.9

* Direct cost inputs divided by the number of projects under active supervision

**Average elapsed time shown is from FY92-FY98

Scheduled and Unscheduled Reports and Coefficients by Region

<i>Total Reports (#)</i>	<i>FY89</i>	<i>FY90</i>	<i>FY91</i>	<i>FY92</i>	<i>FY93</i>	<i>FY94</i>	<i>FY95</i>	<i>FY96</i>	<i>FY97</i>	<i>FY98</i>
Ecuador	3	4	5	1	3	2	1	1	3	-
IDA & Bankwide	307	352	333	383	363	329	360	323	265	291
Africa	110	133	123	152	134	109	142	115	75	93
South Asia	31	28	32	31	29	25	21	24	37	29
East Asia & Pacific	33	37	32	39	33	36	42	43	48	45
Europe & Central Asia	18	16	28	45	71	76	55	60	36	57
Middle East & North Africa	27	32	25	30	24	28	32	22	18	18
Latin America & Caribbean	88	106	93	86	72	55	68	59	51	49
<i>Direct Costs (\$000)</i>										
Ecuador	\$172	\$350	\$452	\$230	\$251	\$110	\$239	\$204	\$329	\$17
IDA & Bankwide	\$34,929	\$34,087	\$35,779	\$40,580	\$51,828	\$54,878	\$52,907	\$43,918	\$39,469	\$32,676
Africa	\$11,672	\$11,900	\$11,194	\$12,452	\$17,663	\$13,608	\$16,405	\$15,754	\$10,402	\$10,808
South Asia	\$3,784	\$3,302	\$4,420	\$4,070	\$4,106	\$5,255	\$5,527	\$2,614	\$9,011	\$5,327
East Asia & Pacific	\$6,020	\$6,065	\$6,747	\$8,002	\$6,829	\$7,766	\$7,161	\$7,938	\$6,672	\$4,822
Europe & Central Asia	\$2,445	\$1,543	\$4,369	\$5,133	\$10,698	\$13,255	\$9,139	\$8,197	\$4,164	\$6,111
Middle East & North Africa	\$3,191	\$3,553	\$2,150	\$3,049	\$4,311	\$5,479	\$6,192	\$3,136	\$3,735	\$1,846
Latin America & Caribbean	\$7,816	\$7,723	\$6,898	\$7,874	\$8,222	\$9,515	\$8,483	\$6,279	\$5,485	\$3,762
<i>Coefficients (Cost/Report)</i>										
Ecuador	57.4	87.4	90.5	229.8	83.7	55.1	238.8	204.1	109.6	-
IDA & Bankwide	113.8	96.8	107.4	106.0	142.8	166.8	147.0	136.0	148.9	112.3
Africa	106.1	89.5	91.0	81.9	131.8	124.8	115.5	137.0	138.7	116.2
South Asia	122.1	117.9	138.1	131.3	141.6	210.2	263.2	108.9	243.5	183.7
East Asia & Pacific	182.4	163.9	210.8	205.2	206.9	215.7	170.5	184.6	139.0	107.2
Europe & Central Asia	135.9	96.4	156.1	114.1	150.7	174.4	166.2	136.6	115.7	107.2
Middle East & North Africa	118.2	111.0	86.0	101.6	179.6	195.7	193.5	142.5	207.5	102.6
Latin America & Caribbean	88.8	72.9	74.2	91.6	114.2	173.0	124.7	106.4	107.5	76.8

ESW Reports, FY89-FY98

Report Title	Economic or Sector Report	Date	Report #
Agriculture (1)			
Agricultural sector review - Ecuador	SR	6/1/93	11398
Education (2)			
Ecuador - Education finance study : efficiency and equity in education	SR	10/24/96	16100
Ecuador - Is society getting what it needs from public spending on education : issues in efficiency and equity	SR	4/15/97	16489
Environment (1)			
Latin America and Caribbean Region - Market based instruments for environmental policymaking in Latin America and the Caribbean :lessons from eleven countries	SR	12/1/96	16221
Industry (2)			
Ecuador - Development of manufacturing : policies, performance and outlook	SR	10/2/90	8412
Ecuador - Private sector assessment	SR	6/28/94	12994
Infrastructure (2)			
Ecuador - Urban water supply and sewerage sector study	SR	6/1/88	7341
Housing delivery system and the urban poor : a comparison among six Latin American countries	SR	9/1/92	11189
Multi-sector (7)			
Ecuador - Country economic memorandum	ER	8/1/88	7321
Ecuador - Development issues and options for the Amazon region	ER	6/16/89	7809
Ecuador - Macroeconomic stabilization and medium term growth prospects	ER	4/1/91	9531
Ecuador - Policy options for the rest of the 1990s	ER	8/1/92	11161
Ecuador - Poverty report	ER	11/27/95	14533
Illegal drugs in the Andean countries : impact and policy options	SR	1/22/96	15004
Ecuador - Policy notes	ER	10/18/96	16058
Population, Health and Nutrition (1)			
Ecuador - A social sector strategy for the nineties	SR	11/28/90	8935
Public sector management (3)			
Ecuador - Public sector finances : reforms for growth in the era of declining oil output	ER	1/1/91	8918
Ecuador - Public expenditure review : changing the role of the state	ER	8/1/93	10541
Ecuador - Judicial sector assessment	SR	8/19/94	12777

ANNEX B
Table B.7

Bank Managers (FY89-98)

YEAR	VICE PRESIDENTS	COUNTRY DIRECTORS
1989	Shahid S. Husain	Pieter P. Bottelier
1990	Shahid S. Husain	Pieter P. Bottelier
1991	Shahid S. Husain	Pieter P. Bottelier
1992	Shahid S. Husain	Ping-Cheung Loh
1993	Shahid S. Husain	Ping-Cheung Loh
1994	Javed Shahid Burki	Ping-Cheung Loh
1995	Javed Shahid Burki	Yoshiaki Abe
1996	Javed Shahid Burki	Paul Isenman
1998	Javed Shahid Burki	Andres Solimano

Source: World Bank Directories from 1989-1998

Recent Ecuadorian Policy Reform Initiatives¹

Since taking office in August 1998, the Mahuad Government has managed several significant accomplishments. In September 1998, it eliminated the cooking-gas subsidy and restricted the electricity subsidy to poorer consumers. At the same time, it implemented an innovative program of direct subsidies to mothers of poor families and impoverished retired people. Previous governments had failed to address the subsidy issue. The saving to the government on an annual basis is estimated at US\$150m (just under 1 percent of GDP). No less important, these actions targeted subsidy funds to poorer people and reduced perverse market incentives.

In November 1998, after several months of intense diplomacy, the Mahuad Government signed a peace accord with Perú, ending half a century of border conflict. The agreement has already encouraged growth of bilateral commerce. Border areas previously threatened by conflict are now open to development. Ecuador will have commercial access to the Amazon River, and should be able to cut armed-forces expenditure.

In May 1999, the President presented Ecuador's anti-corruption Plan to a meeting at the Carter Center, which has been assisting the Government, along with the World Bank and Transparency International. The Government intends to implement the Plan in coming months.

Since taking office, the Government has had to deal with a deepening macroeconomic and banking crisis, which it had inherited. It has been working with the IMF, the IDB and the World Bank on a program of support for banking-sector restructuring and macroeconomic stabilization. Early in December 1998, the Government secured approval of legislation encompassing tax and banking-sector changes. The law set a one-percent tax on all transactions paid by check, starting January 1999, and also suspended the poorly performing personal and corporate income tax. To deal with the banking crisis, the law set a general guarantee on all banking-system deposits, established new means for managing banks in crisis, and established a Deposit Guarantee Agency. In December 1998, the Deposit Guarantee Agency took over the country's largest bank, and since then has taken over nine other banks and financial institutions. Some of the banks have been kept open while being restructured, and others are being liquidated. In March 1999, facing imminent deposit runs and failure of a large bank, the Government froze most banking-system deposits and loans. It then contracted several foreign firms to carry out audits of 31 commercial banks. On the basis of the results, due at the end of June 1999, the Government intends to carry out a generalized banking-system restructuring, with many entities to be closed, fused, or recapitalized.

In April 1999, the Government approved fiscal legislation, encompassing elimination of some value-added tax exemptions, restoration of the income tax, creation of several new taxes, and some expenditure reductions.

An IMF mission is now in Quito developing a stand-by program. IMF, World Bank, IDB and CAF missions are working on support for the banking-sector restructuring.

¹ Submitted by LCR on May 21, 1999.