FOR AGENDA

EBS/87/263
Correction 1

CONFIDENTIAL

December 22, 1987

To: Members of the Executive Board

From: The Secretary

Subject: Ecuador - Request for Stand-By Arrangement

The following corrections have been made in EBS/87/263 (12/9/87):

Page 17, line 2: for "4-year" read "3-year"

line 3: for "period," read "period from January 1987,"

line 4: for "19-year" read "20-year"

Page 18, last para., line 5: for "US$50.5 million" read "US$50.3 million"

Page 30, title, line 2: for "December 1987" read "January 1988"

columns 2 and 3: References to "1987" should read" 1988"

column 2, last line: Reference to "1988" should read "1989."

Corrected pages are attached.

Att: (3)

The 1983 and 1985 new money loans (US$431 million and US$200 million, respectively) are rescheduled over 10 years, including a 3-year grace period from January 1987, at 1 percent over LIBOR. The term sheet makes provisions for exit bonds at a fixed rate of 5 1/2 percent and a 20-year maturity (including a 7-year grace period) for banks with an exposure of up to US$5 million. Finally, the term sheet also stipulates that a new oil facility of similar magnitude and term to the existing oil facility needs to be in place in 1988.

The authorities also intend to seek a comprehensive rescheduling under the aegis of the Paris Club of interest and principal obligations due and not paid in 1987 (when the current MYRA expires) and falling due in 1988. The authorities are aware that in case the amount of debt relief sought for 1988 were to be less than envisaged in the program they would need to adjust their policies, or seek alternative sources of foreign financing to ensure observance of the program's objectives.

The continued pursuit of a flexible exchange rate policy is a crucial element of the program. The virtual phasing out in the second half of 1987 of the transitional arrangement under which the Central Bank continued to provide foreign exchange at the intervention rate for imports authorized before the introduction of the new system has further enhanced the market determination of the exchange rate. The authorities consider the broad maintenance of the real effective exchange rate at the level prevailing at the time of the negotiation of the program as consistent with the overall balance of payments objectives of the program. They intend to continue to allow the private sector to conduct all its exchange transactions in the free market, with the Central Bank intervening in this market only to ensure compliance with the net international reserve target of the program and to maintain an adequate level of external competitiveness.

The spread between the central bank intervention rate and the free market rate remained small in the period between August 1986 and February 1987, but it widened appreciably in the aftermath of the earthquakes, marking the return of a multiple currency practice. The authorities were of the view that the spread could not be eliminated rapidly in the unstable circumstances which characterized the free market after the earthquakes. Nevertheless, the authorities stepped up the frequency and size of adjustments of the central bank intervention rate in order to avoid an undue widening of the spread vis-a-vis the free rate. As noted earlier, the letter of intent contains a timetable for the unification of the exchange rates, which is a performance criterion.

The authorities have reaffirmed their commitment to continue implementing a policy aimed at reducing restrictions on international trade. Since 1985 several measures have been taken to liberalize Ecuador's trade system; in particular, a large number of import items has been freed from the requirement of prior import authorizations, as such authorizations are presently required for only 338 sensitive products--compared with 713 products at the end of 1984--and import tariff rates have been substantially reduced. In the context of an export development loan under negotiation with the IBRD, the Government intends to reduce existing quantitative restrictions and import duty exonerations (both before Board consideration), and review customs tariffs with a view to rationalizing and reducing the level of effective protection afforded to domestic producers. Ecuador is not a contracting party of the General Agreement on Trade and Tariffs (GATT) but, in the context of this loan, is considering acceding to it.

On October 21, 1987 the authorities reintroduced a prior import deposit scheme (last eliminated in August 1986) requiring private sector importers to make a non-interest bearing 90-day deposit at the Central Bank for a sucre amount equivalent to 50 percent or 80 percent of the c.i.f. value of imports depending on the type of imports. Imports of certain priority goods such as pharmaceuticals are exempt from the requirement. The noninterest bearing feature of the requirement involves an effective exchange rate spread of about 7 percent in the case of imports subject to the higher requirement, and constitutes a multiple currency practice. As noted, the authorities have undertaken to eliminate the prior import deposit requirement before the first purchase under the stand-by arrangement subject to performance criteria.

The authorities have stated also their intention not to impose or intensify restrictions on payments and transfers for current international transactions, or to introduce or intensify multiple currency practices, or to conclude new bilateral payments agreements which are inconsistent with Article VIII of the Fund's Articles of Agreement, or to impose any new or intensify existing import restrictions for balance of payments purposes. 1/ In addition, the import licensing system, which is applied to all imports for statistical purposes, will not be used for restrictive purposes.

IV. World Bank Operations in Ecuador

Net disbursements by the World Bank in Ecuador increased from US$12.2 million in 1985 to US$125.1 million in 1986 and US$100 million in the first ten months of 1987 (Statistical Appendix Table 15). Gross disbursements in January-October 1987 amounted to US$131.6 million, with US$50.3 million of this total coming under a US$80 million emergency loan approved in May 1987 for repairs of the damage caused by the earthquakes to the oil pipeline and other related reconstruction work. Also, a total of US$24.5 million was disbursed under a US$100 million agricultural sector loan supporting policy actions in the trade, interest rate,

---

1/ Ecuador currently maintains two bilateral payments agreements with Fund members, under which outstanding balances are periodically settled in convertible currency. These restrictions are subject to Fund approval under Article VIII.

exchange rate applicable to the intervention market to per U.S. dollar, and retained the official rate of S/. 95.00 only for its own internal accounting purposes.

On August 11, 1986 private transactions were transferred to the free market, where the rate is determined by market forces, and on August 19, 1986 the decision was taken to move the intervention rate of the Central Bank closer to the rate prevailing in the free market. The spread between the two rates, which had remained below 2 percent in the period October 1986 - February 1987, moved to a range of 10 to 20 percent in April-November 1987.

VII. Last Article IV Consultation: The 1986 Article IV consultation was concluded by the Executive Board on June 29, 1987 (SM/87/68, SM/87/75, and EBS/87/126). Consultations with Ecuador are on the 12-month cycle.

VIII. Statistical Data: The currentness and coverage of Ecuador's statistical data in the IFS is considered reasonably adequate at this time, although the currentness of the government finance and monetary data could be improved.

IX. Technical Assistance: In May 1987 Mr. Muirragui (BUR) provided technical assistance in the area of money and banking with the purpose of improving compilation and presentation of Central Bank and commercial banks data.

In June 1987, Mr. Gala-Palacios (BUR) organized a three-week seminar on public finance in Quito.

Ecuador: Schedule of Purchases During Period of Stand-By Arrangement--January 1988-February 1989

Amount	Scheduled Availability Date	Conditions Necessary for Purchase 1/
SDR 15.07 million	After Board meeting	Board approval of program.
SDR 15.07 million	On or after May 13, 1988	Compliance with quantitative performance criteria as of March 31, 1988; reduction to less than 5 percent of spread between intervention and free market rates; elimination of the prior import deposit introduced in October 1988; and elimination of all external arrears.
SDR 15.07 million	On or after August 15, 1988	Compliance with quantitative performance criteria as of June 30, 1988; elimination of spread between intervention and free market rates; and completion of mid-term review.
SDR 15.07 million	On or after November 14, 1988	Compliance with quantitative performance criteria as of September 30, 1988.
SDR 15.07 million	On or after February 14, 1989	Compliance with quantitative performance criteria as of December 31, 1988.

1/ Other than generally applicable conditions under the arrangement and nonquantitative performance criteria (including the performance clause on the exchange and trade system).