

April 9, 2020
Approval: 4/16/20

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/16-1

2:30 p.m., March 11, 2019

1. Ecuador—2019 Article IV Consultation and Request for an Extended Arrangement Under the Extended Fund Facility

Documents: EBS/19/9 and Correction 1; and Correction 2; and Correction 3; and Correction 4; and Supplement 1; and Supplement 1, Correction 1; SM/19/43; and Correction 1; and Correction 2

Staff: Ivanova, WHD; Chalk, WHD; Gonzalez Miranda, SPR

Length: 1 hour, 2 minutes

Executive Board Attendance

C. Lagarde, Acting Chair

Executive Directors Alternate Executive Directors

D. Mahlinza (AE)

H. Razafindramanana (AF)

D. Vogel (AG), Temporary

G. Preston (AP), Temporary

A. Tombini (BR)

P. Sun (CC)

L. Villar (CE)

L. Levonian (CO)

R. Kaya (EC)

H. de Villeroché (FF)

S. Meyer (GR)

M. Siriwardana (IN)

M. Psalidopoulos (IT)

Y. Saito (JA)

M. Dairi (MD)

D. Fadhel (MI), Temporary

H. Etkes (NE), Temporary

T. Ostros (NO)

L. Palei (RU)

R. Alkhareif (SA)

K. Tan (ST)

P. Trabinski (SZ)

S. Riach (UK)

M. Svenstrup (US), Temporary

H. Al-Atrash, Acting Secretary

H. Malothra, Summing Up Officer

D. Jiang, Board Operations Officer

M. McKenzie, Verbatim Reporting Officer

Also Present

Communications Department: W. Murray. Finance Department: E. Chamoun, D. Moore.

Legal Department: K. Christopherson Puh, H. Pham, K. Vasquez Suarez. Monetary and

Capital Markets Department: M. Mansilla Arrieta. Strategy, Policy, and Review Department:

J. Gold, I. Halikias, P. Koeva Brooks, S. Lizarazo Ruiz. Statistics Department: S. Arslanalp.

World Bank Group: J. Araujo. Western Hemisphere Department: I. Burgara, N. Chalk,

M. Ghilardi, A. Ivanova, R. Mowatt. Alternate Executive Director: P. Fachada (BR), A. Guerra (CE), D. Ronicle (UK). Senior Advisors to Executive Directors: Y. Danenov (SZ), Z.Mohammed (BR), J.Weil (CO). Advisors to Executive Directors: M. Bernatavicius (NO), L. Cerami (IT), M. Coronel (BR), K. Florestal (BR), O. Haydon (UK), G. Kim (AP), M. Mulas (CE), E. Ondo Bile (AF), F. Rivadeneira (BR), Y. Zhao (CC), K. Hennings (BR), A. Sode (FF).

1. ECUADOR—2019 ARTICLE IV CONSULTATION AND REQUEST FOR AN EXTENDED ARRANGEMENT UNDER THE EXTENDED FUND FACILITY

Mr. Tombini and Mr. Rivadeneira submitted the following statement:

On behalf of our Ecuadorian authorities, we thank IMF management and staff for their engagement and support to Ecuador's economic program. Mindful of the enormous challenges ahead, our authorities reaffirm their commitment to pursue sound macroeconomic and financial policies and are grateful to the Executive Board and the international community for their assistance in the socio-economic transformation of the country.

After years of excessive government intervention and large public spending, the Ecuadorian authorities have initiated a fundamental change of the country's economic structure. The current administration has recognized that the model of the past decade was unsustainable, especially in an environment of lower oil prices, highly uncertain global growth prospects, and volatile financial conditions. To support the authorities' program, the international community is committing US\$10.2 billion to Ecuador over the next three years, including—in addition to the IMF—financing by the World Bank, the Inter-American Development Bank (IDB), the Development Bank of Latin America (CAF), the Latin American Reserve Fund (FLAR) and other international financial institutions. Contingent to Executive Board's approval, the Fund will contribute about USD 4.2 billion (435 percent of quota) to this effort, under an Extended Fund Facility (EFF) arrangement.

The authorities' economic vision is centered at creating a sustainable, dynamic, inclusive, and environment-friendly economy based on four main pillars: (i) restoring the foundations of the dollarization regime; (ii) improving competitiveness, growth, and job creation; (iii) promoting shared prosperity while protecting the poor and the vulnerable; and (iv) fostering transparency, public accountability, and good governance. The authorities are well-aware that strengthening the foundations of a dollarized economy will require substantial efforts on several dimensions, including restoring fiscal sustainability, the central bank's institutional role, and enhancing the overall soundness and resilience of the financial system.

To achieve their objectives, the Ecuadorian authorities have already taken important steps. For instance, in August 2018 the National Assembly passed the Productive Development Law (Ley para el Fomento Productivo), which, among other provisions, forbid the financing of the budget by the Central Bank of Ecuador (BCE), strengthened the fiscal framework, and stimulated private investment and job creation through tax incentives. The

authorities have also reduced discretionary public spending and have started unwinding fuel subsidies, while protecting the most vulnerable segments in society. Accordingly, the non-oil primary deficit (including fuel subsidies) was lowered by an estimated 2.3 percent of GDP from 2016 to 2018.

Nonetheless, the authorities are adamant that more needs to be done to achieve their objectives. Therefore, they are prepared to take the necessary steps on the fiscal, financial, institutional and competitiveness fronts to support the current monetary regime and lay the groundwork for a more prosperous and balanced economy that creates formal jobs through private investment together with a sustainable fiscal stance.

Fiscal Policy

The Ecuadorian authorities are strongly committed to restore fiscal discipline and sustainability. Their overarching objective is to quickly reverse the recent upward trend in public debt and, over time, bring it below 40 percent of GDP. To achieve that objective, the authorities' plan to continue reducing the non-oil primary deficit (including fuel subsidies) by an additional 5 percent of GDP over the course of the EFF arrangement. This will be reached by a combination of expenditure and revenue measures. The fiscal strategy has been carefully formulated to minimize its impact on the real economy. Importantly, part of the fiscal savings achieved in 2019 will provide space to increase social spending by around 0.4 percent of GDP. Looking forward, the authorities aim at maintaining a floor on social assistance spending of about 1 percent of GDP until 2021.

A significant part of the strategy to reduce the non-oil primary deficit will be attained upfront, in 2019. This will include a careful streamlining of the wage bill through wage restraint, limits to new hires and temporary contracts in the public sector and better alignment of wages of new hires with those of the private sector, further optimization of fuel subsidies for industrial use, improvement of public procurement processes, and an update of certain fees charged by the public sector. The authorities also target revenue gains stemming from concessions to the private sector.

Over the medium-term, reforms of the tax system will contribute to strengthen the fiscal position and facilitate investment. In the second half of 2019, the authorities plan to submit to the National Assembly a broad-based and growth-friendly tax reform. This reform will increase efficiency and equity while simplifying the tax system and reducing

exemptions and preferential treatment, targeting an increase in revenues of 1.5 to 2 percent of GDP by 2021.

The authorities are also working to improve public financial management and intend to publish an action plan by the end of April. The action plan includes improved controls for expenditure commitments and domestic expenditure arrears, among other features.

The authorities are committed to strengthen the fiscal framework to enhance fiscal discipline and promote transparency and accountability. They plan to complement the current expenditure growth rule with binding annual targets for the non-oil primary balance. They also intend to review legislation to ensure that the public debt ratio is defined and measured in line with best practices, inconsistencies are eliminated, budget execution data is promptly disclosed, and future breaches to the legislation leads to effective sanctions.

The fiscal program anticipates that with the financial assistance provided by the international community, there will be no need, in principle, to access the international capital markets.

Central Bank Policy

The fact that monetary policy is constrained in a dollarized economy does not imply that there is no role for the central bank. The Ecuadorian authorities are committed to rebuild and modernize the institutional basis and structure of the BCE. They wish to consolidate the new institutional framework in legislation, ensuring that the BCE has clear objectives and functions, designed to support the dollarization. This will include strengthening the bank's operational autonomy by, among other measures, establishing an independent Board that has fiduciary responsibilities and creating strong internal and external audit functions. As a first step in this process, and consistent with the authorities' commitment to transparency and good governance, they have recently published BCE's past externally-audited financial statements.

Monetary financing of the deficit has been eliminated. In complement to the provisions of the Productive Development Law of 2018, regulation has been approved regarding the prohibition of all quasi-fiscal activities of the BCE. Direct and indirect lending to the public sector, including loans, advances, guarantees or any other transaction that indirectly support lending of the public sector have been duly regulated. The authorities intend to incorporate these changes into legislation by the end of 2019. The BCE will

still be able to provide temporary liquidity support to public banks for prudential and financial stability purposes.

The authorities want to gradually rebuild international reserves to more prudent levels. It is their intention to ensure that, by the end of 2021, international reserves fully back the monetary reserves of private and public financial institutions held at the BCE plus coins in circulation.

Financial Sector

The Ecuadorian financial system remains sound, liquid, and well-capitalized. Nonetheless, the authorities are aware that risks to financial stability should not be neglected, particularly in the context of relatively rapid credit growth in some segments of the system. They intend to improve the monitoring of household indebtedness and house prices and may consider the need to adopt macroprudential measures to contain risks. They are also willing to support financial resilience. In order to do so, they will reassess banking resolution procedures, crisis preparedness, and the adequacy of the liquidity fund and deposit insurance scheme.

The authorities plan to simplify and establish more efficient liquidity requirements for banks to deepen financial intermediation and better align with international best practice. They also plan to improve interest rate policies to foster a more competitive financial system and encourage savings, investment and production.

Competitiveness and Job Creation

Ecuador is committed to restore international competitiveness and to attract private sector investment. This will require fundamental changes on a number of fronts, including promoting labor market flexibility, improving infrastructure and the business environment, developing capital markets, and opening up the country to external trade.

Labor market reform to reduce informality, remove rigidities and facilitate access to jobs—especially for women and the youth—is a priority. This will involve carefully rolling back restrictions imposed by the current system on labor contracts and eliminating rigidities that increase hiring costs. Less rigid labor contracts will particularly benefit women and young workers that may prefer part-time jobs or temporary employment. The authorities expect that these initiatives will not only provide strong incentives for firms to create new jobs, but also bring workers from the informal to the formal sector.

The authorities are committed to foster entrepreneurship and innovation and are currently discussing an Entrepreneurship Law that will generate a strong legal framework to business formation and operation. To provide capital for new ventures, the capital markets' legal framework is currently being reassessed. The introduction of an institutional framework for public-private partnerships (PPPs), guided by best international practices is also in consideration.

On the external trade front, the authorities have already taken steps to opening Ecuador to world trade. Recent trade agreements with the European Union and the European Free Trade Association (EFTA) have increased business opportunities, and the country is in process of joining the Pacific Alliance. There is clear interest to close the negotiation process with other partners, including the United States. Ecuador is also undertaking conversations with the OCDE with the aim of accessing the organization in the future.

Social Policies and Governance

Poverty indicators in Ecuador have improved markedly in recent years. Nonetheless, the authorities are determined to continue making progress in this front. Under the EFF arrangement, social assistance spending has been protected. To accelerate poverty reduction, the current administration established the plan *Toda Una Vida* and will continue to expand its coverage. The authorities are also extending coverage and raising the level of benefits for their Human Development Bond conditional cash transfer program. Specific social programs for the disabled and the elderly are also being strengthened. At the same time, the authorities are preparing a comprehensive strategy to better target their social programs and ensure that resources are used to support those most in need. This strategy will encompass improvements in the registration of beneficiaries, as well as other institutional enhancements.

Over a longer horizon, the authorities remain committed to strengthen the efficiency and quality of primary education and health spending, to better develop and tailor human capital to the needs of a dynamic and modern economy.

Much has been achieved in promoting transparency and fighting corruption in Ecuador during the present administration. However, the authorities recognize that there is room for further progress on this front. They are committed to continue advancing good governance and combating

corruption to improve the business climate, lower the cost of public financing, and support private investment and job creation.

The authorities intend to submit to the National Assembly later this year a broad anti-corruption law. This legislation will enhance independence and power of law enforcement agencies and the judiciary, strengthen domestic and international coordination of anti-corruption efforts, and improve access to information about government operations. Prior to this legislation, a transitional Citizens Participation and Social Control Council was appointed last year.

A large part of the anti-corruption strategy is related to more transparency of fiscal data and better accountability of public servants. The authorities remain committed to enhance the transparency of the draft budget process. Monitoring the adherence to the fiscal framework will be strengthened with the publishing of more timely data on the budget execution and fiscal outturns. The authorities are also working to strengthen public procurement processes and, in the future, will require all procurement contracts to be published.

In the case of Ecuador, any anti-corruption strategy should address risks of mismanagement of the oil wealth. The authorities will begin publishing externally-audited financial statements of the two state-owned oil companies and will increase the transparency of their employment policies and practices. They intend to merge their operations to achieve synergies and improve governance. To further institutionalize transparency in the oil sector, the authorities will seek technical assistance during the period of the EFF to pursue membership of the Extractive Industries Transparency Initiative (EITI).

The authorities also plan to develop an AML/CFT national risk assessment in line with FATF standards that prioritizes corruption-related threats. They will use their regulatory and supervisory tools to ensure that banks and other entities adequately monitor business relationships with senior public officials, and that the existing asset declaration regime is strengthened. The authorities plan to submit legislation to the National Assembly later this year to ensure that the proceeds of acts of corruption can be seized.

Economic Prospects and Final Considerations

The authorities are confident that their economic program will be successful in generating growth, jobs and prosperity to the Ecuadorian people.

They see staff's short and medium-term GDP projections to be highly conservative. They agree that their fiscal consolidation effort can be contractionary, but this impact will be offset by the overall improvement in business and consumer confidence, better expectations on future economic developments, reduction in private and public financing costs, and increase in bank liquidity and credit stemming from the elimination of the external financing gap for the next three years. In this regard, Ecuador will offer a great opportunity to the Fund to better understand the working and idiosyncrasies of a dollarized economy, especially in the context of a positive confidence shock.

Ms. Levonian, Ms. McKiernan and Mr. Weil submitted the following statement:

Thank you to staff for their report, and to Mr. Tombini for his helpful buff in which he outlined the authorities' plans to move away from an economic model dependent on oil prices. The authorities should be commended for their reform efforts since taking office in 2016 amid post-quake reconstruction efforts, challenging external imbalances, and a deteriorating macroeconomic environment. Ecuador is now seeking the international community's support to transition to a sustainable, dynamic and inclusive economy, and we hope that this is the beginning of a new relationship with the Fund and the international community.

We support Ecuador's request for a three-year Extended Fund Facility (EFF) with access of 435 percent of quota. The proposed EFF program will support the authorities' efforts to address significant balance of payments vulnerabilities and help restore fiscal prudence after years of excessive spending financed by the central bank. The program will also serve as a catalyst to stimulate the development of the private sector, strengthen key institutions, and address governance and corruption challenges. It will be critical to ensure adequate social protection during this economic transition, particularly as Ecuador faces acute risks, such as a sharp tightening of global financial conditions, rising protectionism, US dollar appreciation, and oil price volatility.

The program includes a significant up-front fiscal adjustment that will need to be implemented carefully. We support the authorities' reform agenda, which includes a large front-loaded fiscal consolidation to finance the EFF program in the face of significant gross financing needs. The combined impact of job losses and wage cuts in the civil service, coupled with tax increases and an eventual phase-out of household fuel subsidies, will need to be managed carefully. As such, Staff have rightfully identified political and social

opposition to policy changes under the program as a key risk. The authorities and staff have designed appropriately apolitical conditionality bearing in mind the current minority Government. It will still be incumbent on the authorities to secure bi-partisan support for key legislation, which includes comprehensive tax and labor market reforms.

An adequate social safety net will be crucial to manage the impacts of the economic transition and protect the most vulnerable. Ecuador has made significant poverty reduction gains in recent years that need to be protected. As such, we strongly support the authorities' plans to increase social assistance spending by extending the coverage and enhancing the benefits of several social programs. The authorities have also wisely decided to defer the phase-out of untargeted household fuel subsidies until the social safety net is properly calibrated. This plan places significant importance on the development, in consultation with the World Bank, of a social registry that can be used as the basis for targeting social programs to the poorest. The implementation of the registry should be prioritized. We look forward to seeing further details of the authorities' longer-term plans to improve health and education outcomes.

Challenges in the transparency of debt reporting are being addressed. We support the authorities' commitment to refrain from non-standard borrowing arrangements in the future, in particular those collateralized against reserves. The Fund should support Ecuador with appropriate technical assistance to build on recent debt transparency achievements, including to help the authorities meet the structural benchmark on SOE financial transparency. Staff should closely monitor progress towards this important benchmark, which would ideally encompass the entire spectrum of SOEs, including those that operate at arm's length from government. Is it possible for the authorities to formalize their commitment regarding non-standard collateralized debt as part of their debt management strategy?

Labor market reform is necessary but should be approached incrementally. We support narrowing the gap between wages and productivity to help realign the real-effective exchange rate with fundamentals. Thus, measures to reduce unit labor cost, such as permitting short-term contracts, eliminating severance for voluntary separation, and lengthening probation periods are welcome. We noted that these reforms would have the added benefit of providing households with young children more flexible employment options. However, in their efforts to reduce labor costs, the authorities should be careful not to go too far in the promotion of part-time employment to the detriment of those seeking to work full-time.

Strengthening the operational autonomy of the Central Bank will be essential to rebuild reserves and the institutional foundations of dollarization. We welcome the 2018 prior action to prohibit most types of central bank financing of the government, a root cause of Ecuador's current weak reserves position. Moving forward, it will be important to address the central bank's interdependence with the government through reforms to the institutional framework. In a dollarized economy, it will also be important to rebuild sufficient reserves so that the central bank can back bank deposits in the event of a liquidity crisis.

Liquidity rules should be modernized, and distortionary financial sector policies should be re-assessed. The authorities should prioritize simplification of bank liquidity rules by adopting international best practices, such as the liquidity coverage ratio, while considering the implications of more limited sources of high quality liquid assets beyond sovereign debt. We also support the eventual elimination of the distortionary interest rate cap, which prevents financial institutions from properly pricing risk, harms productivity, and limits financial inclusion.

Mr. De Lannoy and Mr. Etkes submitted the following statement:

We thank staff for their informative set of papers and Messrs. Mr. Tombini and Rivadeneira for their helpful buff statement. Ecuador struggles to sustain the dollarization, due to a structural non-oil fiscal deficit, a drop in fuel prices and the resulted rising debt. We commend the authorities for adopting a challenging reform agenda including prudent fiscal policy, strengthening the central bank independence, and reducing frictions in the labor market. This agenda is expected to yield results in a few years yet may harm growth in the very short term. As Ecuador's external reserves are very limited, the Fund's assistance is urgently needed. We broadly concur with the thrust of staff appraisal and add the following comments for emphasis.

We note that Ecuador's public debt increased from about 15 to over 30 percent of GDP between 2013 and 2018, while real GDP grew by 5 percent. A significant part of the mounting debt financed public investment in infrastructure projects such as the Coca Codo Sinclair dam, which according to media reports is not very productive. Another indication of unproductive investments is the negative TFP in 2010-16 after a decade of positive TFP (p. 24). Can staff comment on the efficiency of public investments? Is there scope for TA, such as PIMA, to enhance public investment efficiency? Staff also asserts that future increases in productivity

will need to be sourced from private sector investments, including from public private partnerships in infrastructure.

We support the authorities' steps to improve governance, tackle corruption, and strengthen the effectiveness of the AML/CFT framework (pp: 20-21). Indeed, weak governance could be a major reason for low efficiency of public spending, including on infrastructure. In this context, we also commend the authorities for signing the OECD's Convention on Mutual Administrative Assistance in Tax Matters, and look forward to the beginning of automatic information exchange via the CRS to start in September 2020. An upcoming study by FAD indicates that automatic exchange of information frameworks reduced foreign-owned deposits in offshore jurisdictions by an average of 25 percent, and we believe it will also benefit the source jurisdictions.

The labor market suffers from a number of rigidities that hamper productivity. The public wage is double the wage in the private sector, which is not only a fiscal burden but most likely also affects wages in the formal private sector. The government's plan to reduce wages for new public-sector employees, but not for veteran employees, implies that the public wage bill will remain inflated for years. In addition, the probation period (after which employees are entitled to protection, including severance payments) is expected to be extended by the government from 3 months to 12 months. Extensive research documents show that a sharp increase in cost of employment after a year or two of employment could cause "revolving doors" of short term workers and a high level of frictional unemployment. We advise the authorities to examine options for reducing the public wage of veteran workers together with the wage of new recruits and for smoothing the increase in costs of employment to avoid having a two-tier labor market.

Mr. Psalidopoulos and Ms. Cerami submitted the following statement:

We support the conclusion of the 2019 Article IV consultation with Ecuador and the authorities' request for a 36-month Extended Fund Facility. We thank Mr. Tombini and Mr. Rivadeneira for their helpful buff statement. The comprehensive set of staff's papers provides a clear analysis of the causes that led to the significant deterioration of the country's internal and external imbalances and identifies key policies to stabilize the economy. We welcome the authorities' commitment to fully implement an ambitious reforms program aligned with staff's recommendations, as indicated in the attached Memorandum and confirmed in the buff statement. The authorities' intention to seek technical assistance from the Fund and the World Bank on multiple

fronts, which we strongly encourage, also bodes well for the program. However, Ecuador remains highly vulnerable to external downside risks associated with a possible further fall in oil prices and an appreciation of the U.S. dollar. The unfavorable balance of risks will require a careful calibration of the program and a close monitoring of its implementation.

We appreciate the parsimonious selection of the quantitative performance criteria, including a floor on social assistance spending. The program sets an ambitious target for the non-oil primary deficit including fuel subsidies, underpinned by legislative changes to strengthen fiscal management and fiscal rules and introduce a comprehensive tax reform, which constitute structural benchmarks to be achieved in 2019. We welcome the authorities' commitment to use part of the savings and revenue generated by these fiscal measures to increase social spending and to maintain a floor on such spending of about 1 percent of GDP until 2021. We call on the authorities to swiftly amend the central bank's legal framework to prohibit monetary financing of the non-financial public sector and to ensure that the central bank is fully independent, recapitalized and entrusted with clear functions and objectives. The reform of the central bank framework will be key to rebuilding foreign reserves and meeting the floor set by the program.

The timeline of the structural benchmarks is heavily concentrated in the period up to October 2019. During this period, Ecuador is expected to undertake several major reforms to strengthen public financial management, fiscal rules and the central bank legal framework, enhance fiscal transparency, establish a broad anti-corruption framework, improve the tax code and the efficiency and quality of primary education and health spending. While we acknowledge the need to step up reform efforts consistently with the recommended frontloaded fiscal adjustment, we wonder whether a more evenly distributed agenda over the duration of the program might increase the chances of a successful program. It may also provide greater latitude in carefully sequencing the envisaged measures and exploiting their synergies. How would staff assess Ecuador's capacity to fully and timely enact the proposed program?

We support the retention for a one-year period of the exchange restriction arising from the foreign exchange outflow tax, on the basis that it is maintained for balance of payment reasons, is temporary and non-discriminatory. We take note that the authorities intend to eliminate this tax, which was introduced in 2007, once macroeconomic stability is restored, and the reserve position is strengthened. At the same time, staff assess international reserves to be well below levels adequate to mitigate potential

shocks to a dollarized economy. What level of reserves would staff consider adequate for phasing-out the tax on transfers abroad?

Mr. Geadah and Ms. Fadhel submitted the following statement:

We thank staff for the comprehensive set of reports and Mr. Tombini and Mr. Rivadeneira for the helpful buff statement. We broadly agree with the staff appraisal and support the authorities' request for a 36-month Extended Fund Facility and the proposed decisions.

A broad-based fiscal reform is warranted to restore fiscal discipline and sustainability. This should include addressing inefficiencies in the tax system, reducing public spending including the high public-sector wage bill, and optimizing fuel subsidies. We take note of the authorities' fiscal strategy which aims to reduce the non-oil primary deficit (including fuel subsidies) by 5 percentage points of GDP over 2019-21, and to reverse the upward trend in public debt in order to reduce it below 40 percent of GDP. We are pleased to note that the fiscal strategy has been formulated to protect social spending. In 2019, there will be space to increase social spending by around 0.4 percent of GDP. The authorities aim at maintaining a floor on social assistance spending of about 1 percent of GDP until 2021.

The financial system remains stable. Banks are reasonably capitalized, and non-performing loan ratio is low at 3 percent. However, liquidity conditions are tightening as private credit growth has outpaced deposit growth. Financial intermediation could be made more effective through eliminating the current ceilings on interest rates to allow better allocation of resources, and to replace the multiple liquidity requirements with liquidity requirements in line with international best practice. We are encouraged by the steps taken by the authorities under the "Productive Development Law" to increase central bank independence including to fully prohibit direct and indirect financing of the government and the nonfinancial public sector. We are also encouraged by the plans to strengthen the governance of the central bank including the introduction of an independent board and audit committee, as well as the oversight of banks and cooperatives.

Ambitious structural reforms are needed to address labor market rigidities and improve competitiveness. This could include the introduction of more flexible labor contracts that facilitate female participation in the labor force and provide more job opportunities for the youth. Also, reducing the costs of hiring and firing labor can help enhance labor market flexibility and benefit competitiveness. We encourage the authorities to adopt policies that

help address low TFP growth, which has been negative for almost a decade. These policies can include adopting public private partnerships especially in infrastructure projects, as well as continuing to remove trade barriers, improve the business climate, and strengthen institutions. The Selected Issues and Analytical Notes paper showed that the oil sector contributed only 9.9 percent of output in 2015, which is not high compared with other oil producing countries. Does staff think that the economy is overly vulnerable to the volatility in oil prices given the low share of the oil sector in the economy?

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the comprehensive set of reports and Mr. Tombini and Mr. Rivadeneira for their informative buff statement. We note that Ecuador is facing daunting and increasing challenges. Domestically, although inflation remains subdued and unemployment rate has fallen, the fiscal path has been unsustainable and growth remains weak. Vulnerabilities in the external sector have increased due to the significant depletion of foreign reserves, high gross external financing needs and a significantly appreciated REER. Against this backdrop, we support the Ecuadorian authorities' request for a three-year extended fund facility (EFF) based on the proposed policies elaborated in the MEFP, the objectives of the program and the political ownership given to the program. We broadly concur with the thrust of the staff's appraisal and recommendations and would like to offer following remarks for emphasis.

We are encouraged by the authorities' reform agenda aimed at putting debt firmly on a downward path, build reserve buffers and restore international competitiveness while improving social assistance system. We also welcome the plans for taking measures to restore central bank autonomy, tackle corruption and increase transparency. The authorities' economic vision, which is aimed at creating a sustainable, dynamic, inclusive, and environment-friendly economy, based on four main pillars, elaborated in the buff statement, is well-suited to achieve these objectives. However, a key challenge would be to achieve the envisaged program targets without jeopardizing the substantial social progress achieved in recent years. The program seems to be ambitious and subject to significant risks, given its substantially front-loaded nature. As the strong ownership of the program will be key for ensuring its success, we urge authorities' unwavering commitment during the entire program period to achieve the desired outcomes.

Fiscal policy will have to do the heavy lifting in the reform process as the use of exchange rate and monetary policy is constrained in a dollarized

economy like Ecuador. A strengthened fiscal position will also be key to reinforce the foundation for dollarization in the economy. Hence, fiscal adjustment cannot be further postponed given the widening financing gap. In this backdrop, we note the additional 5 percent of GDP adjustment in the non-oil primary deficit expected in the program period, which is obviously envisaged to achieve through rebalancing the composition of revenue and spending and strengthening PFM while ensuring the protection of the poor, improving public investment and minimizing the impact on the real economy. More specifically, we see that adjustments mainly involve expenditure restraint by unwinding fuel subsidies and reducing salaries and wages by realigning public sector wage bill and reducing the number of public sector employees. We welcome the plans to maintain a floor on social assistance spending of about 1 percent of GDP until 2021, which will help safeguarding the poor and vulnerable from the impact of reforms. Staff comments are welcome on the authorities' plans for rapid fiscal tightening in an environment of low domestic growth and weakening global expansion. We are encouraged by the proposal to reform tax system to make it more equitable and growth friendly. Also, we take the positive note of authorities' plans to review legislation to ensure that the public debt ratio is defined and measured in line with best practices, as elaborated in the buff statement.

We commend the envisaged reforms in the Banco Central del Ecuador (BCE) to improve its institutional framework, restore autonomy, and strengthen the governance and accountability. We positively note that the decision to forbid the financing of the budget by the BCE has already been taken. Could staff comment on any interim arrangements to address potential difficulties to the government cash flow due to this decision? We welcome the authorities' intention to gradually rebuild international reserves to more prudent levels. Staff's comments are welcome on the ambitious targets on net and gross reserves in the program compared to the low level of current reserves, given the substantial risks in the external sector.

The financial sector needs efforts to reinforce confidence and minimize risks to its stability. We note that Ecuador's financial system is sound and adequately capitalized while NPLs are relatively low, although liquidity conditions are tightening. With risks to the financial sector are mounting, particularly in the context of relatively rapid credit growth, the regulatory and supervisory framework needs to be strengthened. We commend the plans to improve financial oversight, banking resolution procedures and crisis preparedness. Measures to address impediments to financial intermediation are also a priority.

Restoring the international competitiveness of the Ecuadorean economy is crucial to revive growth given the significant appreciation of the real exchange rate that has eroded the competitiveness of the economy. Hence, medium-term policy reforms to address Ecuador's structural characteristics i.e. inflexible labor markets, high unit labor cost relative to labor productivity and low economic diversification, are unavoidable to restore competitiveness and achieve long-term sustainable growth and job creation. Improvement of the investment climate through structural reforms and development of capital markets is also essential in attracting FDIs as well as fostering entrepreneurship, innovation and productivity. Further, we welcome the developments in trade agreements and measures to address corruption and strengthen the AML/CFT framework.

With these remarks, we wish Ecuadorean authorities all the very best in their future endeavors.

Mr. Saito, Mr. Ozaki and Mr. Komura submitted the following statement:

We thank staff for the comprehensive report and Mr. Tombini and Mr. Rivadeneira for the informative statement.

The Ecuadorian economy, which is fully dollarized, faces a difficult situation. The drop in oil prices and rise in the US dollar in 2014-15 caused a sharp economic slowdown in 2015-16, leading to the high non-oil primary fiscal deficit. The deficit was financed by short-term domestic debt, a draw-down of central bank reserves, and the placement of debt in international markets at a high cost. Such fiscal policies have undermined the viability of the dollarized system, with balance of payments vulnerabilities including low gross international reserves.

We welcome that President Moreno has pushed forward important reforms to strengthen the foundation of the dollarized system since May 2017. In particular, we highly commend that with a support from technical assistances, the authorities have been working on improving debt transparency, such as publishing a report by the auditor general which revealed that the public debt was significantly higher than previously stated. Accurate information, including one on public debt, is imperative for Ecuador's policy making and its Fund-supported program.

It is also welcoming that the administration has been strengthening relationships with IFIs. In particular, we support that the authorities have well

utilized technical assistances on a wide range of areas, including statistics, the fiscal responsibility framework, and debt management.

Looking ahead, we support the administration's ambitious reform agenda. As the economy faces significant vulnerabilities and downside risks, including a further fall in oil prices and a global capital market tightening, Ecuador needs to fundamentally change the country's economic structure. We therefore support the request for an Extended Arrangement Under the Extended Fund Facility. The main objective of the program is to restore its macroeconomic stability of the fully dollarized economy. At the same time, in the longer horizon beyond the program period, does staff consider it appropriate for Ecuador to move to a de-dollarized economy? What would be necessary conditions where de-dollarization becomes appropriate?

As we broadly concur with the staff's appraisals, we would like to offer three comments for emphasis:

Fiscal Policy

Prudent fiscal policies, together with adequate protections for poor and vulnerable, are imperative. The public debt has more than doubled between 2012 and 2017 to 45.4 percent of GDP, well above the prudent debt ceiling. To put public debt on a firmly downward path, we tend to support the authorities' commitment on reducing the non-oil primary deficit by 5 percent of GDP over the next three years and look forward to steady implementation of the specified reform agenda, including tax reform, reducing public sector wage bills, and reducing fuel subsidies. Could staff comment on the appropriateness of the staff's baseline assumption on the impact of the proposed reduction of the non-oil primary deficit on economic growth, including multipliers, as a preliminary finding of the Review of Conditionality flags risks to underestimate such impacts? On debt arrangements, we note that Ecuador has entered into certain sovereign repurchase agreements and other borrowing arrangements with collateral-like features. Could staff elaborate on associated benefits and risks on borrowing arrangements with collateral-like features? We strongly commend the authorities' commitment on providing full information on past and future borrowing with collateral-like features.

Next, given the high dependency on oil with volatile revenues and historical overspending during oil booms, we agree with staff and the authorities that the medium-term fiscal framework is warranted for ensuring counter cyclical fiscal policies.

Finally, we would like to reemphasize the importance of protecting poor and vulnerable. Social indicators presented in the table 1 show that poverty level remains high while having significantly fallen over the decade. In this context, mitigating negative effects from ambitious reforms is important for the program success.

Supply-side Reforms

Enhancing competitiveness needs strong supply-side measures. We support the authorities' priorities, including labor market reforms and governance reforms. On labor market reforms, we note that Ecuador's minimum wage is the highest among Latin American countries, hurting its competitiveness. Meanwhile, inadequate employment rates which include those who work with less than minimum wages are high. Against this backdrop, we believe that a certain reform, for example, lowering minimum wages and strengthening associated enforcement, to ensure both competitiveness and safety net for workers. On governance reforms, we support the authorities' efforts, including penalizing corruption, and look forward to seeing more progress.

Financial Sector and Monetary Policy

A more resilient financial sector and a stronger and more independent central bank are warranted. We welcome that the financial system remains stable. We agree with staff that credit growth should be carefully monitored as private credit is growing at 15 percent y-o-y while deposits have been flat over the past year. We also concur with staff that the authorities need to eliminate ceilings on interest rates and replace the complex system of bank liquidity regulations with minimum liquidity requirements. Finally, Ecuador needs a stronger and more independent central bank. In this regard, we commend the authorities' commitment on fully prohibiting all direct and indirect central bank financing which has already been partly envisaged by the 2018 Law on Productive Development. We positively take note that the authorities intend to improve its legal framework in line with best practices for dollarized economies. Could staff elaborate on the best practices of the legal framework for central banks in dollarized economies?

Mr. Kaya and Mr. Hagara submitted the following statement:

We thank staff for their well-focused reports and Messrs. Tombini and Rivadeneira for the informative buff statement. Ecuador's economy is gradually returning to positive growth after a contraction in 2015-16, caused

by the fall in oil prices and rise in the US dollar, and further amplified by a major earthquake. We welcome the recent progress with reform implementation, but significant domestic and external imbalances remain to be resolved to increase the economy's growth potential. We broadly concur with staff's appraisal and support the authorities' request for a three-year Extended Arrangement under the Extended Fund Facility.

Continued fiscal consolidation is needed to put public debt on a downward trajectory. The high non-oil primary deficit, exposed by the 2014 oil price decline, was the main reason behind the significant increase of public debt. While the authorities' cuts in capital expenditure have reduced the deficit since 2016, further fiscal consolidation is needed for public debt to return on a declining path and we welcome the authorities' plan of front-loaded fiscal consolidation. We appreciate staff's extensive analysis of the calibration of Ecuador's debt ceiling level, which indicates that, in the longer term, the authorities should aim to reduce public debt to 30 percent of GDP. Equally important will be to ensure adequate institutional coverage of the debt and strengthening the budgetary framework.

As for the composition of fiscal consolidation, the public wage bill and fuel subsidies are high in regional comparison and need to be reduced, while also protecting the poor segments of the population by a sufficient safety net. At the same time, capital expenditures should be carefully prioritized. On the revenue side, we concur with the principles of the tax reform, including shifting towards indirect taxation, broadening the tax base, eliminating exemptions and phasing out distortionary turnover taxes. Since the tax reform is assumed to bring significant additional revenues, we wonder whether staff can provide us with more details about specific tax changes under consideration as well as their distributional impact. We welcome that the amended budgetary framework will introduce a contingency reserve in the budget and would like to know what the size of the reserve for 2020 will be.

Independence of the Central Bank should be strengthened. In view of the low reserves, the authorities' steps to restrict central bank financing of the government and public entities as well as their plan to expand and formalize the prohibition of all types of central bank financing, are welcome. Furthermore, the central bank's institutional framework should be enhanced, including by the introduction of an independent Central Bank Board and Audit Committee as well as by strengthening the BCE's financial and personal autonomy.

While the financial sector seems stable for now, the rapid credit growth should be monitored to avoid credit and liquidity risks and we encourage the authorities to enhance the effectiveness of financial oversight. The interest rate caps on lending should be abolished, allowing competition in the banking sector to play a bigger role. We also share concerns about the forced overexposure of banks to domestic assets due to various liquidity requirements. At the same time, the AML/CFT framework should be aligned with the FATF recommendations.

In view of Ecuador's dollarization, the internal devaluation is important for restoring price competitiveness and improving the external position. Following more than a decade of excessive growth, public sector wages are twice as high as those in the private sector. Besides containing public wages, the authorities should also pursue reforms to increase the flexibility of the labor market.

Mr. Meyer and Ms. Kuhles submitted the following statement:

We thank staff for their comprehensive and informative set of reports and Mr. Tombini and Mr. Rivadeneira for their helpful buff statement. We concur with the thrust of the staff appraisal. Ecuador is subject to significant vulnerabilities stemming from a policy path inconsistent with the dollarization regime. An imprudent fiscal policy is at the core of the country's imbalances and has been further exacerbated by central bank financing. At the same time, the economy has lost competitiveness with wage increases outpacing productivity growth and together with exchange rate developments of the US dollar leading to a significant REER overvaluation. In order to revitalize the underpinning of the dollarization regime it is imperative to undergo a wide-ranging adjustment effort covering decisive fiscal consolidation, boosting competitiveness through structural reforms and replenishing very low international reserves while safeguarding social cohesion. With the authorities being determined to continue an ambitious fiscal adjustment and implement reform measures commensurate to the economic policy constraints under dollarization, we can support the requested EFF arrangement.

We commend the authorities for committing to a determined correction of the unsustainable fiscal path. The authorities appropriately intend a consolidation strategy comprising both revenue and expenditure measures. Restraining the public wage bill and reducing the headcount are useful beyond their direct impact on the budget deficit by also sending signals to the private sector wage formation process relevant to restoring competitiveness. A careful social spending strategy should focus on protecting

the most vulnerable by redeploying resources from the fuel subsidy scheme to more efficient and targeted social programs. A fiscal framework with well-designed budgetary rules and preventing recourse to central bank financing are important steps to secure longer-term progress towards a sustainable fiscal path.

We note that the magnitude of the implied fiscal adjustment path under the program will be in the upper range of fiscal adjustment realized by countries in the past (DSA figure 3, page 54). In consequence, it will be important to guard against the risk of overoptimistic assumptions and to maintain strong reform ownership. Could staff further elaborate on how much of the projected improvement in the headline fiscal balance is depending on the assumption of higher oil revenues? Furthermore, we also like to recall that the forecast track record of the primary balance has in the past featured a significant optimism bias (DSA figure 3, page 53) in the case of Ecuador, thus further underpinning the need for prudent program assumptions.

We appreciate staff's work on deriving a prudent public debt ceiling in Ecuador. The calibration seems reasonable given the country's setting and provides for a sensible safety margin.

We welcome the thrust of the program's structural reform package. The focus should be on restoring competitiveness through productivity-enhancing reforms and reducing the rigidity of the labor market. Eliminating structural and institutional obstacles will help the private sector to adapt more efficiently and thus unfold productive forces. At the same time, nominal wage restraint should allow productivity growth not to be outpaced by inflation and thus to reduce the REER overvaluation. Further steps are also needed on improving the governance of public entities and tackling corruption.

We wholeheartedly support the objective to strengthen the framework of the central bank. Besides the reinforcement of the legal framework granting institutional and operational independence, it is vital to credibly prohibit all direct and indirect central bank financing of the state. Considering the characteristics of a dollarized economy, we also fully support the requirement to gradually cover liabilities towards the domestic banking system with international reserves. The strengthening of the central bank will be indispensable for the credibility of the authorities' adjustment efforts as the last safeguards assessment in 2017 concluded that the central bank's institutional framework was not ensuring independent management of its resources. Hence, we strongly encourage the authorities to expedite remedial

actions to identified shortcomings and look forward to the safeguards assessment to be updated before the first program review.

We reiterate our concerns about the provision of direct budget support. Could staff elaborate on the content of the memorandum of understanding between the central bank and the government on their respective roles and obligations mentioned in paragraph 42?

We take note that the minimum circulation period has been breached. An excessively short circulation period impedes an adequate assessment and risks undermining the oversight function of the Executive Board. This is particularly deplorable in the case at hand of a program request entailing substantive adjustment needs and significant risks for program success.

We take positive note of staff's work on non-standard borrowing arrangements in box 4 and the authorities' commitment not to enter into new ones. To adequately assess risks for debt sustainability as well as Ecuador's capacity to repay the Fund, the authorities' commitment to provide detailed information on external non-financial public-sector debt, including information on all collateralized debt and debt with similar arrangements and the expected repayment schedules is of the essence. Could staff further elaborate on the significance of the debt service payments or loss of export revenues associated with existing non-standard borrowing arrangements?

Mr. Mouminah, Mr. Alkhareif and Mr. Rouai submitted the following statement:

We thank staff for their work, including in the SIP to improve the accuracy of growth projections by using nowcasting and forecasting GDP. We also thank Mr. Tombini and Mr. Rivadeneira for their comprehensive buff statement. We welcome this opportunity to review recent developments in Ecuador given that the last one was completed in July 2016, almost three years ago. We broadly agree with staff conclusions and policy recommendations and support the authorities' request for an extended arrangement under the EFF.

In recent years, large macroeconomic imbalances have been building in Ecuador. Ecuador has been pursuing an unsustainable fiscal policy with excessive government intervention and large public spending. Such policy has been compounded by the 2016 devastating earthquake and the appreciation of the US dollar. As a result, the country's financial position and its competitiveness deteriorated. We also note that the overall fiscal deficit reached 8.2 percent of GDP in 2016 and gross international reserves declined

to only US \$ 2.2 billion at end 2018, making Ecuador's gross reserve coverage the lowest of any emerging market economy.

Against this background, we welcome the authorities' initial policy response detailed in ¶5. Important adjustment efforts have already been made under the 2018 Productive Development Law to send a strong signal about the importance of fiscal transparency and the autonomy of the central bank, coupled with initial measures to cut subsidies and reduce the non-oil primary deficit.

Beyond this initial policy response, we consider that the authorities are right in recognizing the need for a fundamental change to the country's economic structure. We consider that the proposed arrangement will help Ecuador address its macroeconomic imbalances and strengthen the foundations for sustainable and inclusive growth. In this regard, we support the emphasis on restoring prudent fiscal policy and put public debt on a downward path by committing to increase the non-oil primary balance by 5 percent of GDP during the program period 2019-21 through both revenue and spending measures.

We welcome the supply side measures under the program and efforts to strengthen institutions. Ecuador needs to improve competitiveness and foster higher private sector productivity and we therefore welcome the efforts to contain labor costs, reduce labor market rigidities, promote open trade, and create a more efficient tax system. In the same vein, we encourage the authorities to improve financial intermediation, enhance governance and transparency, and strengthen the autonomy of the central bank.

The emphasis in the program on protecting the poor and vulnerable is appropriate. Despite recent efforts to improve social outcomes, poverty remains high and we therefore agree with the authorities on the need to strengthen their support to the poor, particularly in view of current plans to further reduce fuel subsidies. We however encourage the authorities to proceed gradually with subsidy reform and rely on good communication. We welcome the involvement of the World Bank to enhance targeting. We support the inclusion of a quantitative performance criterion on the floor on social assistance spending of the central government in the program.

Having said this, we would appreciate staff elaborations on the following issues:

On the timing of the request for an arrangement, we noted that the authorities placed US\$ 1 billion in 10-year bonds in January 2019 at a yield of 10.75 percent. Could staff clarify why the authorities had to accept such elevated yield instead of approaching the Fund at an earlier stage?

On social spending, could staff confirm our understanding that the floor on social spending is at 1 percent of GDP under the program? There seems to be a discrepancy between the 0.4 percent of GDP in the Table in page 16 which points to an increase, whereas the same amount in Table 2b seems to indicate the total for each year under the program. In the same vein, could staff offer some indications on the level of social spending in the years prior to the program? Finally, is the coverage of social spending consistent with current efforts by the Fund to go beyond social protection? And are there any preliminary lesson from the extension of social spending to health and education?

Structural reforms. Normally, an arrangement under the EFF is a vehicle for implementing structural reforms to modernize and diversify the economy. Our preliminary impression is that the EFF is short on structural reforms and we would appreciate if staff could elaborate on this issue.

Statistical Issues. Staff assessment of statistical issues in the Informational Annex points to a number of shortcomings in addition to the finding by Ecuador auditor general of deficiencies in the compilation of public debt. Could staff elaborate on these shortcomings as they relate to the SDDS and on the effectiveness of IMF technical support since Ecuador has been benefiting from extensive TA by STA in the last three years?

On program modalities, could staff elaborate why they saw the need for quarterly reviews instead of semi-annual reviews?

With these comments, we wish the authorities all the success.

Mr. Tan and Mr. Pham submitted the following statement:

We thank staff for the comprehensive set of documents and Messrs. Tombini and Rivadeneira for their informative buff statement.

Ecuador is facing deep-rooted structural issues including an inefficient public sector, significant macroeconomic imbalances, a lack of stabilization mechanisms and limited private investment. Decisive actions are needed to strengthen fiscal sustainability and the institutional foundation for a fully

dollarized economy, boost competitiveness and job creation while protecting the poor and most vulnerable, as well as improve transparency and strengthen the fight against corruption. Against this backdrop, it is encouraging that the authorities have been taking steps toward strengthening fiscal institutions and re-establishing a more competitive private sector-led economy. We also welcome the recent efforts to adapt the economy to a challenging international context that is characterized by low oil prices, appreciation of the US dollar and rising external financing costs. In this light, we support the authorities' request for a three-year Extended Fund Facility and the retention for a one-year period of exchange restriction arising from making payments and transfers on current international transactions, as required under Article VIII, Section 2(b) of the Fund's Article of Agreement. We agree with the thrust of staff's assessment and offer the following comments for emphasis.

Restoring fiscal discipline and long-term sustainability remains the top policy priority. Maintaining government spending on social programs while ensuring the sustainability of public finances will be a significant challenge for Ecuador in the near term. In this regard, we welcome the authorities' policy plan to achieve fiscal realignment through both revenue and spending measures while maintaining a floor on social assistance spending of about 1 percent of GDP until 2021. These efforts would help generate the necessary fiscal space for social assistance spending and phasing out the distortionary tax on transfers abroad as macroeconomic and reserve conditions improve. While we support a time-bound retention of restriction on transfers abroad for BOP reasons, could staff comment on the policy options and sequencing to avoid disruption in the financial market and the economy as a whole when the restrictions are phased out? We note staff's assessment that the real exchange rate remained overvalued and acted as a constraint on the country's competitiveness, growth and job creation, as well as a key vulnerability for the economic outlook. Henceforth, the external position should be strengthened by building up adequate reserve cushions. The authorities' proposed measures, including eliminating untargeted fuel subsidies, better targeting the conditional cash transfers program, and eliminating supplier arrears, should also be undertaken in a timely manner to help reduce distortions in the economy and strengthen the private sector.

Strengthening the institutional framework of the BCE and the oversight of banks and other financial institutions will help boost financial sector resilience and support market confidence. We take positive note of the large buffers and low NPLs in the banking sector. We also welcome the 2018 adoption of the Productive Development Law which would allow the BCE to refrain from providing further monetary financing of the budget. As rapid

credit growth could expose the financial sector to liquidity risk in the short-term and credit risk in the medium-term, we encourage the authorities to make further efforts to remove barriers to effective financial intermediation, enhance banks' risk management, and improve oversight and contingency planning.

Comprehensive and well-sequenced measures to improve competitiveness, foster job creation and raise productivity are critical for program success. Given Ecuador's current exchange rate regime, these measures are particularly important to improve the business climate and support growth in the medium-term. Therefore, we welcome the authorities' plan to implement comprehensive reforms that address, among other things, existing labor market rigidities such as providing for more flexible employment. At the same time, continued structural reforms are also needed to ease regulations and enhance competition in the labor and financial markets.

With these comments, we wish Ecuador and its people every success in their future endeavors.

Mr. Lopetegui and Mr. Vogel submitted the following statement:

We thank staff for the reports and Mr. Tombini and Mr. Rivadeneira for their helpful buff statement.

We support the request for an Extended Arrangement under the Extended Fund Facility. Our support is based on the ongoing efforts and the authorities' commitment to boost potential growth, protect the most vulnerable sectors of society, restore fiscal sustainability, and improve governance, as well as the staff's positive assessment regarding Ecuador's capacity to repay. We commend the Ecuadorian authorities for the policies and structural changes implemented over the past two years, which are clearly summed up in the buff statement. We fully share and applaud the authorities' vision and the four main pillars on which it is based.

The diagnosis of the country's risks and challenges is rightly illustrated in the staff report when stating that the core of Ecuador's imbalances is deeply related to unsustainable fiscal policies carried out in the past. Fiscal deficit and public debt had substantially increased, the former surpassing 8 percent of GDP in 2016. Even though public debt-to-GDP ratios were not at high levels, the rising trend was unsustainable. Evidently, previous economic policies, especially those in the fiscal area, were not consistent with

dollarization. Imbalances over the past year led Ecuador to suffer a critical reduction of international reserves and, as underscored in the Selected Issues and Analytical Notes' chapter on Reserve Adequacy, the NIR position is well below prudent levels. Therefore, it is of the essence to undertake policies aimed at rebuilding reserves, as envisaged in the program.

We welcome the authorities' firm decision to put the public debt on a downward path. The significant decline of the overall fiscal deficit from 2016 to 2018 clearly reflects their commitment. Staff provides excellent guidelines and recommendations regarding the need to enhance the tax system and revenue administration, on which IMF and World Bank's technical cooperation will be key. Phasing out the tax on transfers abroad could be important to mitigate distortions. The report indicates that the authorities intend to phase out such tax once macroeconomic stability is restored. Regarding reforms to the tax system, we would like to have staff's views on the political support for this reform.

We are encouraged by Mr. Tombini and Mr. Rivadeneira's remarks that the authorities are determined to continue making progress to improve social conditions and reduce poverty, with a vision not only to maintain past achievements, but more importantly, to do more in terms of quantity and, especially, efficiency. Education and health are vital to improve social conditions and boost potential growth. We fully support the establishment of a floor on social assistance spending of the central government.

Even in a dollarized economy, a country's central bank has a key role to play. Evidently, its role should be (the buff statement is reassuring in this regard) very different from that observed until a few years ago, when the institution provided direct and indirect financing to the government and nonfinancial public sector. The 2018 Law on Productive Development and the expected legal framework on central bank activities are crucial to increase confidence and promote appropriate incentives. Meanwhile, the financial system should play a much better role in the country's economy, for which it would be important to address the remaining obstacles regarding intermediation, as well as the financial exposure to the central government.

We agree with the necessity of implementing a combination of supply side measures, which include some in the labor market. On the social burden of adjustment program on labor, it would be important to avoid an excessively pendular movement from protection to liberalization, which may potentially pose political and social hurdles to accept and support other key reforms. As an example of this, the report mentions the government's intention to increase

the probation period prior to an open-ended contract from 3 to 12 months. How would 12 months of probation compare to other countries in the region? Could staff also comment on the degree of labor informality in Ecuador? We fully support the authorities' intention to improve governance, tackle corruption, build a framework for public private partnerships, and further insert Ecuador in the global economy.

Mr. Ostros and Mr. Bernatavicius submitted the following statement:

We thank staff for their informative reports and Mr. Tombini and Mr. Rivadeneira for their useful buff statement. In light of the authorities' well-designed economic plans and commitments going forward, we support the request for a 36-month Extended Fund Facility. We also take note of the significant additional financing commitments from other international financial institutions.

After an abrupt downturn in 2015-2016, the economic activity returned to growth, but significant imbalances remain. Over the past decade, wage increases have outpaced productivity growth and the real effective exchange rate is assessed to be significantly overvalued in the context of the dollarized economy. Ecuador lags its peers in competitiveness indicators and total factor productivity growth has been negative for much of the past decade. In this context, we welcome the authorities' ambitious reform plans. We take note that some key measures have been already implemented and accepted by staff as prior actions. We would like to ask staff whether they considered imposing any additional prior actions before going to the Board?

Restoring central bank independence and terminating monetary financing of the government is of the utmost importance to the fully dollarized monetary system. To ensure the credibility of the central bank's independence, authorities should introduce a strong legal and institutional framework underpinned by financial autonomy, clear procedures for the appointment and dismissal of Board members, and strong internal mechanisms to ensure proper audit and accountability. Ecuador's international reserves at the end of 2018 representing only 1.25 months of imports should be adequately replenished. We particularly welcome that one of the program's quantitative performance criterion will be the floor on the central bank's net international reserves.

Unsustainable fiscal policies were at the core of Ecuador's current imbalances and we strongly support an ambitious fiscal adjustment strategy. In the context of a dollarized monetary system, fiscal consolidation is the

main and the most important policy tool. The social safety net should also be improved by increasing the effectiveness of public spending. We welcome the authorities' commitments to gradually eliminate the untargeted fuel subsidies, which remain a significant component of government expenditure.

We welcome the authorities' plans to improve governance and tackle corruption. The enhanced independence and effectiveness of law enforcement agencies and the judiciary could make Ecuador a more attractive destination for private business. We also welcome recent efforts to increase fiscal transparency and adopt consistent international standards for the reporting of public debt.

The financial system is stable, but vulnerabilities remain. The strong pace of credit growth and increasing loan-to-deposit ratio amid weakening economic activity warrants consideration on the need for more active macroprudential policies. Staff comments would be welcome.

The ratification of a trade agreement with the European Union in 2017 is a good step in the right direction towards improving Ecuador's competitiveness. Even though import tariffs imposed at the end of 2017 were eliminated by June of 2018, a further tariff reduction is warranted as staff analysis shows that Ecuador's export share is lower than other countries with a similar profile.

Mr. Mahlinza and Mr. Tivane submitted the following statement:

We thank staff for the comprehensive set of reports, and Mr. Tombini and Mr. Rivadeneira for their helpful buff statement.

The Ecuadorian economy has seen a modest recovery from the devastating impact of the 2016 earthquake, owing to a steadfast policy response and supportive policy conditions. Nonetheless, near term risks including tightening global financial conditions, a fall in global oil prices, and rising trade tensions could weigh on growth. Against this backdrop, implementation of growth-friendly adjustment policies while simultaneously improving policy buffers to weather external shocks is essential to cementing macroeconomic stability, and improving growth and social outcomes.

We support the authorities' request for an extended three-year arrangement under the Extended Fund Facility (EFF). The set of policy proposals laid out in the authorities' reform program strikes the right balance between adjustment, debt sustainability, and growth objectives. We also take

note of staff's assurances that the program financing needs albeit high are sufficiently covered and capacity to repay the fund remains adequate.

Steadfast implementation of fiscal consolidation measures is essential to reducing debt vulnerabilities and supporting economic transformation. To this end, revenue-enhancing measures to support supply-side policies and social priorities are essential. These efforts should be complemented by measures to rebalance expenditure towards growth-enhancing sectors and the implementation of fuel subsidy reforms. That said, we welcome the authorities' plan to ensure the phase-out of subsidies do not negatively impact the poor. Further, we support continuation of efforts to improve public debt management through the development of a domestic debt market, enhancing transparency and accountability of the state-owned oil companies, and boosting public spending efficiency.

Strengthening the governance framework at the Ecuador Central Bank (BCE) as well as financial sector resilience remain critical objectives. The enactment of the 2018 "Law on Productive Development", in August 2018, which, among other provisions, fully prohibits all direct and indirect central bank financing of the government and nonfinancial public sector is a welcome step. Efforts to streamline the BCE's current legal framework in line with international best practices for dollarized economies as well as the introduction of the Independent Central Bank Board are welcome developments. While the banking system's capital buffers appear to be adequate, the financial intermediation bottlenecks and sovereign-banking related risks should be closely monitored. To this end, revamping policy measures to enhance the banking resolution and crisis preparedness framework, and strengthening prudential regulations should be given primacy going forward. Further, we welcome the proposal to introduce legislation requiring the central bank to cover all its liabilities with international reserve assets. We would however, appreciate staff comments on whether this is foreseen during the period of the program and an elaboration on whether the absence of this legislation has affected program design.

Finally, broadening structural reforms is fundamental to addressing Ecuador's competitiveness challenges and slowly increasing the private sector's footprint in the economy. We support the authorities' plans to implementing supply-side measures to bolster external competitiveness and support job creation, by improving labor market flexibility, including putting in place a framework to attract capital through public private partnerships and efforts to foster trade liberalization. Furthermore, the steps underway to improve governance and fight corruption are essential to boosting

competitiveness. We also support the authorities' efforts to strengthen transparency and governance in the oil sector, including through adherence to the Extractive Industries Transparency Initiative (EITI) and enhancement of the AML/CFT framework.

Mr. Razafindramanana, Mrs. BoukpeSSI and Ms. Nankunda submitted the following statement:

We thank staff for their well-written report and Mr. Tombini and Mr. Rivadeneira for their insightful buff statement.

Economic activity in Ecuador continues to suffer from the adverse effects of external shocks, including the sharp decline in oil prices and the US dollar appreciation, which have negatively affected the country's financial position and competitiveness. Wage increases have further dampened the latter. The medium-term outlook is titled to the downside with risks stemming from further decline in prices of oil, continuous appreciation of the real effective exchange rate (REER), tighter external financing conditions and possible political and social strains which could constraint the implementation of the authorities' policy plan. We also note the high and still rising debt as well as the low level of international reserves.

Against this backdrop and given the authorities' stated commitment to address the imbalances and structural challenges identified in their discussions with Staff, we support the proposed three-year Extended Arrangement under the Extended Fund Facility (EFF) to assist the country meet large financing needs. Fund support will be key to sustain the authorities' efforts aimed at ensuring fiscal sustainability, enhancing resilience to future shocks and laying solid foundations for a sustainable and inclusive growth while protecting the most vulnerable.

We broadly agree with staff assessment and policy recommendations and wish to emphasize the following points.

We commend the authorities' strong commitment to restore fiscal discipline and sustainability which is crucial to swiftly bring the public debt below 40 percent of GDP. We note the upfront adjustment plan underpinned by a comprehensive policy package to lower the non-oil primary balance including subsidies by 5 percent of GDP by 2021. On the revenue side, we welcome the upcoming reform of the tax system along with further measures to enhance tax administration. On the spending front, the authorities are encouraged to sustain their efforts in containing the wage bill, rationalizing

other expenditures—including the misclassified capital spending—and overhauling fuel subsidies while protecting the poor. As such, the focus on accelerating poverty reduction as indicated in Messrs. Tombini and Rivadeneira's buff statement is appreciated. Moreover, we look forward to the authorities' strategy aiming at better targeting social programs and benefits, notably in education and health, and improving safety nets for the vulnerable groups. Staff's comments on the timing and status of preparation of this upcoming strategy is welcome.

Recent changes in the medium-term fiscal policy framework, notably the ban of budget financing by the Central Bank of Ecuador (CBE), are significant steps towards enhancing fiscal discipline, encouraging transparency and accountability, and strengthening the autonomy of CBE. They are also critical to establishing sounder oil cash management during boom periods, to building buffers to help create fiscal space necessary to meet countercyclical needs, and to maintaining fiscal sustainability. Regarding efforts to curb public, we look forward to the public financial management action plan by end April 2019 and would appreciate staff's update on the related technical assistance received so far and/or planned looking forward. We welcome the steps taken in improving governance and addressing corruption, including the implementation of the Citizens' Participation and Social Control Council, and the efforts to improve the country's AML/CFT framework in line with international standards.

We encourage the authorities to press ahead with measures to safeguard the financial and liquidity system with the view to minimize financial stability risks and support growth. In this context, while we note that the banking sector is sound and stable, with adequate capital and profitability ratios, emerging risks from a rapid pace of credit growth of both corporates and households call for appropriate macroprudential measures and closer oversight. Ensuring financial stability is also predicated on the authorities addressing the sovereign-financial linkages. Furthermore, strengthening the CBE's governance and independence framework as well as preserving its liquidity and reserves are warranted to support the dollarized economy. Attention should also be given to enhancing the supervisory, regulatory and crisis preparation frameworks to build financial resilience. The last FSAP for Ecuador took place in 2004. An update could be envisaged as it would allow discussions on options for strengthening the financial sector. Staff' view will be appreciated.

On structural reforms, we urge the authorities to implement the envisaged measures to foster competitiveness and reduce labor market

rigidities. We take positive note of the authorities' comprehensive reforms to address existing rigidities in the labor market. Reforms should also aim at easing regulations and enhancing competition in the goods and services and financial markets more broadly. Finally, participation in Regional Trade Agreements (RTAs), with the benefit of strengthened productivity and competitiveness, could buttress Ecuador's trade and external position.

With these remarks, we wish the Ecuadorian authorities further success in their endeavors.

Mr. Johnston and Mr. Kim submitted the following statement:

We thank staff for their report and Mr. Tombini and Mr. Rivadeneira for their informative buff statement. Ecuador's economy experienced an abrupt downturn due to the fall in oil price and dollar appreciation. Although the economy has recovered from these unfavorable conditions, structural problems remain including sizable financing needs, insufficient international reserves and a high level of public debt. We commend the authorities' recent efforts to strengthen institutions, undertake reforms and build closer relationships with IFIs.

We support Ecuador's request for a three-year Extended Fund Facility. The program has the right aims: reducing debt and achieving a better fiscal policy mix; improving financial management; strengthening central bank independence; increasing competitiveness, including through labor market reforms; and doing all this while strengthening social programs and safety nets. Financing under the EFF, alongside other international support, will give Ecuador breathing space to improve its fiscal position and make necessary policy adjustments. We note that at the end of the program, international reserves are expected to reach only 63 percent of the ARA metric. Given the helpful discussion in the selected issues paper, is this an adequate level of reserves as measured against staff's alternative metric, i.e. to cover deposits at the central bank and other liabilities?

Fiscal consolidation and reduction of the debt-to-GDP ratio are essential to reduce financing needs and improve competitiveness. An improvement in the primary balance and reduction in public debt could also lower Ecuador's EMBI spread, as shown in Box 5. We do not underestimate the difficulty in undertaking the proposed fiscal consolidation, involving as it does a reduction in jobs and wages, withdrawal of fuel subsidies and an overall tax increase. It will be important to present social assistance increases as a package with some of the more challenging consolidation measures, to

mitigate the effects on vulnerable citizens and help maintain domestic support. How solid is support for tax and other legislative changes in the National Assembly? We also welcome the introduction of a fiscal framework that will contain overspending during oil price booms.

We welcome the authorities' commitment to enhance the central bank's independence and prohibit its financing of the government, especially as this will help maintain the viability of dollarization in Ecuador. It is striking that total factor productivity growth has been negative for much of the past decade. We appreciate the authorities' efforts to foster higher productivity, including through containing the public sector workforce and public wage growth. In addition, as illustrated by indicators such as the Global Competitiveness Index and the Doing Business Index, there is room for improvement in areas such as starting a business and clearing insolvencies.

Ms. Pollard and Ms. Svenstrup submitted the following statement:

The Ecuadorian authorities' have taken significant and commendable steps over the last year to address the complex macroeconomic and structural challenges facing the country. The passage of the Productive Development Law along with efforts to reduce fuel subsidies, increase public debt transparency, and fight corruption have underscored their commitment to reform. The authorities now have a window of opportunity, with the help of the international community, to address systemic vulnerabilities and fundamentally transform the economy, reorienting it towards more sustainable and inclusive growth. We commend the authorities' political courage to return to the Fund to support their domestic reform agenda. We also appreciate their close cooperation with the multilateral development banks for financing and technical advice to design structural reforms.

We thus support Ecuador's request for a three-year Extended Fund Facility. The EFF complements the authorities' homegrown macroeconomic program by improving fiscal sustainability, boosting competitiveness, and strengthening governance and institutional frameworks. We strongly welcome the combination of policies that underpin the authorities' choice in exchange rate regime. Nevertheless, the challenges facing Ecuador remain high, particularly in the context of the frontloaded adjustment and as the authorities strive to tackle longstanding structural issues. In this context, we welcome the authorities' strong commitment to fully implementing their reform agenda, as described in Mr. Tombini and Mr. Rivadeneira's buff Statement, and urge continued communication with the population to build a broad consensus for reforms.

The program includes an ambitious but achievable fiscal consolidation – on top of the significant adjustment in 2018—to put debt on a sustained downward path and support dollarization. This level of adjustment is necessary to address financing pressures and address legacy structural weaknesses in the fiscal framework. While proposed reforms may dampen demand in the short term, they will set the stage for sustainable and private sector led-growth going forward. The planned tax reform is a critical component of the fiscal strategy, and it will be important that measures are designed to be growth friendly. Given this reform will be subject to legislative approval, could staff discuss the broader sentiment toward tax reform in the country? We appreciate that significant portions of the two key expenditure measures—reductions in fuel subsidies and the public sector wage bill—have already been announced publicly.

The authorities rightly prioritize social protection as a key pillar of their reform program. To this end, we support the proposed measures to enhance and better target benefits and the authorities’ commitment to maintain a floor on social spending throughout the program. We urge the authorities to work closely with the World Bank to finalize the planned enhancements to the social safety net system prior to the next round of subsidy reductions in 2021.

More transparent and effective debt management and fiscal frameworks are critical to realizing the authorities’ fiscal strategy and solidifying investor confidence to support private sector-led growth. We commend the authorities and staff for directly confronting these issues in the design of the program. The recent steps to publish public debt data are welcome, and we urge the authorities to bring fiscal reporting fully in line with international standards as soon as possible. Further, the authorities’ provision of the full details of external non-financial public-sector debt, including non-standard borrowing arrangements, was essential to provide a complete picture of the country’s debt obligations. We welcome the authorities’ commitment to refrain from contracting new non-standard borrowing arrangements going forward. Could staff comment on whether this commitment could be enshrined in the program? We also look forward to full completion of the end-June structural benchmarks aimed at improving the transparency of fiscal management, public debt, and state-owned enterprises.

While we agree that Fund resources are best used for budget support, we recognize that this leaves Ecuador exposed to risks related to their low reserve adequacy levels. The fiscal adjustment envisioned in the program will allow for a gradual rebuilding of reserve buffers. We welcome the authorities’ commitment to increase reserves to a more comfortable level over the

program period. In support of this strong reform program, we urge staff to keep this objective under review in case global conditions deteriorate and capital flows are less benign than anticipated.

Efforts to strengthen and increase the autonomy of the central bank are also essential to underpin Ecuador's monetary regime and lay the foundation for more sustainable growth. We fully support efforts to prohibit all direct and indirect central bank financing of the government and nonfinancial public sector. The 2018 Law on Productive Development was a step in the right direction, and the program rightly focuses on closing remaining loopholes, including through the proposed amendments to the central bank's legal framework.

We welcome the structural reforms envisioned in the program, which will improve competitiveness and support growth. Given the gap in wages between Ecuador and its peers, efforts to reduce labor market rigidities are welcome, particularly efforts to increase female and youth labor force participation. We strongly support the authorities' efforts to tackle corruption and look forward to the completion of the structural benchmark regarding the submission of the comprehensive anti-corruption legislation to the National Assembly. We urge staff to consider including additional structural benchmarks at later stages of the program to support the authorities' anti-corruption efforts—e.g., to strengthen the asset declaration regime for senior government officials.

Finally, although we approve the exchange restriction at this time, we welcome the authorities' commitment to phase out the tax on transfers abroad as soon as macroeconomic stability is restored in line with their obligation under Article VIII.

Mr. de Villeroché, Mr. Castets and Ms. Albert submitted the following statement:

We thank staff for their comprehensive report, as well as Mr. Tombini and Mr. Rivadeneira for their informative buff statement. In the face of increasing external and fiscal vulnerabilities over the last years, the authorities have already started to implement significant reforms to put Ecuador on a more sustainable path. Nevertheless, many challenges remain for this dollarized and oil-dependent economy and the magnitude of the external financing requirements makes IMF assistance necessary. Consequently, we support the proposed the 36-month Extended Arrangement under the Extended Fund Facility with access of 4.209 billion USD. While the six pillars of the authorities' policy plan that inspired the program architecture tackle the

most significant vulnerabilities, including some institutional weaknesses, the pace of the adjustment and the frontloading of the fiscal consolidation appear ambitious and might prove challenging. Given this program feature, we encourage the authorities and staff to monitor closely the impact of the warranted adjustment on activity and the poor and the vulnerable. We share the thrust of staff's appraisal, and would like to add the following comments:

A conjunction of external shocks and an economic policy in contradiction with the dollarization of the economy have put the economy under considerable strains. Ecuadorian growth was subdued over the recent years, and the rapidly rising public debt, the increase in the dollar valuation simultaneous to the decline of oil prices have rapidly depleted the already limited buffers. As the external position is weaker than the level consistent with medium term fundamentals and desirable policies and the real exchange rate overvalued by 30 percent according to staff, and given the constraint created by the dollarization, the reduction of imbalances appear as imperative. The relatively high level of external funding needs in the coming years as well as the very low level of international reserves make a strong case for the engagement of the Fund. Moreover, the authorities have taken decisive steps already to curb the public deficit and restore macroeconomic stability. This is encouraging regarding their commitment to the upcoming program.

We concur with staff that risks are tilted to the downside, especially tighter financial conditions (identified with the highest probability and impact in the RAM), an oil price decrease, or a dollar appreciation. On this last aspect, the impact could be high on a dollarized economy, but this risk appears to be receding as the Fed announced a pause in its monetary stance normalization. According to staff's projection, inflation should remain subdued throughout the next few years.

The warranted fiscal consolidation appears ambitious under the programs targets. We concur with staff on the need to curb the risks regarding debt sustainability, Ecuador being highly reliant on external funding. We also thank staff for the detailed analysis on how to determine an adequate public debt target taking into consideration the Ecuador's economy specific features. Nonetheless, the objective of a reduction of the non-oil primary balance by 5 percent of GDP over the next 3 years appear imply quite a rapid fiscal consolidation effort. In 2020, staff projects a fiscal surplus 3.8 percent of GDP, from a balance level in 2019. This is much more ambitious than for most IMF engagements. Despite the impact of the fiscal adjustment, staff projects that Ecuador will grow again, even if very moderately, that same year. Could staff provide the fiscal multiplier used for its projections? As

regards the quality of the adjustment, we note that if tax revenues would increase in 2020, they would otherwise remain below the level reached in 2018 for the program period.

Given the expected impact of fiscal consolidation on growth and employment, we commend the authorities and staff for the attention dedicated to the protection of the poor and the vulnerable. We call on staff to keep following closely, in cooperation with the World, that the social protection spending are effectively protecting by the floor on social assistance spending. Could staff indicate whether health and education spending are covered by this floor? The projected pace of fossil fuels subsidies reduction is also massive and frontloaded (-1.7 pt of GDP, -0.1 pt next year and 0.5 pt in 2021). The report mentions p.17 that the subsidy reform should not have a major impact on retail consumer prices, could staff elaborate on why? Given the likely significant adverse impact on the poor and the most vulnerable, the increase of the nominal level benefits under the conditional cash transfer program will be paramount. We wonder whether the planned increase in social spending by 0.4 pt of GDP this year will be of sufficient magnitude to limit the cumulative impacts of the cut in public wages (0.5 pt of GDP), the 10 percent reduction in the number of state enterprise workers and the phasing out of subsidies. Could staff explain why no social spending effort is mentioned after 2019? We note the focus on elderly and disabled people, can staff precise if there any disposal for the young population?

The new fiscal framework and the oil stabilization are key to improve countercyclical capacity and ability to absorb future shocks. Moreover, we encourage transparency efforts and publication of detailed information with the help of the Fund through technical assistance (TA) as we consider comprehensive, coherent and comparable data in line with international standards as key to restore confidence. We note from the DSA that at end-2017, there was an additional 7.7 percent of GDP of accounts payable from SOEs, local governments and the social security that could be part of debt. What would be the risks on the public debt sustainability if this amount were added to the public debt?

Discontinuing monetary financing of the fiscal deficit is a major step forward. We encourage the authorities to accelerate the introduction of the new legal framework which will help the BCE to have clearer objectives and functions, more compatible with the choice made to maintain dollarization. It will notably help to cover all the BCE liabilities vis à vis banks with international reserves. We particularly support the improvement aiming at bringing governance and transparency into line with best international

practice. Staff could continue to play a key role in this regard through dedicated TA. We see merit in rebuilding the reserves to strengthen the basis for dollarization. Stock of gross international reserves (GIR) represents only about 12 percent of the Fund's ARA metric. While ARA metric might not be fully adequate reference for a dollarized economy as underlined in the selected issues, we agree that the current level is not sufficient to prevent sudden capital outflows or terms of trade shocks. The floor on the change in the stock of NIR will therefore be of particular importance for the program execution. We take note of staff overall positive assessment of the situation of the financial sector and encourage the authorities to keep ensuring appropriate liquidity levels to swiftly pass the legislation to strengthen the AML/CFT framework.

Structural reforms

As the country is less and less reliant on oil revenues, enhancing productivity and pivoting towards a more private sector driven economy are the main challenges to boost potential growth. After a decade of rapid growth of the public sphere, promoting competitiveness, improving the business environment and cutting the red tape appear as priorities, while preserving the decline of poverty rate and the good public infrastructure network of the country. Against this background, initiatives to improve the terms of trade, through more trade agreements like EFTA and enhanced labor market flexibility appears warranted, notably to facilitate the insertion of workers in the formal economy. Indeed, in the last ILO report¹, informal employment amounted to 59 percent of total employment. Could staff provide some elements about how this aspect will be tackled under the program? We support the realized and announced elimination of tax distortions and exemptions, including the deletion of import tariffs introduced last year. We also strong support the authorities' intention to improve governance and fight corruption and concur with staff that fiscal transparency will be key in that regard. Joining EITI initiative to bring more transparency in the oil sector will also be helpful. Those progress should help to attract new FDI, which could play also a greater role as a source of external financing in the future.

Mr. Trabinski and Mr. Danenov submitted the following statement:

We thank staff for a valuable set of papers and Mr. Tombini and Mr. Rivadeneira for their insightful buff statement.

¹ ILO, "Women and men in the informal economy: A statistical picture. Third edition", April 2018

We support the request for a three-year Extended Fund Facility (EFF) and commend the authorities for their challenging reform agenda. The 2015–2016 downturn revealed multiple structural vulnerabilities of Ecuador’s economy. High and rapidly increasing public debt, very low international reserves, and central bank financing of fiscal spending, resulting from weak central bank independence, have contributed to significant balance of payments needs. In addition, legacy issues, such as a widening productivity-wage-gap, pose significant risks to future economic growth. Hence, we welcome the authorities’ willingness to work closely with the IMF and other IFIs to underpin their reform agenda. The proposed EFF targets the existing vulnerabilities in an adequate timeframe and at a moment when both the political landscape and the economic recovery, albeit modest, provide a window of opportunity for reforms.

Efforts to placing debt on a firm downward path are welcome. We support the fiscal realignment through both revenue and spending measures. At the same time, the realignment should be designed in a way that protects the most vulnerable parts of the population and fosters inclusive growth. Given the considerable damage to the public infrastructure and its role in sustaining productivity and inclusiveness, preserving public investment spending is warranted. We also encourage the authorities to improve its effectiveness through adjustments in governance and procurement practices. Moreover, a more transparent and comprehensive debt coverage could help avoid negative surprises for both the program’s and the authorities’ reform path, and better safeguard debt sustainability. In this context, we welcome the Fund’s technical assistance.

Strong ownership of reforms is needed against the background of the external downside risks to the program. A significant decrease in oil prices, tightening global financial conditions, and an appreciating US dollar remain key risks to the program. As these risks are beyond the authorities’ control, strong ownership of the planned reforms is crucial to cushion potential negative effects on growth. We welcome the authorities’ continued commitment in advancing their reform agenda and the progress made so far. For example, the passage of the Productive Development Law in August 2018 was an important step in increasing Banco Central del Ecuador (BCE) independence. Nevertheless, we take note of staff’s continued concerns regarding the BCE’s institutional framework and its ability to manage resources, including the IMF disbursements. Thus, we welcome the inclusion of structural benchmarks to address this issue. Furthermore, we take note that there are arrears to the private sector. Could staff elaborate on the nature of

these overdue obligations? Finally, it is not entirely clear whether the authorities have already completed all prior actions. Could staff comment?

Mr. Villar, Mr. Guerra and Mrs. Del Cid-Bonilla submitted the following statement:

We thank staff for the set of comprehensive reports and Mr. Tombini and Mr. Rivadeneira for their valuable buff statement. Large unsustainable public spending, combined with terms-of-trade shocks, U.S. dollar appreciation and a natural disaster in 2016, have negatively hit the Ecuadorian economy in recent years. Downside risks are substantial and pose important challenges to the reform agenda that the authorities are pursuing. To mitigate these risks and put the economy on a sustainable and equitable growth path, it is of utmost importance to re-align the institutional framework consistent with the dollarization regime, improve the economy's competitiveness and productivity, and enhance social programs. In this context and given the authorities' commitment to a broad reform agenda to fulfill these objectives, we fully support the Extended Fund Facility request, as well as the retention of the exchange restriction along the terms proposed by staff. We have the following further comments:

A strong medium-term fiscal framework is key to restore the economy's reserve buffers, put debt on a firm downward path and generate enough resources to protect the poor. A robust fiscal framework requires a comprehensive set of measures including tax reform, enhancement of tax administration and improvement of public financial management. The actions contemplated to strengthen fiscal rules, budget preparation execution and control, and fiscal transparency are fundamental. Compliance with the social expenditure floor and increasing other social programs will be essential to get public support for the reforms. The 5 percent of GDP adjustment in the primary balance envisaged in the program is not minor and is even more challenging in a context of the current minority government and as far as the timeline of structural benchmarks is heavily concentrated in the period up to October 2019. The program contemplates a tax reform that is expected to be approved in the first half of this year and which should produce additional revenues of 1.5 to 2.0 percent of GDP. How does staff evaluate the political feasibility of such a reform being accomplished?

As depicted in Table 1, the adjustment path significantly impacts the contribution of domestic demand but is largely compensated by that from external demand. Can staff expand on where this compensatory effect comes from and how robust the estimation is? Given Ecuador's large financial needs, how does staff assess the risks of the country having to resort to the market

and what could be the impact on the interest rate bill? Staff assures in the report that there is evidence that around 20 percent of the expenditure recorded under capital expenditure is misclassified as current expenditure; is staff working with the authorities to clarify this figure and make the necessary adjustments? How could this affect the reduction in capital expenditure foreseen in the program?

An integral reform is crucial to ensure that the framework of the Central Bank of Ecuador (BCE) is fully consistent with the dollarization regime. Large BCE lending to the government and public sector, and other quasifiscal operations significantly weakened the level of net international reserves (NIR) over the past years leaving liquidity buffers below prudent levels. We believe the measures adopted by the authorities to prohibit BCE direct and indirect financing to government and NFPS entities are in the right direction and we welcome their commitment to make them permanent through legal reforms. We notice that a new BCE organic chapter to address these issues as well as to strengthen CBE's independence and governance is expected to be sent this year to the Legislative National Assembly. Can staff explain how BCE's objectives and functions to be contemplated in the new law would compare with those currently in place? Can staff elaborate on how NIR are to be restored given that the expected financial support during the program, including from the Fund, is budgetary? With regards to the retention of the exchange rate restriction, we wonder if a sudden and pre-announced dismantling could generate additional problems. Staff's comments are welcome.

A robust, resilient financial sector and strong supervision are vital in a dollarized regime. While financial soundness indicators are adequate, the crisis preparedness and resolution frameworks need to be strengthened as well as the oversight of all financial institutions. We also see important the elimination of financial distortions and welcome the authorities' decision to review their interest rate policies and the complex regulatory liquidity requirements to banks. Can staff comment on the timeline associated to these intended actions?

Flexible labor markets are crucial to enhance the economy's resilience to shocks and foster competitiveness and productivity. We entirely support the authorities' commitment and efforts to reach these objectives; the actions recently taken to open the economy to world trade are also in the right direction. We wonder, however, if the provision contemplated in Art. 97 of the labor code which establishes a mandatory transfer to workers of 15 percent of enterprises earnings has been considered by staff in the analysis.

Efforts to promote transparency and fighting corruption will contribute to improve government's policies credibility and effectiveness. Strengthening reliability and reporting of debt and fiscal variables as well as other relevant statistics is warranted for more accurate macro-financial assessments. We welcome the authorities' intention to submit an anticorruption law initiative at the end of the year and to develop an AML/CFT framework in line with international standards.

With these remarks, we wish the authorities success with their future endeavors.

Ms. Riach and Mr. Haydon submitted the following statement:

We thank staff for a clear set of papers, and Mr. Tombini and Mr. Rivadeneira for their informative buff statement.

We support the proposed Extended Fund Facility (EFF) for Ecuador. As Mr. Tombini and Mr. Rivadeneira point out, the Ecuadorian authorities have recognized that the economic model of the past decade was unsustainable, especially in an environment of lower oil prices, highly uncertain global growth prospects, and volatile financial conditions, and have initiated fundamental changes to the country's economic approach. We agree with staff that the authorities' economic plans are well-designed to reduce Ecuador's vulnerability to risks, and that these efforts merit the support of the international community. Commitments to improve the fiscal framework, including by improving transparency, are important components of the program. It is also essential, as staff point out, to maintain the authorities' strong commitment to protecting the poor.

We focus our comments, therefore, on the following points:

Debt transparency. Debt transparency is very important in assessing and managing debt risks. We welcome the commitment by the authorities not to enter into new sovereign repurchase agreements or borrowing that encumbers international reserves during the period of the arrangement, alongside their commitment to provide full information on past and future borrowing with collateral-like features. Provision of detailed information on various types of debt has also, rightly, been incorporated into the prior actions and structural benchmarks. In the context of the review of the Market Access Country Debt Sustainability Framework (MAC DSF), this chair, alongside others, has called for a broadening of the definition of government debt, to ensure that DSAs give as accurate a picture as possible of the state of the

public finances and the risks. Do staff consider that these commitments from the Ecuadorian authorities could serve a useful guide for other countries, including those in other regions, for reporting collateralized debt? And will the additional information from the Ecuadorian authorities be provided to Fund staff only, or will it also be shared with the board and/or made public?

Political constraints. The Fund's reputation in Ecuador, historically, has been mostly negative. While the more pragmatic observers in the country generally welcomed the staff level agreement when it was announced, many have questioned what terms and conditions will be attached to the program. Gaining broader political consent for implementing the more challenging measures may therefore prove difficult. Specifically, some of the key measures that the authorities have committed to require legislation. The most significant of these is the package of tax changes, which must be submitted to the National Assembly later this year. The governing party, however, no longer has a clear majority in the Assembly, meaning that it requires the support of opposition parties to pass its legislative agenda. How confident are staff that the required legislation will gain the support of the National Assembly? Has there been consideration of a fall-back plan for meeting the fiscal objectives if, for example, the tax package cannot gain legislative assent?

Minimum wage. Staff call for a more vibrant, private sector-led growth model, and stress the importance of increasing competitiveness and productivity. Staff highlight separately, however, that for several years the minimum wage in Ecuador has been increasing steadily, while regional competitors have largely seen a low or negative change in minimum wages in US dollar terms. Ecuador's minimum wage as a result is the highest in Latin America, more than 60 percent higher than the average of its main regional comparators. Do staff consider that moderating the level or growth rate of the minimum wage over the medium term could help address labor market rigidities and support private sector-led growth?

Circulation of papers. We were disappointed, once again, by the delay in circulating the papers ahead of this board meeting. They were sent out just one week prior to the board meeting, which is half the time of the minimum circulation period. Given there is no acute crisis in Ecuador, it is not clear to us why the board was given such a condensed amount of time to consider this lengthy set of papers. We hope that this can be improved upon for future program discussions, and that this recent trend does not become a permanent feature. Staff comments are welcome.

Mr. Mozhin and Mr. Palei submitted the following statement:

We welcome the discussion of the staff report on Ecuador for the 2019 Article IV consultations. We thank staff for the report, the Selected Issues paper, and the recently distributed Working Paper on Ecuador's fiscal framework. We also thank Mr. Tombini and Mr. Rivadeneira for their informative BUFF statement. This Article IV discussion is long overdue, as the previous report was issued almost three years ago, and we would welcome staff's comments on the reasons for such a long delay. Given that this Article IV discussion takes place after a long break and, in addition, simultaneously with the approval of a large three-year EFF arrangement, we were also somewhat surprised by the short time given to the Board to review the papers. Staff comments would be appreciated.

During the period of high oil prices and favorable global conditions, Ecuador's public debt declined to about 20 percent of GDP, in 2014. While the fiscal deficit was on the high side, close to 5 percent of GDP, the economy was growing at a comfortable high rate. However, this rather benign and healthy macroeconomic picture was about to change. In 2014 and afterwards, the authorities faced what we called a "perfect storm" of exogenous shocks. The oil prices collapsed, while the U.S. dollar appreciated significantly, while undermining the competitiveness of the dollarized Ecuadorean economy. Many regional economies went into a significant and sustained growth slowdown. The El Nino and the eruption of the Cotopaxi volcano further aggravated the challenges. In the beginning of 2016, a major earthquake hit the country with the damage estimated at well above 3 percent of GDP. It was no surprise that the authorities had to embark on a sustained fiscal and structural adjustment of the economy. Fortunately, at the outset of the reforms, the authorities had a very low public debt level, which provided a cushion to make the adjustment relatively gradual and less detrimental for economic growth and social cohesion of the society.

In 2019, the public debt level is expected to increase to almost 50 percent of GDP (in staff's definition) and the fiscal accounts are likely to be balanced. Inflation remains low, while wages in the state sector have been frozen to address fiscal pressures and to provide the needed signal to the private sector. Despite the sequence of negative exogenous shocks, Ecuador's current account remains surprisingly stable, close to a balance. Overall, it does not seem to point to any severe imbalances in the external sector. At the same time, we agree that the authorities relied on some unconventional measures to protect the economy, and the foreign exchange reserves in Ecuador are very low.

Under the circumstances, we believe that it is difficult to estimate possible misalignment of the exchange rate. We find staff's estimate of 31 percent overvaluation to be questionable and unnecessarily precise. In our opinion, insisting on a large overvaluation instead of admitting the high degree of uncertainty in such estimates may be a disservice to the authorities.

We agree with staff that the dynamics of the economy over the past several years have been worrisome, while external risks are still high. Thus, a further strengthening of the U.S. dollar, the weakening of the oil prices may push the economy into a precarious situation, and that additional reforms are necessary to gradually rebuild the buffers. A well-designed and credible adjustment program supported by large financing can help the authorities with this challenging task.

We welcome the authorities' efforts and plans under the proposed EFF program to strengthen institutional underpinnings of dollarization, to strengthen the central bank, and further increase the resilience of the financial sector.

Strengthening and clarifying fiscal framework is appropriately in the center of the authorities' attention. Further improving fiscal transparency and credibility of the fiscal framework should also be a priority. We welcome the ongoing efforts to enhance the quality of fiscal data, including public debt statistics and their monitoring. We also agree with staff that a fiscal transparency evaluation by the Fund is highly advisable.

Unfortunately, we feel that, at the outset of the EFF program, the fiscal reforms and any specific measures remain to be defined. We ask staff to elaborate in the written answers on these measures and their contribution to the envisaged further fiscal consolidation.

In consultations with staff, the authorities aim at additional sustained fiscal consolidation of about 3 percentage points of GDP with an emphasis on increasing the revenues by 1.5-2 percent of GDP by 2021. The public debt-to-GDP ratio is projected to decline from 49 percent to 40 percent of GDP by 2023. Is such a reduction of the public debt over short period of several years necessary? Could staff clarify, whether somewhat less ambitious change in the fiscal balance would be more conducive to medium-term economic growth? To what extent can the authorities reduce public debt through privatization of presumably large state assets? What are the current estimates of the value of state assets in Ecuador? Do staff intend to examine public balance sheet in greater detail?

In addition, we would like staff to clarify the reasons to include petroleum subsidies in the targeted non-oil primary balance. This subsidy is linked to the international oil prices, which are not under the authorities control. How will the authorities deliver on their commitment in case of a significant increase in oil prices?

Mr. Sun and Ms. Zhao submitted the following statement:

We thank staff for the set of reports and Mr. Tombini and Mr. Rivadeneira for the helpful buff statement. The Ecuadorian economy is facing difficulties exacerbated by challenges including a strong U.S. dollar and high public debt. We welcome the authorities' recent reform efforts, but decisive actions are needed to address remaining vulnerabilities in the economy. We broadly agree with the staff appraisal and support the authorities' request for a three-year Extended Arrangement under the Extended Fund Facility. We offer the following points for emphasis.

Prudent fiscal policy is needed to achieve fiscal sustainability and improve competitiveness. We welcome the authorities' commitment to lower non-oil primary deficit through both revenue and spending measures. We agree with staff that realignment of the public-sector wage bill, optimization of the fuel subsidy system, as well as a more efficient and equitable tax system are important components of fiscal reform. The publication of the in-year fiscal reports would help increase transparency and accountability, while continued efforts to bring down the debt-to-GDP ratio is crucial for strengthening confidence in Ecuador's fiscal policy. We also support efforts to improve the social safety nets to protect the poor.

In face of an overvalued real exchange rate and capital outflow pressures, more strategic policy actions are needed to reduce external sector vulnerabilities. As a fully dollarized economy, Ecuador's real effective exchange rate is assessed to be overvalued by more than 30 percent, which has greatly weighed on its competitiveness. To this end, we agree with staff's recommendation of maintaining restraint in public wages and reducing labor market rigidities. In staff's view, to what extent could the overvaluation of REER be offset by fiscal adjustment and structural reforms? We encourage staff to conduct further analysis on how to deal with challenges brought about by dollarization.

A stronger central bank would help enhance Ecuador's financial resilience. We welcome the authorities' plans to improve financial system oversight and crisis preparedness. The authorities' efforts to strengthen the

central bank, including prohibiting it from providing fiscal financing, are steps in the right direction. Meanwhile, given that Ecuador's gross reserve coverage is lower than peers and is insufficient to confront significant shocks, we encourage the authorities to take more active measures to increase international reserves.

With these remarks, we wish the authorities every success in their reform endeavors.

Mr. Tombini made the following statement:

Let me just address one point that was raised by Directors with respect to the short circulation period of the staff report, and I apologize for that. I thank Directors for having this meeting today. This meeting was scheduled well in advance, and the date set was today Monday, March 11. The authorities did not want to have the meeting too close to the local elections, which will take place on Sunday, March 24.

The staff and the authorities were aware that the deadlines were short. I thank the staff for the effort to have the report ready following the minimum circulation period. Despite their efforts, that was not possible. My office will strive to make sure that the minimum circulation period is complied with in many reviews that I hope this program will have in the future.

The Chairman remarked that she had met with the President of Ecuador and the country's Finance Minister. She was pleased that the process that had been in the works for some time was reaching conclusion.

Mr. Daïri made the following statement:

We have not issued a gray statement, so I have a few points. We thank the staff for an excellent set of papers and Mr. Tombini and Mr. Rivadeneira for their informative buff statement, and the clarification this afternoon.

We commend the Ecuadorian authorities for their timely, bold, and comprehensive response to the deteriorating macroeconomic situation, which has saved the country from a full-blown crisis, including by strengthening the foundation of the dollarization regime, addressing deep-rooted macro-financial vulnerabilities, and putting the economy on a path to stronger and more inclusive growth.

The strong ownership and commitment to their program, as indicated by Mr. Tombini and Mr. Rivadeneira, bodes well for successfully addressing the serious challenges facing the economy. We concur with the thrust of the staff appraisal and support the authorities' request for a three-year Extended Fund Facility (EFF) arrangement. In view of the still difficult balance of payments position, we also support a retention of the exchange restriction for one year.

The ambitious program is well articulated and adapted to Ecuador's situation and needs, and is fully financed, including through strong financial support from the Fund and other multilateral and bilateral institutions.

Frontloaded fiscal adjustment, based on improving non-oil revenue and streamlining expenditure—in particular, wages and subsidies—and strengthening the fiscal framework, public financial management, and fiscal transparency—including in the oil sector—will support the dollarization regime, put public debt on a firm declining trend, free resources for pro-growth spending, and build buffers to absorb shocks.

Modernizing the central bank, strengthening its independence, the recent ban on financing the fiscal deficit while limiting lending to other public sector entities, enhancing financial sector soundness and resilience, and rebuilding reserves, as intended, would also contribute to a stronger foundation of the monetary regime, as highlighted by Mr. Tombini and Mr. Rivadeneira.

Attention given to protecting the poor, increasing social spending more broadly, and improving its efficiency and equity is welcome and strengthens the chances for garnering domestic support. Strengthening competitiveness, reducing the state's footprint in the economy, and improving transparency and governance, including continued efforts in fighting corruption, as intended, will provide an environment that is more conducive to private sector development, including FDI, will promote growth, and help maintain strong support from the international community for the authorities' adjustment and reform efforts. Ongoing trade liberalization, including through plurilateral and bilateral agreements, are also welcome.

We wish the authorities continued success.

Mr. Saito made the following statement:

We thank the staff for the comprehensive report and Mr. Tombini and Mr. Rivadeneira for their informative statement.

As we have issued a gray and support the request for the EFF arrangement, we would like to offer three comments for emphasis.

First, on the sequence and the prioritization of the reform agenda, we welcome the authorities' strong commitment to ambitious reforms aimed at the socioeconomic transformation of the economy. At the same time, we believe that implementing the wide-ranging reforms would be challenging for the authorities. Therefore, appropriate sequencing and prioritization of the reform agenda, with support from technical assistance (TA), are critically important. In this regard, we would like to hear the staff's view on the necessity of sequencing and prioritization of the reform agenda over the program period.

Second, on the pace of fiscal adjustment, we note that the magnitude of fiscal adjustment envisaged in the program—5 percent of GDP for the next three years—is relatively large, compared to the other programs. In this regard, we associate ourselves with the point made by Mr. Meyer on the importance of prudent program assumptions and would ask the staff to continuously review and revise the assumptions over the program period. In particular, the impact of the fiscal adjustments on economic growth should be carefully monitored. As the staff rightly emphasized in its response to our technical questions, we urge the authorities to prepare concrete contingency plans if the growth is worse than forecasted.

Third, we welcome the authorities' commitment to improving debt transparency and debt management. We commend the authorities for having already started working on these reforms, including publishing a report by the auditor general.

On the borrowing arrangements with collateral-like features, we appreciate the staff's response, elaborating on the benefits and the costs. We note that the current volume of the borrowing arrangement with collateral-like features is small. But different from the sovereign deposit agreement, there is a possibility that the authorities can increase the collateral-like borrowing in the future. We urge the staff to continue to closely monitor those developments and to assess the impact on debt sustainability in the future reviews.

Mr. Alkhareif made the following statement:

We thank the staff for the comprehensive work and for answering our technical questions. We also thank Mr. Tombini and his colleagues for the comprehensive buff statement.

We have issued a detailed gray statement, in which we supported the authorities' request for the EFF. I would like to raise one point on the selected issues paper. The staff did excellent work on the potential output analysis, the GDP nowcasting techniques, and forecasting. We encourage the staff to build on this work and to use it for other countries as well.

I would like to ask the staff, what is their experience in their interactions with the authorities? How much have they appreciated this work? Have they used these models by themselves to do their internal analysis?

With these remarks, we wish the authorities all the success.

Mr. de Villeroché made the following statement:

We welcome this arrangement. We do not have many comments, just a few remarks for emphasis.

We view the fiscal consolidation as something which is needed. We see the path as being ambitious, so its implementation will be challenging, to a certain extent. In this context, we are a bit concerned about how social safety nets may be affected. We believe it is important to preserve strong social safety nets in this context of an adjustment and to get permanent ownership by the authorities and the country at large. On that, working with the World Bank may be helpful.

Regarding monetary policy, we are encouraged. We see the prohibition of all quasi-fiscal activities of the central bank as a very important step.

Regarding reserves, we agree that they need to be strengthened. We have a question on how to design the appropriate level for a dollarized economy and an oil-exporting economy.

On getting back confidence, that is something we all aim for. The country had never lost access to financial markets, but its borrowing costs are very high. It will be the main indicator which will demonstrate that confidence is back after this agreement. We can only monitor that from here, but it is a key point.

We are all cognizant of the fact that there are longer issues in terms of structural reforms and how to increase productivity. I ask the staff to specify how it intends to work with the authorities on these long-run issues.

Mr. Trabinski made the following statement:

Ecuador faces significant challenges to its growth prospects. That stems partially from uncertainty about global growth prospects and lower oil prices, but also partially from their past policies. The current vigorous efforts expressed by the authorities in the already introduced reform package, and their willingness to transition to a sustainable and inclusive economy, with the support of the international community, is encouraging and deserves attention.

As we issued a gray statement in which we support Ecuador's request for the program, let me offer the following two points for emphasis.

First, we are encouraged by the authorities' commitment to fiscal discipline in order to reverse the debt trajectory and to reduce the non-oil primary deficit, as explained by Mr. Tombini and Mr. Rivadeneira in their candid buff statement. To this end, we support a further fiscal realignment through revenue and spending measures, improving public financial management, and introducing necessary changes to the medium-term fiscal framework. We would, nevertheless, like to emphasize, like Mr. Saito, that such a comprehensive and broad reform will require from the authorities adequate planning and a prioritization of their reforms, as well as a sustained commitment to the reform efforts. In this regard, we encourage the authorities to continue to draw from the Fund's and the World Bank's expertise provided through technical assistance, specifically as it comes to ensuring fiscal transparency consistent with the international standards for the reporting of public debt.

Second, we agree with Ms. Levonian, Mr. Psalidopoulos, Mr. Gokarn, and other Directors that the strengthening of the operational autonomy of the central bank is essential to rebuild reserves and the institutional foundations of dollarization. We take positive note of the authorities' fulfillment of prior actions, which prohibits quasi-fiscal operations of the central bank and any direct or indirect lending to the non-financial public sector, which was introduced by the 2018 Law on Productive Development. However, more has to be done to improve international reserve assets and to strengthen the central bank's institutional framework through, inter alia, increasing its institutional autonomy and providing budgetary and operational independence.

Mr. Ostros made the following statement:

I thank the staff for the reports, and I thank Mr. Tombini and Mr. Rivadeneira for their useful buff statement.

We support the request for the 36-month EFF, and we welcome the authorities' ambitious reform plans. Two issues are important for the success of the program. Restoring the central bank's independence and terminating monetary financing of the government is one of them. But given the fact that unsustainable fiscal policy is at the core of the current imbalances, there is a big need to implement a strong fiscal adjustment strategy.

I asked the floor to support a proposal from colleagues. Ms. Pollard and Ms. Svenstrup urged the staff to consider including additional structural benchmarks at a later stage of the program to support the authorities' anticorruption efforts, for example, to strengthen the asset declaration regime for senior government officials. I urge the staff to have that in mind going forward.

Mr. Vogel fully supported the authorities' request for an EFF and remarked that policies and imbalances observed until 2016 were absolutely inconsistent with the dollarization regime and with sustainable and inclusive growth. He remarked that the new arrangement, along with the authorities' vision, would contribute to addressing the country's vulnerabilities and implementing the needed structural changes, thus, meeting the strategy's four pillars.

Mr. Villar made the following statement:

First, we fully support the EFF request, as well as the retention of the exchange restriction, allowing the terms proposed by the staff. We issued a gray statement, so I will just mention three of our comments for emphasis.

We welcome the commitment of the authorities, with a strong medium-term fiscal framework. The 5 percent of GDP adjustment in the primary balance envisaged in the program is not minor. It is even more challenging in a context of the current minority government. Thus far, the timeline of the structural benchmarks is heavily concentrated in the period up to October 2019.

The program contemplates a tax reform that is expected to be approved in the first half of the year and which should produce additional revenues of 1.5 to 2 percent of GDP. This would require intensive work with

the legislative National Assembly and political parties outside of the executive branch of the government, as well as difficult-to-obtain public support. Compliance with the social expenditure floor and increasing social programs, such as the non-contributory pension programs, will be essential to gain public support for the reforms. We feel encouraged by the policy support provided by the opposition leaders to the Fund program, as mentioned in the staff's responses to technical questions.

My second comment is about the integral reform that is crucial to ensure that the framework of the central bank of Ecuador is fully consistent with the dollarization regime. Besides the essential fiscal adjustment, we believe the measures adopted by the authorities to prohibit the central bank's direct and indirect financing to government are in the right direction. We also welcome their commitment to strengthening the central bank's independence and governance through a law that expected to be sent this year to the legislative National Assembly.

Third, we entirely support the authorities' commitment toward more flexible labor markets. Wage flexibility becomes crucial in a dollarized economy where there is no room for the exchange rate to help in the adjustment. Also, we are encouraged by the authorities' vision of a more open economy. The actions recently taken to open the economy to world trade are in the right direction.

With these remarks, we wish the authorities success with their adjustment program and the best to the future Ecuadorian economy.

Mr. Meyer made the following statement:

We thank the staff for their comprehensive and informative set of reports and Mr. Tombini and Mr. Rivadeneira for their helpful buff statement.

We support the request for the EFF arrangement. I commend the authorities for committing to a determined correction of the unsustainable fiscal path.

We welcome the thrust of the program's structural reform package and would support those who indicated that once the situation stabilizes, the program should increasingly focus on those elements, probably with structural benchmarks too.

We wholeheartedly support the objective of strengthening the framework of the central bank. We reiterate our concerns about the provision of direct budget support. In that regard, we had one question on the memorandum of understanding. It is paragraph 42 of the staff report. Perhaps the staff would elaborate on that. But more generally, I wanted to ask staff about the strategy to build up reserves. There is an answer in the text, but part of our concern with full budget support is exactly that. We are not setting aside part of the financing to build up reserves more quickly. Some elaboration on the strategy in this regard would be helpful.

With this, I wish the authorities all the best.

Mr. Kaya made the following statement:

We issued a statement and thank the staff for their answers to our questions. We welcome the authorities' recent reform efforts. Since Ecuador continues to face significant internal and external imbalances and vulnerabilities, strong commitment to reforms is necessary to address these challenges.

Fiscal consolidation is key for stabilizing the economy. The authorities should seriously finalize their tax reform proposal, with help from the Fund's technical assistance, aiming to simplify the tax system and make it more growth-friendly and more equitable. We take positive note of the government's communication to the broader public on the need for these reforms and that the main opposition leader expressed support for the Fund's program. Nevertheless, given the difficulties with tax revenue mobilization efforts in several recent Fund programs, we call for a cautious approach and adequate contingency planning.

With that, we wish the authorities all the success.

Mr. Palei made the following statement:

I thank the staff for the report and also for the written answers to the many questions Directors had in their gray statements. As a follow-up to the staff's answers, I have a few additional clarifications in mind.

On energy subsidies, it was not entirely clear from the report what was the mechanism of formation of these subsidies, and how they depend on the international oil prices. If international oil prices go up significantly, would the authorities be able to increase domestic prices in a similar manner? There

was a mention of some compensatory measures, but they remain to be defined at a later stage of the program.

Another question was related to the debt level and the authorities' desire to reduce their debt level as soon as possible. We asked about the possibility of using the privatization of state assets as one of the ways to reduce the debt level. Supposedly, Ecuador has a large state footprint in the economy. Are there any estimates of the state balance sheet? What are the state's assets? How are they valued? Is there any range of estimates? Are there any intentions to clarify what these assets are and how could they be used?

I understand that at this stage, the authorities do not want to proceed with privatization, but if the state assets are very large, it could be one of the ways to reduce debt.

On tax reforms, we felt that the specific measures could be spelled out a bit better in the report, but maybe the staff could elaborate on the current situation. As far as I understand, there was a technical assistance mission. There is a report with specific measures that have specific estimates of their contribution to fiscal consolidation. However, these measures are not spelled out in the report yet. The conditionality is that the authorities will enhance these measures sometime in August or maybe later. But it is not entirely clear what the current situation is. A related question is whether the authorities have the intention to publish the technical assistance report, which is available.

On the external sector, is it possible to discuss it in current account terms or in real effective exchange rate terms? In their written answers, the staff says that the external sector will be close to equilibrium by 2021, by the end of the program. The staff refers to the current account surplus. At the same time, the staff says in the report that the real effective exchange rate is misaligned by about 30 percent. I do not see how the real effective exchange rate will change over the coming two or three years to such a great extent. Some clarifications would be useful.

Ms. Levonian made the following statement:

I thank the staff for the comprehensive reports and Mr. Tombini for the helpful buff statement.

There was much material to cover, including a fascinating selected issues paper on the unique international reserve requirements of a fully dollarized economy. Very consistent with Mr. de Villeroché, we welcome the

authorities' decision to re-engage fully with the Fund and fully support the proposed EFF program. It will hopefully serve as a catalyst to create fiscal sustainability and transparency, rebuild reserves, strengthen key institutions, eliminate market distortions, and tackle corruption. The single greatest risk to the program is the significant frontloaded fiscal adjustment, which will need to be managed carefully. Given this risk, we were pleased to see concrete plans in place to protect the most vulnerable during Ecuador's transition.

As I am sure the news of the Fund's program is still being digested on the ground, we encourage the authorities to adequately engage the civil society, labor unions, and the private sector to ensure they are fully bought into this new vision for Ecuador.

I would also support the issue raised by Mr. Ostros but articulated in Ms. Pollard and Ms. Svenstrup's gray statement, on the inclusion of additional structural benchmarks.

With that, I wish the authorities well on their ambitious reforms.

Mr. Lerrick made the following statement:

This is an ambitious program, but I believe all Fund programs should be ambitious. That is one of the reasons we are here.

The Fund will be helping a government that has chosen to correct the mistakes of past administrations. Those mistakes were clear. They have led to serious imbalances in the Ecuadorian economy, and we welcome the new government's proposed reforms.

There was a great discussion about the right size of this program, and I believe the Fund has found a good balance between the needs of the government, the resources that are available, and the types of reforms that need to be supported. If we combine the Fund's resources with the finances that will be provided from the other international financial institutions (IFIs), this is more than enough to provide the government with the resources it needs to enact its reforms. Therefore, we fully support the program that the Fund has outlined.

Mr. Etkes made the following statement:

I thank the staff for the well-written report and Mr. Tombini for the buff statement.

I would like to go back to the question we raised in our gray statement about the efficiency of public spending. This is the other side of the fiscal adjustment.

Some media reports and also the negative total factor productivity (TFP) suggest that perhaps investment is not efficient, but the staff provided some indications that investment in public infrastructure is efficient. I ask the staff to explain how a huge debt of 15 percent of GDP has further accumulated over the last five years, and did not result in significant growth. We simply are surprised by this reply. If public spending is not efficient, perhaps a Public Investment Management Assessment (PIMA) and other technical assistance for public-private partnerships (PPP) are warranted.

The staff representative from the Western Hemisphere Department (Ms. Ivanova), in response to questions and comments from Executive Directors, made the following statement:²

I thank Directors for the useful remarks and for all the questions. I will cover the broader issues first and then go into specifics. There were many questions about the prioritization of reforms, their ambitious structural reform agenda, as well as the frontloaded consolidation. I will start with that.

The country is facing a challenging set of problems, and we could not solve everything at once. We had to decide where to proceed. As one will see from our diagnosis, we believe that very low reserves, as well as an expanding fiscal balance, were the two big problems that the country is facing. Competitiveness problems are also very important, but unfortunately, those will take time to resolve, as well as the issues related to governance and transparency. We moved on that premise. We wanted to correct, to put out the most important fires first. Therefore, there is an emphasis on fiscal framework, on fiscal consolidation, and on the reform of the central bank as an immediate priority.

The government has taken prior actions, not only to prohibit borrowing from the central bank through bonds but also through other means, which was not prohibited in the Productive Development Law. There was a question of whether there were new prior actions. This was a new prior action that they had done. We thought that was absolutely necessary for starting the program.

² Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes

Then we move into the issues of fiscal consolidation. For that, we thought that the authorities would need a comprehensive strategy, not only lowering the deficit in the near term but also building a credible framework for the future. Therefore, one of the first reforms that they are undertaking—and that we fully support—is the reform of the fiscal framework, which will ensure that the reforms that they are taking in the next two years and the convergence of debt to the official limit of 40 percent of GDP will happen soon. They will be able to reinstate the fiscal rules that they had in place before, augmented by the recommendations from our technical assistance.

We do see these are two clear priorities. There are supporting reforms, such as the reform of public financial management, which are needed to fulfill these objectives of consolidation and making sure that we can monitor fiscal developments and that the authorities can report on the fiscal indicators.

That was really the motivation behind frontloading these reforms. We have also provided a significant amount of technical assistance. The work has been ongoing for eight months. The authorities received technical assistance on public financial management, on the fiscal framework, on a reduction in the wage bill, on debt statistics as well as other types of statistics, public debt management, and there was just now a mission on the tax reform. These reforms are ambitious, but we believe that the authorities have already done a significant amount of background work that was needed to fulfill this conditionality that we have in 2019.

In terms of fiscal consolidation, it is ambitious fiscal consolidation, but it is needed to provide reassurances to the domestic audience, as well as to the public, that this government is taking this task seriously and is moving forward with them. Since the new administration, there were many expectations following the positive political changes that the government would be able to resolve fiscal imbalances quickly. This process maybe did not move as fast as the markets expected. We are now in a situation where the government is facing very high costs, and they need to move quickly on correcting these imbalances and on reversing the trend in public debt, which has doubled in the last five years.

We are aware of the potential cost to growth, and we have done analyses on how these fiscal reforms could affect growth. We believe growth will be negative this year. We are more pessimistic than the government. The government believes that growth will remain slightly positive. The reason why we believe that growth will not be affected too much is because there is

room for improving the credibility of the government and also because a dollarized economy, like Ecuador, is very dependent on inflows from outside.

The lack of access to external financing and the lack of access of inflows—the FDI level, for example, is very low—is constraining growth in Ecuador. We believe that the program and the ambitious reforms that the authorities are undertaking would strengthen the credibility of government but will also help with the general perception of this economy and with foreign investment.

In addition, there is also a point on the composition of fiscal adjustment. Some of this adjustment, as one can see from the tables, is automatic. It is related to a reduction in oil prices. We do not believe that the effect will be very damaging for growth. We have estimated the impact of other reforms carefully one by one. We believe that our growth forecast is reasonable. Nonetheless—and this is one of the reasons why we believe that quarterly reviews are useful—we will be monitoring the situation carefully. If needed, we will have to make adjustments to the program if the growth turns out to be lower than we expected.

On the question of social protection and the efficiency of public spending, we are aware of the potential impacts. Therefore, the program is very frontloaded in terms of an increase in social spending. We do not expect the subsidy reforms that took place today to have a significant impact on the poor because the increase in gasoline prices—in particular, high octane gasoline—is really not affecting the poor, according to the estimation of our colleagues at the World Bank. The other increases were in the industrial diesel prices, which do not have a direct impact on the retail price. We do not believe that these subsidy reforms have a significant impact. However, the reduction in employment in the public sector, as well as potentially the future tax reform, could have an impact. We will be working closely with the World Bank on estimating the tax reform package, once being articulated, to see whether additional adjustment or social spending is needed. In the meantime, we believe that the development of a social registry is very important to improve the targeting of social protection programs.

On the efficiency of public spending, we believe that some of the capital investment has been quite productive, but not all. There are some inefficiencies. As well as inefficiencies in other types of spending. Our colleagues at the World Bank are looking at the efficiency of health and education spending. They have found that there is much room to improve. For example, on health spending, if the country wants to achieve the Sustainable

Development Goals (SDGs), they have to reduce health spending, not increase, because they have been overspending in that area. Before we impose any floors on this type of spending, we need to investigate where there are some savings to be made.

In terms of what has happened in the last 10 years, there was a big increase in the wage bill. To a large extent, that drove the increase in expenditure. There was also an increase in capital spending, but it has been cut dramatically. It was probably the largest cut in Latin America in the last five years. It went from 15 percent to 10 percent, and it will be reduced more in the program. We believe that there were already some savings made in that area, and there probably are more to be made. The problem includes some further reductions in capital spending.

Regarding the external assessment, we fully agree that our estimates are not very precise. We have uncertainty around all of the estimates, but we presented the model that we believe fits the best the case of Ecuador, which is the consumption allocation model, designed specifically for oil producers. That model shows large overvaluation. It is also supported by other indicators. I agree that the exact size is hard to determine, but it is all going in the same direction—that the exchange rate is overvalued.

We do show in the program that the current account will return to equilibrium over the next three years, but the exchange rate adjustment will be slower, and we do not believe the overvaluation will be fully eliminated even by the end of 2021.

On privatization, there are legal restrictions in Ecuador in terms of privatizing assets. I do not believe this path is viable in the near term. Of course, there may be some changes in the future. That is why the authorities are pursuing this leasing of assets. We do have some estimates of non-financial assets of about 17 percent of GDP. But we are aware of the statistical difficulties of estimating the value of these assets. The program, in fact, incorporates some of these leasing assumptions, but they are not large. But I agree that in the future, there is more potential to utilize these assets. Nonetheless, in the short term, just establishing the regulatory framework for this is already a big step that the authorities are working on. Things will take time. We do not believe they can use it right now to reduce debt dramatically.

The staff representative from the Strategy, Policy, and Review Department (Ms. Gonzalez), in response to questions and comments from Executive Directors, made the following statement:

We commented in the written answers that we would provide an answer to the question on debt collateralization from Ms. Riach, and on whether commitments from the Ecuadorian authorities, in terms of their transparency, could serve as a guide for other countries.

Yes, the program commitments for the Ecuador EFF and for the Angola EFF do provide useful examples for countries with debt that has collateral or collateralized-like features. We just wanted to make the Board aware of two challenges.

The first challenge relates to the detailed information under surveillance, vis-à-vis program cases. In this case, for Ecuador and Angola, the teams had specific access to confidential contracts that allowed them to gauge in a detailed way the terms and the magnitude of the debt contract. We are encouraging surveillance teams to do the same thing, but this may be a bit more difficult when there is no conditionality available.

The second point has to do with the complexity in identifying debt with collateral-like features to properly design conditionality. Markets are innovating all the time, and there are many instruments that are functional equivalents to collateralized contracts but are not technically or legally collateralized. This fact has implied that we need to study and properly understand the risks and the terms of these contracts to properly gauge risk. But in general, we will be considering these issues in more depth in the review of the Debt Limits Policy.

Finally, I would like to mention that there will be a correction to the staff report. In the text table on page 16 there will be an addition on the non-financial public sector coverage for the measures taken under the program. The Transparency Policy requires that I announce this to the Board.

The staff representative from the Western Hemisphere Department (Ms. Ivanova), in response to further questions and comments from Executive Directors, made the following additional statement:

I just realized that I missed a few important questions. One question was on the design of the tax reform and that the measures are not well articulated. Indeed, the government has just received a technical assistance mission on tax reform. They were together with us in the field. They provided about 100 recommendations on how to improve the system, and it is not all about raising revenue. The system is complex. In fact, the uncertainty about the tax code has been quoted by many investors as an impediment to doing

business in Ecuador because the tax code was changed frequently during the previous administration. The idea is to simplify the system and to make it more growth-friendly and to raise revenue, as mentioned in the program.

We believe that this reform has to be designed carefully, because there could be implications for the poor; in particular, if this reform considers an increase in taxes. We need to analyze the impact of these measures, and the government will have to decide what options will pursue in terms of raising revenue. We are working already with the World Bank on trying to estimate the potential impact on the poor from these reform options.

This reform will be very difficult politically because it will require a majority in the legislature. This reform has to be discussed publicly. It has to get support internally. Therefore, we believe that postponing it to the end of the year is appropriate to give the authorities time to design the appropriate tax reform. We will elaborate on the measures once they are known.

In the meantime, I want to emphasize that the other measures listed in the table are quite detailed. The authorities received, for example, technical assistance from the Fiscal Affairs Department (FAD) on the wage bill. They have specific options on reducing the wage bill, including separations from occasional contracts.

In Ecuador, unfortunately, there are constitutional restrictions on a reduction in nominal wages. These have to be carefully thought through, and the options have to take into account the legal constraints. These are the measures that we have. They are detailed. They are costed, including by our FAD mission, in consultation with the authorities. That reform is well defined. The authorities have already announced some of the measures in this reform, including the roughly 10 percent reduction in the employment of the public sector.

There are also measures on this subsidy that are detailed. They already have done some of the measures that will gain revenue in 2019. They have further measures in 2021. In goods and services, they had a procurement reform with the help of the World Bank. They designed savings in the procurement process. The measures are quite detailed. We will report on the specifics as they come along.

In terms of the memorandum of understanding, we did answer the question. This memorandum is quite technical. It is really that the money will be deposited in the account of the government at the central bank. Because of

some constitutional restrictions, we wanted to make sure that the government basically takes the liability for this loan. This was the same idea in the Rapid Financing Instrument in 2016. We followed this legal proceeding. But the question was bigger and not so technical in terms of why we are providing the budget support, as opposed to reserve support, to Ecuador.

At present, the government has a fairly large financing gap. We are closing it with the resources, not only from the Fund but also other IFIs. We feel that in order to support growth as much as we can—and the consolidation is already very large—at this stage, we need to just allow the government to smooth the adjustment. They will build reserves slowly, as the consolidation proceeds. We believe that this is where support was mostly needed at present to smooth the adjustment.

The Chairman asked the staff to comment on the removal of subsidies and the price adjustment in response to oil prices. She also remarked that the staff's responses demonstrated how technical assistance teams and mission teams worked hand in hand.

The staff representative from the Western Hemisphere Department (Ms. Ivanova), in response to further questions and comments from Executive Directors, made the following additional statement:

The subsidy is dependent on the oil price. When the oil price goes up, the subsidy goes up. When oil price goes down, the subsidy goes down. The reforms that the authorities have taken so far are not full price liberalization. That is only for high octane gasoline—the price is following international prices. The other prices are still fixed. Therefore, there will be an automatic effect because we did not want to remove all the subsidies quickly, being aware of the social implications. The authorities are moving slowly.

Ideally, they should move to an automatic price adjustment mechanism. But in the program, for gasoline, the assumption is that the full liberalization happens only by 2021. It is rather slow. It is not happening immediately.

The Chairman asked whether liberalization was happening much faster on other categories of oil-related products?

The staff representative from the Western Hemisphere Department (Ms. Ivanova) responded that it was happening mostly for industrial diesel prices.

Mr. Tombini made the following concluding statement:

I would like to start by thanking the Chairman for chairing today's Board meeting. I also wanted to thank her for having been personally involved throughout the process and for having given all the necessary support for us to get to the point we are at today.

I also would like to thank Mr. Furusawa, Mr. Werner, Mr. Chalk, the mission chief, Ms. Ivanova, as well as the entire team working with Ecuador, for all the commitment and effort made in reaching an agreement with the country that suits both parties.

I also thank Directors for their support and for their comments. Please be assured that the comments will be duly conveyed to my authorities.

Ecuador has decided to depart from the past economic model that was essentially unsustainable. This change of model implies returning to the path where the main driver of growth is the private sector, while the public sector recovered its role of facilitator and redistributor of wealth to ensure a peaceful, homogeneous, healthy, and educated society. This is fundamental to contribute to the well-being of the population and to face the new challenges that have arisen in this century.

The country has also returned to a path of international cooperation to deepen its relations with the world. This implies reintegrating the multilateral financial organizations network.

In the case of the Fund, this implies strengthening the relationship that was sometimes difficult in the past. The authorities are now fully benefitting from technical assistance from the Fund, and look forward to deeper program engagement.

The authorities are requesting this EFF, rather than a Stand-By Arrangement, because they do not want to concentrate their efforts only in the short term and on urgent balance of payment needs. In their homegrown program, the authorities want to attack the structural problems that affect the Ecuadorian economy in the long run, particularly in terms of improving the competitiveness of the Ecuadorian economy amid the constraints imposed by dollarization.

This will imply eliminating the excessive rigidity of the Ecuadorian labor market, increasing the openness of the country toward the world,

incorporating new commercial agreements, providing greater ease and legal security to international and national investment partners.

This agreement with the Fund and other IFIs will support the main policy objectives of the Government of Ecuador, particularly those related to strengthening the foundations of dollarization, ensuring fiscal sustainability, strengthening the institutional role of the central bank, increasing financial resilience, and fostering competitiveness. The authorities are also committed to improving the living standards of the poorest and most vulnerable, and the program has specific quantitative performance criteria for social spending.

Finally, a large part of the program is related to promoting transparency, good governance, public accountability, and fighting corruption.

To ensure the success of this program, it has been possible to include financial support from other multilateral institutions, such as the World Bank, the Inter-American Development Bank, the Development Bank of Latin America, the Latin American Reserve Fund, among other organizations that will complement the Fund's program. We expect that this agreement will ensure the necessary discipline and transparency in the management of Ecuador's economy. This, in turn, will generate predictability that will increase the confidence of national and international private actors, which should lead to a significant decrease in country risk, and consequently, there should be a substantial increase in investment and in economic activity, among other benefits.

To conclude, I thank again Directors for their support and management for this intensive engagement with Ecuador.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for their efforts to transform the economy and address Ecuador's complex macroeconomic and structural challenges. Directors welcomed the authorities' focus on strengthening the fiscal, financial, and institutional foundations, and emphasized that strong commitment to sound policies and reforms will be critical to reducing balance of payments vulnerabilities, consolidating macroeconomic stability, putting dollarization on a stronger footing, and fostering job creation and sustainable growth.

Directors welcomed the authorities' commitment to restore fiscal discipline and sustainability. They agreed that adjustment efforts should focus on a combination of expenditure and revenue measures. Directors saw need for a realignment of the public sector wage bill, careful reduction in untargeted subsidies, and reprioritization of capital and goods and services spending. They also emphasized the importance of making the tax system more equitable, growth-friendly, and simpler. Directors acknowledged that while these fiscal efforts might impact growth in the near term, they are key to sustained and equitable growth over the medium-term.

Directors welcomed the focus on lowering the debt-to-GDP ratio and complementing the existing expenditure growth rule with binding annual targets for the non-oil primary balance. They concurred that the publication of timely and periodic in-year reports to assess compliance with fiscal rules would further strengthen credibility. Over time, better public financial management, budget procedures, and procurement practices, combined with more rigorous fiscal controls, would make fiscal policy more effective.

Directors welcomed the authorities' commitment to protect the poor and the most vulnerable. To manage the impact of the economic transition and maintain societal support for the economic program, Directors encouraged the authorities to move quickly to expand the eligibility of social assistance programs, with better targeting and a higher level of benefits. Over the longer term, they called for action to improve education and health outcomes.

Directors underscored the importance of supply-side reforms in restoring competitiveness. A more efficient tax system, public wage restraint, enhanced access to the formal labor market through improved hiring processes, and better governance will all contribute to a vibrant, private sector-led growth model. Directors emphasized that there remains scope to remove trade barriers, improve the business climate, and create opportunities for greater private sector involvement.

To support dollarization, Directors endorsed measures to build financial resilience, remove impediments to effective financial intermediation, and strengthen the central bank, including through building up international reserves. To better anticipate and adapt to shocks, Directors recommended increasing the oversight of banks and cooperatives and building crisis- preparedness and contingency-planning capabilities. Directors considered that simplifying the complex system of liquidity regulations and gradually phasing out interest rate ceilings would support greater access to financial intermediation. They commended the authorities' efforts to make the central bank more operationally independent, to strengthen its governance, and to restrict it from providing fiscal financing. Directors encouraged steps to strengthen the effectiveness of the AML/CFT framework.

It is expected that the next Article IV consultation will be held in accordance with the Executive Board decision on the consultation cycle for members with Fund arrangements.

The Executive Board took the following decisions:

Ecuador—Request for an Extended Arrangement Under the Extended Fund Facility

1. Ecuador has requested an Extended Arrangement in an amount equivalent to SDR 3.035 billion for a period of three years from the date of adoption of this decision.
2. The Fund approves the Extended Arrangement for Ecuador set forth in EBS/19/9 and decides that purchases may be made under the arrangement, on the condition that the information provided by Ecuador on the implementation of the measures specified as prior actions in Table 2 of the Memorandum of Economic and Financial Policies attached to the letter from the General Manager of the Central Bank of Ecuador and the Minister of Economy and Finance of Ecuador, dated March 1, 2019 is accurate.
3. The Fund waives the limitation in Article V, Section 3(b)(iii). (EBS/19/9, 03/04/19).

Decision No. 16488-(19/16), adopted
March 11, 2019

Ecuador—Request for Approval of Exchange Measures Subject to Article VIII, Section 2(a)

1. Ecuador maintains an exchange restriction subject to Fund approval under Article VIII, Section 2(a) of the Fund's Articles of Agreement, which arises from a 5 percent tax on transfers abroad for the making of some payments and transfers on current international transactions.
2. In the circumstances of Ecuador, the Fund grants approval for the retention of this exchange restriction for a period of twelve months from the date of this decision. (EBS/19/9, 03/04/19).

Decision No. 16489-(19/16), adopted
March 11, 2019

APPROVAL: April 16, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Real Sector

1. *The Selected Issues and Analytical Notes paper showed that the oil sector contributed only 9.9 percent of output in 2015, which is not high compared with other oil producing countries. Does staff think that the economy is overly vulnerable to the volatility in oil prices given the low share of the oil sector in the economy?*
 - Oil is not a large share of the economy compared to some other oil-producing countries but does occupy a large share of exports (35 percent). Nonetheless, Ecuador vulnerability to volatility in oil prices is exacerbated by the fact that:
 - Oil production in Ecuador—which is undertaken by the state-owned oil company or by service contracts with private providers—has a disproportionate impact on the fiscal accounts. Consequently, negative oil price shocks in the past have been amplified by abrupt and procyclical cuts to public capital spending which tends to have a relatively high multiplier (fiscal financing constraints become increasingly binding, preventing the government from smoothing spending when faced by a loss of oil-related fiscal revenues).
 - Ecuador cannot adjust to a negative terms of trade shock through a depreciation in the exchange rate. The adjustment must come instead through downward movements in wages and prices which are difficult to achieve, resulting in an increased impact on output.

2. *Could staff provide the fiscal multiplier used for its projections? Staff comments are welcome on the authorities' plans for rapid fiscal tightening in an environment of low domestic growth and weakening global expansion. Could staff comment on the appropriateness of the staff's baseline assumption on the impact of the proposed reduction of the non-oil primary deficit on economic growth, including multipliers, as a preliminary finding of the Review of Conditionality flags risks to underestimate such impacts?*
 - The average fiscal multipliers used in staff's macroeconomic framework were 0.3 for current expenditures, 0.7 for tax changes, and 0.8 for capital expenditures.³ Ecuador's dollarized system, relatively rigid labor laws, and an important share of households

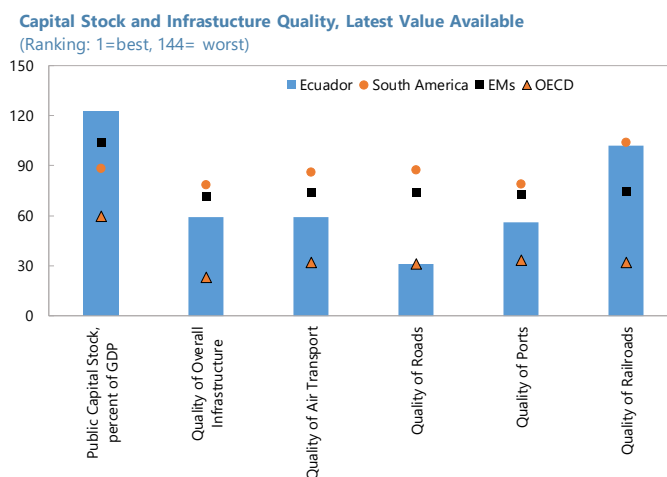
³ See Batini, Eyraud and Weber (2014). "A Simple Method to Computer Fiscal Multipliers", IMF Working Paper 14/93.

facing liquidity constraints argue for higher fiscal multipliers. However, there is also significant room for credibility and confidence effects to support growth, particularly given the authorities' ambitious fiscal plans and, more broadly, their desire to pursue more private-sector friendly policies (the authorities' program puts significant efforts into phasing out distortionary and inefficient policies). The fiscal contraction's impact on domestic demand and imports is also partly offset from higher oil production (a result of project investment in past years coming on-line).

- From the Review of Conditionality two messages have emerged:
 - Teams often overestimate growth (for a number of reasons, including relying on optimistic fiscal multipliers). Thus, there is a need for clear contingency plans to be able to react if growth is worse-than-forecasted. In Ecuador's case the authorities are committed to take additional measures, if needed, to ensure that the program achieves its objectives.
 - The composition of fiscal adjustment ex-post is often much worse than that planned ex-ante, with negative implications for growth. The government is working closely with technical assistance providers to ensure that its fiscal plan is implemented as designed.
3. *As depicted in Table 1, the adjustment path significantly impacts the contribution of domestic demand but is largely compensated by that from external demand. Can staff expand on where this compensatory effect comes from and how robust the estimation is?*
- Fiscal consolidation, and the resulting reduction in domestic demand, is estimated to reduce imports by 1.2 percent of GDP between 2018 and 2020. On the other hand, investments in the oil sector that are already in place as well as the planned structural reforms to improve competitiveness are estimated to increase exports from 2018-20 by 0.3 percent of GDP more than the increase resulting from stronger trading partner demand. Both of these forces should support an increased contribution from external demand in the next 2 years.

Fiscal Policy

4. *Can staff comment on the efficiency of public investments? Is there scope for TA, such as PIMA, to enhance public investment efficiency?*
- The efficiency of public investment is relatively high compared to peers. As the FAD expenditure assessment tool shows, Ecuador ranks well in the quality of overall infrastructure (see below). Technical assistance, such as PIMA, could be useful although the authorities have not seen it as an immediate priority (focusing most recently instead on topics like tax policy, public employment and wages, social assistance, the fiscal responsibility framework, and public financial management).



5. *Could staff further elaborate on how much of the projected improvement in the headline fiscal balance is depending on the assumption of higher oil revenues.*
- Oil revenues are expected to reduce the overall balance between 2018 and 2021 by 1.1 percent of GDP which will be more-than-offset by the 5 percent of GDP adjustment in the primary non-oil balance that is at the core of the authorities' program.

| | 2019 | 2020 | 2021 | 2019-2021 |
|--------------------------|-------------|------------|-------------|-------------|
| Total Revenue | -1.0 | 3.1 | -2.9 | -0.8 |
| Oil | -0.9 | 1.5 | -1.7 | -1.1 |
| Non-oil | -0.3 | 1.4 | -0.4 | 0.7 |
| Total expenditure | 2.0 | 0.7 | 2.0 | 4.6 |
| Total | 1.0 | 3.7 | -0.9 | 3.8 |

6. *We note from the DSA that at end-2017, there was an additional 7.7 percent of GDP of accounts payable from SOEs, local governments and the social security that could be part of debt. What would be the risks on the public debt sustainability if this amount were added to the public debt?*
- Other accounts payable are already recorded as part of the public debt reported in the fiscal table of the report. The text of the DSA has been corrected to reflect this.
7. *How does staff assess the risks of the country having to resort to the market and what could be the impact on the interest rate bill?*

- Over the course of the program, Ecuador is not programmed to rely on market financing and will accumulate at least US\$2 billion in public sector deposits per year. If market terms improve and the authorities issue new debt, those resources will be used to build international reserves. However, if there were a negative shock to oil prices then fiscal financing needs could be larger (resulting in a slower pace of reserve accumulation and/or the need to issue debt which would result in a higher interest bill).
8. *Staff assures in the report that there is evidence that around 20 percent of the expenditure recorded under capital expenditure is misclassified as current expenditure; is staff working with the authorities to clarify this figure and make the necessary adjustments? How could this affect the reduction in capital expenditure foreseen in the program?*
- Staff is currently working with the authorities to clarify this figure including through a broader technical assistance effort, which is planned to align Ecuador's fiscal accounts with GFSM classification.
9. *Unfortunately, we feel that, at the outset of the EFF program, the fiscal reforms and any specific measures remain to be defined. We ask staff to elaborate in the written answers on these measures and their contribution to the envisaged further fiscal consolidation. Since the tax reform is assumed to bring significant additional revenues, we wonder whether staff can provide us with more details about specific tax changes under consideration as well as their distributional impact?*
- The table on page 16 of the staff report provides a summary of the fiscal measures underpinning the program.
 - Wage bill reduction is expected to come from the termination of occasional contracts, a reduction in wages to new officers, and filling only one-half of vacancies.
 - The authorities have already increased the price of regular gasoline, cut gasoline subsidies for domestic and industrial usage, and increased the price of diesel for fishing.
 - The authorities are either delaying or cancelling lower priority capital projects and expect to realize efficiencies in spending on goods and services (including from better procurement practices).
 - The specific form of the tax reform is still being considered by the authorities drawing on a range of options identified by Fund technical assistance. As a clearer picture emerges of possible policy choices, staff and other IFIs will provide input including on the distributional effects of reform options (indeed the World Bank is already working to estimate the distributional impact for alternative tax reform packages).

10. *Is such a reduction of the public debt over short period of several years necessary? Could staff clarify, whether somewhat less ambitious change in the fiscal balance would be more conducive to medium-term economic growth? To what extent can the authorities reduce public debt through privatization of presumably large state assets? What are the current estimates of the value of state assets in Ecuador? Do staff intend to examine public balance sheet in greater detail?*

- The planned fiscal consolidation is ambitious but is necessary to reverse the upward trend in public debt and re-establish the credibility of fiscal policy. The authorities goal is to bring debt back below the legally binding public debt limit of 40 percent of GDP (which has been temporarily lifted) as quickly as possible. Also, there is an urgent need to build reserves which, in a dollarized system, can really only be achieved through an increase in public deposits. The authorities have been clear that they are not planning to privatize assets but do plan to raise revenues by leasing government assets to private sub-contractors for temporary use and maintenance (see table on page 16). Data limitations (including the valuation of government owned assets) precludes a full analysis of the public balance sheet at this time. IDB is providing technical assistance on establishing a framework for asset leasing.

11. *In addition, we would like staff to clarify the reasons to include petroleum subsidies in the targeted non-oil primary balance. This subsidy is linked to the international oil prices, which are not under the authorities control. How will the authorities deliver on their commitment in case of a significant increase in oil prices?*

- Since an important part of the authorities' adjustment in their fiscal position is expected to arise from a reduction in energy-related subsidies, using the non-oil primary balance including fuel subsidies as the main anchor of their fiscal program would give credit for the reform of fuel subsidies. Fund research (see A Primer on Fiscal Analysis in Oil-Producing Countries, IMF WP/09/56) staff argues that "fuel subsidies should be included in the non-oil balance on the grounds of fiscal sustainability, their impact on domestic demand, and their contribution to fiscal vulnerabilities and fiscal effort." In the event of a large change in oil prices relative to the current program baseline, the authorities intend to recalibrate the program at the time of each quarterly review, including through the adoption of additional measures if needed.

12. *The report mentions p.17 that the subsidy reform should not have a major impact on retail consumer prices, could staff elaborate on why?*

- The gasoline and diesel retail consumer prices have already been increased for the round of expected savings in 2019. The program does not envision additional retail price increases in 2019-2020. The recent price increases did not create major public backlash. In 2021, a large portion of the subsidy reform relates to prices for producers

with the two exceptions: the relatively small increase in gasoline prices at the pump and an increase in electricity tariffs.

13. *How solid is support for tax and other legislative changes in the National Assembly? Given this reform will be subject to legislative approval, could staff discuss the broader sentiment toward tax reform in the country? The program contemplates a tax reform that is expected to be approved in the first half of this year and which should produce additional revenues of 1.5 to 2.0 percent of GDP. How does staff evaluate the political feasibility of such a reform being accomplished? Regarding reforms to the tax system, we would like to have staff's views on the political support for this reform. How confident are staff that the required legislation will gain the support of the National Assembly? Has there been consideration of a fallback plan for meeting the fiscal objectives if, for example, the tax package cannot gain legislative assent?*

- Passage of the tax and labor legislations will require a broad consensus in the National Assembly that cuts across party lines. The mission met with the leader of the main opposition party, Guillermo Lasso, who subsequently publicly expressed support for the IMF program. In addition, the government has been active in reaching out to the broader public to articulate the need for reform and the benefits of improving both tax and labor legislation. While it is difficult to predict the outcome of the political process in any country, staff believes that the government can find common ground with the opposition on the major reforms that are part of the program.

14. *Do staff consider that these commitments from the Ecuadorian authorities could serve a useful guide for other countries, including those in other regions, for reporting collateralized debt? And will the additional information from the Ecuadorian authorities be provided to Fund staff only, or will it also be shared with the board and/or made public)?*

- The Ecuadorian authorities provided staff with all the information that has been requested to assess the stock of public debt, including for non-traditional borrowing arrangements. Many of the details of these contracts are confidential and the authorities have chosen not to provide them to the public.
- The remainder of the question will be addressed orally.

15. *Regarding efforts to curb public, we look forward to the public financial management action plan by end April 2019 and would appreciate staff's update on the related technical assistance received so far and/or planned looking forward.*

- An FAD Public Financial Management mission took place in September last year. The mission provided an overall diagnostic of the laws, regulations, and practices regarding budget planning, execution, and controls; fiscal rules, and fiscal reporting. The mission provided recommendations in each of these areas that provide input to the authorities' own action plans. IMF staff has also been closely involved as reviewers in the forthcoming PEFA update conducted by the European Commission and a PFM mission from LEG (to advise on legal reforms on PFM and fiscal rules) is planned for the coming months. The authorities have also requested FAD TA on the management of arrears (which will help shape program conditionality in this area).
- 16. *We welcome that the amended budgetary framework will introduce a contingency reserve in the budget and would like to know what the size of the reserve for 2020 will be.***
- We have yet to determine that with the authorities. The appropriate reserve size would depend on the magnitude and likelihood of the fiscal risks the authorities want to provision for. The practice varies by country. Budget contingencies normally vary between 1 and 3 percent of total budget spending.
- 17. *We take note that there are arrears to the private sector. Could staff elaborate on the nature of these overdue obligations?***
- The authorities do not have a definition of payment arrears therefore it is difficult to measure the stock and the nature of arrears in a consistent and defined manner. Over the course of the program, staff will provide technical assistance with the aim of solving these problems and to have a defined definition and reliable data on the stock of arrears.
 - Regarding arrears to international private bond holders arising from outstanding claims on those international bonds that the authorities repudiated in 2008/2009, as explained in the staff report, the majority of government obligations were repurchased by the government. However, US\$52 million (including accrued interests) remain outstanding in the hands of individual creditors and the authorities have been unable to identify these creditors in order to settle the claims. The authorities have, however, contracted the services of an international advisor to search for, identify, contact, and negotiate with these outstanding bondholders. They have also created a web-site where the creditors could claim proceeds on their bonds (see this link: <https://www.finanzas.gob.ec/informacion-para-tenedores-de-bonos/>) Staff's judges that good faith efforts have been made to reach a collaborative agreement with the remaining creditors and will continue to monitor evolving relations with these creditors, confirming, at each review, that the requirements under the policy on lending into arrears have been met.

Social Protection

18. *On social spending, could staff confirm our understanding that the floor on social spending is at 1 percent of GDP under the program? There seems to be a discrepancy between the 0.4 percent of GDP in the Table in page 16 which points to an increase, whereas the same amount in Table 2b seems to indicate the total for each year under the program. In the same vein, could staff offer some indications on the level of social spending in the years prior to the program?*

- The floor on social spending is at 1 percent of GDP during the course of the program. We have amended Table 2b and specified that the values in that line refer to the increase in social spending included in the program rather than the level. Social spending has been declining in recent years, reaching about 0.65 percent of GDP in 2018.

19. *Is the coverage of social spending consistent with current efforts by the Fund to go beyond social protection? And are there any preliminary lesson from the extension of social spending to health and education? Moreover, we look forward to the authorities' strategy aiming at better targeting social programs and benefits, notably in education and health, and improving safety nets for the vulnerable groups. Staff's comments on the timing and status of preparation of this upcoming strategy is welcome. Could staff indicate whether health and education spending are covered by this floor? Could staff explain why no social spending effort is mentioned after 2019? We note the focus on elderly and disabled people, can staff precise if there any disposal for the young population?*

- As detailed in the Technical Memorandum of Understanding (page 97), social assistance spending covers a conditional cash transfer program (Bono de Desarrollo Humano), a program to support people with disabilities (Bono Joaquín Gallegos Lara), non-contributory pension programs (Pensión Adultos Mayores, Pensión Mis Mejores Años, Pensión Para Personas Con Discapacidad) as well as spending on developing the social registry. It does not include health and education spending.
- The authorities, with the help of the WB are currently working on upgrading the social registry to increase targeting of social assistance spending. The authorities are also working with other multilaterals to optimize the efficiency of spending on health and education. The government has already implemented improvements in the public procurement process, including its increased transparency, which are expected to be important for education and health outlays. In addition, with the technical support of the World Bank, a spending review is being carried out in both sectors.

- The IDB is also providing support to improve the institutional arrangement and capacity for evaluating the quality of public spending, including through the creation of a specific evaluation and monitoring unit.

| in US\$ millions | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|------------------|---------|-------|-------|-------|-------|-------|
| Social Spending | 1,029.9 | 863.8 | 692.4 | 689.1 | 649.8 | 643.6 |

External Sector

20. *What level of reserves would staff consider adequate for phasing-out the tax on transfers abroad?*

21. *While we support a time-bound retention of restriction on transfers abroad for BOP reasons, could staff comment on the policy options and sequencing to avoid disruption in the financial market and the economy as a whole when the restrictions are phased out?*

- CFM removal should be conditions-based, linked to macroeconomic/financial stability and external sustainability, which is broader than just benchmarking against reserves. As such, there is no specific level of reserves that would determine when to lift the CFM. The CFM could be removed when the authorities assess that macro stability has been restored (which is a primary objective of the program) and when reserve adequacy is stable (although, since the CFM is not the main element of the authorities' reserve accumulation plan, they may consider removing it even earlier than that).
 - Fund guidance on reserve adequacy in dollarized economies suggest that reaching 100 percent of the ARA metric plus liquidity buffers for fiscal and banking sector needs is a prudent benchmark.
- 22. *Under the circumstances, we believe that it is difficult to estimate possible misalignment of the exchange rate. We find staff's estimate of 31 percent overvaluation to be questionable and unnecessarily precise. In our opinion, insisting on a large overvaluation instead of admitting the high degree of uncertainty in such estimates may be a disservice to the authorities.***
- As in any country, there is significant uncertainty around any assessment of the misalignment of the exchange rate. Staff presented in the report estimates that draw on the Fund's EBA-lite models which all point in the direction of an external position weaker than the level consistent with the fundamentals. Other available evidence (loss of market share of non-oil exports, labor costs evolution through time, and measures

of structural rigidities in the economy) corroborate this view. The authorities agree with the thrust of this assessment and have focused a considerable amount of their reform effort on steps to restore competitiveness and address the large exchange rate overvaluation.

23. *In staff's view, to what extent could the overvaluation of REER be offset by fiscal adjustment and structural reforms?*
- The fiscal and structural reforms envisioned under the program will help restore external equilibrium by the end of the program. By 2021, the current account is expected to reach a surplus of 1.5 percent of GDP, which is consistent with staff's preferred EBA-lite model for estimating the current account norm.
24. *Could staff further elaborate on the significance of the debt service payments or loss of export revenues associated with existing non-standard borrowing arrangements.*
- The debt service on all of Ecuador's non-standard borrowing arrangements together (including oil pre-sales) constitute about 30 percent of public external debt service over the next few years. As described in the staff report, these debts take a variety of forms. There is no loss of export revenue associated with the oil off-take agreements and only a (very small) portion of export revenue is directed to repaying the loans.
25. *Staff's comments are welcome on the ambitious targets on net and gross reserves in the program compared to the low level of current reserves, given the substantial risks in the external sector. Can staff elaborate on how NIR are to be restored given that the expected financial support during the program, including from the Fund, is budgetary?*
- The Fund's financial support is intended to meet the BOP need through partially meeting the gross financing needs of the budget. The increase in net reserves is achieved through a build-up of public deposits held in the central bank (resulting from a combination of financial support from multilaterals and the authorities' ambitious fiscal adjustment effort). Staff see the current low level of reserves as an important vulnerability—particularly given the potential volatility in the terms of trade and in global financial conditions—and the authorities' economic plan is designed to steadily increase reserves throughout the course of the arrangement.
26. *With regards to the retention of the exchange rate restriction, we wonder if a sudden and pre-announced dismantling could generate additional problems. Staff's comments are welcome.*

- Dismantling the exchange restriction is expected to take place once the positive confidence effects coming from the program have set in. Removing the restriction prematurely could indeed affect negatively financial stability and run counter to program objectives.
27. ***Do staff consider that moderating the level or growth rate of the minimum wage over the medium term could help address labor market rigidities and support private sector-led growth?***
- Minimum wages in Ecuador have a large impact on the income of the most vulnerable and disadvantaged workers in the economy (i.e., informal sector workers, youth and female workers, etc.) and various government fees are calculated as a share of the minimum wage. However, the wages of employees in the formal sector, which are in general well above the minimum wage and don't exhibit a strong links to minimum wages, are more relevant for competitiveness and growth. On balance, the negative distributional impact of lowering the minimum wage would outweigh the potential benefits of employment creation. Nonetheless, the authorities should be conservative in increasing the minimum wage in case it either provides a signal for private wages or exacerbates existing labor market rigidities.

Monetary and Financial Sector

28. ***We positively note that the decision to forbid the financing of the budget by the BCE has already been taken. Could staff comment on any interim arrangements to address potential difficulties to the government cash flow due to this decision?***
- The *Junta Monetaria* has already adopted a Decision that prohibits monetary financing of the government and public sector, as well as quasi-fiscal operations by the BCE. These prohibitions will be included in the amended legal framework for the BCE. While this decision implies closing one of the financing sources for the government staff does not envision significant difficulties to the government's cash flow. The program is fully financed from a combination of the authorities' planned fiscal consolidation and the incremental resources provided by the international community.
29. ***On debt arrangements, we note that Ecuador has entered into certain sovereign repurchase agreements and other borrowing arrangements with collateral-like features. Could staff elaborate on associated benefits and risks on borrowing arrangements with collateral-like features?***
- Borrowing arrangements with collateral or collateral-like features have the following risks and benefits:

- **Benefits.** The main benefit is to provide financing to sovereign borrowers which may not have access to conventional financing or would have to pay a sizable premium to obtain it. By providing a credit enhancement, such borrowing can allow the sovereign to have access to financing on improved terms than what the market would normally offer.
- **Risks.** Such borrowing can reduce policy flexibility (by earmarking future revenues or export earnings for servicing obligations) and can complicate debt restructuring (making it difficult to obtain a favorable restructuring resolution). In addition, it may undermine existing investor base who may feel subordinated by such arrangements. The contracts can often be complex and opaque and sometimes may require the borrower to post additional collateral under certain circumstances.
- In Ecuador, staff has confirmed that there are no borrowing arrangements that, legally, would be considered as collateralized (see box 4 Staff Report) and the magnitude of the borrowing arrangements with collateral-like features are a small share of total external debt.

30. *Could staff elaborate on the best practices of the legal framework for central banks in dollarized economies?*

- As is the case for all central banks it is best practice for central bank laws in dollarized economies to ensure adequate levels of autonomy, and effective governance arrangements. However, a difference with central banks issuing their own currencies would be that the use of another country's currency means that the central bank of a dollarized economy cannot pursue an independent monetary policy. Also, as the central bank cannot issue its own currency its LOLR framework needs to incorporate a ceiling for the LOLR it can provide. Finally, in order to strengthen the credibility of the dollarization regime, the central bank law should include a backing rule that requires specific central bank short term liabilities to be fully covered by international reserves. As monetary financing and other quasi-fiscal operations can weaken the level of net international reserves, the backing rule should be complemented by prohibitions on monetary financing and quasi-fiscal operations.

31. *Does staff consider it appropriate for Ecuador to move to a de-dollarized economy? What would be necessary conditions where dedollarization becomes appropriate?*

- There are no plans to de-dollarize in Ecuador. There is no precedent for de-dollarizing under orderly circumstances. Such a plan would be highly disruptive for financial stability.
- Dollarization in Ecuador has strong social and political support because the public sees it as a monetary regime that: 1) protects them from experiencing high inflation that can potentially erode the value of their assets, 2) can potentially reduce the country's external borrowing costs (since it eliminates exchange risk premium), 3)

frees policy makers from having to consider the possible impact of exchange rate volatility on financial stability.

32. ***The strong pace of credit growth and increasing loan-to-deposit ratio amid weakening economic activity warrants consideration on the need for more active macroprudential policies. Staff comments would be welcome.***
- Credit growth has slowed and is expected to decelerate further to a rate commensurate with the growth in deposits and the loan-to-deposit ratio should stabilize this year at relatively low levels. Nonetheless, staff and the authorities agree that more active oversight is needed. The program envisions a process of reforms and modernization of the legal and regulatory framework for the financial sector. Given the nature of risks in the economy, macroprudential measures could be envisioned (and Fund TA in this area has been requested).
33. ***Further, we welcome the proposal to introduce legislation requiring the central bank to cover all its liabilities with international reserve assets. We would however, appreciate staff comments on whether this is foreseen during the period of the program and an elaboration on whether the absence of this legislation has affected program design.***
- By the end of the program private sector claims on the BCE (mainly deposits of public and private financial institutions held at the central bank, plus coins in circulation) should be backed with international reserves. The Safeguards Assessment to be conducted by FIN and a LEG TA mission on the reform of the central bank law will assist in the reintroduction of a backing rule requiring specific central bank short term liabilities to be fully covered by international reserves. There will be a need, however, to define a transition period for the reintroduction of this backing rule.
34. ***The last FSAP for Ecuador took place in 2004. An update could be envisaged as it would allow discussions on options for strengthening the financial sector. Staff' view will be appreciated.***
- The latest FSAP was in 2004 and an update will be needed. The authorities have already requested an FSAP update. However, given the resource intensity of such exercises and the primary need to rebuild the financial legal and institutional framework, the authorities have agreed that the FSAP should be preceded by targeted financial sector technical assistance.
35. ***We note that at the end of the program, international reserves are expected to reach only 63 percent of the ARA metric. Given the helpful discussion in the selected***

issues paper, is this an adequate level of reserves as measured against staff's alternative metric, i.e. to cover deposits at the central bank and other liabilities?

- The projected level of reserves at the end of the program should have reached 63 percent of the ARA metric. Staff guidance suggest that reserve adequacy in a dollarized economy should be guided by the ARA metric plus a liquidity buffer for fiscal and banking system needs.

36. *Can staff explain how BCE's objectives and functions to be contemplated in the new law would compare with those currently in place?*

- The reform to the Monetary and Financial Code will have as its main objective restoring the central bank's independence. This will require a deep reform of its governance both internally and in relation to the Monetary Board (Junta Monetaria). An independent BCE will be able to better carry out its function to safeguard the dollarized regime while avoiding a quasi-fiscal role. The BCE's role in monitoring and preserving financial stability, managing liquidity, and providing clearing house functions should also be strengthened.

37. *We also see important the elimination of financial distortions and welcome the authorities' decision to review their interest rate policies and the complex regulatory liquidity requirements to banks. Can staff comment on the timeline associated to these intended actions?*

- The program will establish a timeline for addressing such financial distortions once appropriate technical assistance can be provided (likely during the course of this year).

Structural Reforms

38. *Our preliminary impression is that the EFF is short on structural reforms and we would appreciate if staff could elaborate on this issue.*

- The EFF includes a very long list of structural reforms including
- revamping the fiscal rules framework,
- strengthening public financial management,
- restoring solid foundations for the functioning of the central bank,
- addressing labor market rigidities,
- reforming the tax system,
- eliminating rigidities in wages and prices,
- improving the reliability and efficiency of the energy sector,
- developing capital markets,

- strengthening the system of social protection,
- improving transparency and tackling corruption.

39. *The report mentions the government's intention to increase the probation period prior to an open-ended contract from 3 to 12 months. How would 12 months of probation compare to other countries in the region? Could staff also comment on the degree of labor informality in Ecuador? Could staff provide some elements about how this aspect will be tackled under the program?*

- The probation period for countries in the region is 3 months or lower (90 days for Argentina, Brazil and Venezuela, 60 days for Colombia, and no probation in Chile and Mexico). However, after completing a 3-months probation period in Ecuador, the worker is entitled to sizable acquired rights including: 1) severance payments are equal to 1 month of salary for each year worked (capped at 25 months), plus a bonus equal to 25 percent of the last remuneration, 2) dismissals require prior approval from a labor inspector, 3) companies are obliged to pay 15 percent of their profits to employees plus 13th and 14th monthly wages. This is considerably more rigid than in other countries of the region with similar probation periods.
- As an indication of the impact of these rigidities, 58.9 percent of employment in Ecuador is in the informal sector (higher than the average level of informality in Latin America of 56.8 percent). Most of the people in the informal sector are young or older workers, women and rural workers (72 percent of young workers don't have adequate employment, and 41 percent of informal workers are women).
- The program will aim to address informality by reducing rigidities in labor contracts at least for newly hired workers. Also, other structural reforms that are aimed to improve the business environment (tax reform, improvement of the reliability of the energy sector, efficiency of capital markets, etc.) are expected to create new high-quality employment opportunities in the economy and should also help to reduce the share of informal employment in the economy.

40. *We wonder, however, if the provision contemplated in Art. 97 of the labor code which establishes a mandatory transfer to workers of 15 percent of enterprises earnings has been considered by staff in the analysis.*

- The mandatory transfer to works of 15 percent of earnings raises the labor cost in Ecuador and, while eliminating this provision is very difficult politically, staff will continue to encourage the authorities to re-examine this provision as part of the labor market reform.

Transparency and Procedural

41. *Could staff elaborate on these shortcomings as they relate to the SDDS and on the effectiveness of IMF technical support since Ecuador has been benefiting from extensive TA by STA in the last three years?*

- STA technical assistance has indeed been provided in a range of areas. As of end-February 2019, Ecuador was in compliance with the SDDS requirements except for the reserve data template (because reported reserves include nonmonetary gold, deposits at certain regional organizations, and a gold derivative transaction that should not be included as reserves). An STA mission in February 2019 assisted the authorities to align the reserve data template more closely with internationally-agreed statistical guidelines and the data are expected to be sent to STA soon for re-dissemination. In 2018 a GFS mission identified a range of shortcomings in debt compilation and dissemination of debt information as well as a significant discrepancy between above- and below-the line fiscal data. The authorities have made a significant progress in compiling information on public debt as well as publishing such information. They have provided all the needed information to the Fund to compile public debt stock based on GFSM2014 classification. The latest mission has also made a considerable progress in sorting out the discrepancy between above- and below- the line as well as stocks and flows fiscal data. Further TA is expected to assist the authorities in fully adhering to GFSM standards.

42. *How would staff assess Ecuador's capacity to fully and timely enact the proposed program?*

- Work on the various structural reforms planned over the remainder of this year is advancing, supported by technical assistance providers. The authorities have also demonstrated a strong commitment to enact the proposed reform program and staff believes that the authorities are in a strong position to implement the reforms envisaged under the program.

43. *Could staff elaborate on the content of the memorandum of understanding between the central bank and the government on their respective roles and obligations mentioned in paragraph 42?*

- The MoU covers operational aspects, including on (i) the maintenance of the budget support funds at the central bank pending their use, (ii) the issuance of the promissory note for IMF holdings of the member's currency, and (iii) the procedures to ensure timely service of the member's obligations to the Fund.

44. *Could staff elaborate why they saw the need for quarterly reviews instead of semi-annual reviews?*

- Given the significant vulnerabilities facing Ecuador, staff believed it prudent to have quarterly reviews (including to make course corrections in the program if needed). This will also provide staff with the ability to offer the authorities more ongoing support in designing and implementing their reform efforts.
- 45. *This Article IV discussion is long overdue, as the previous report was issued almost three years ago, and we would welcome staff's comments on the reasons for such a long delay.***
- In 2017 the Article IV was delayed because of the Presidential elections and the February 2018 referendum. An Article IV mission took place as planned in mid-2018 but then was delayed by ongoing program negotiations.
- 46. *On the timing of the request for an arrangement, we noted that the authorities placed US\$ 1 billion in 10-year bonds in January 2019 at a yield of 10.75 percent. Could staff clarify why the authorities had to accept such elevated yield instead of approaching the Fund at an earlier stage?***
- The authorities requested a Fund program in July 2018 but the negotiations were protracted. The authorities tapped the market in early 2019, before program negotiations were concluded, to support their dwindling reserve position and in anticipation of debt amortizations that were coming due in March.
- 47. *We would like to ask staff whether they considered imposing any additional prior actions before going to the Board? Finally, it is not entirely clear whether the authorities have already completed all prior actions. Could staff comment?***
- All of the prior actions have been met. Prior actions were chosen on the basis that they would provide a strong basis for program success.
- 48. *We welcome the authorities' commitment to refrain from contracting new non-standard borrowing arrangements going forward. Could staff comment on whether this commitment could be enshrined in the program? Is it possible for the authorities to formalize their commitment regarding nonstandard collateralized debt as part of their debt management strategy?***
- The authorities' commitment to refrain from new repo operations or debt liabilities that pledge government assets is contained in their MEFP. In addition, there is structural conditionality to provide the full details on any other new non-standard borrowing arrangements. Staff will continue monitoring this issue during the program reviews.