

2024 -
June

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Component: Revenue and Spending

Modules: RM I – Tax Policy

SM II – Managing Public Finances

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PROJECT SUMMARY	
COUNTRY:	Ecuador
LEAD DEPARTMENT:	FAD
REGION:	AFR
PROGRAM ID:	[To be filled out by Secretariat]
PLANNED DATES:	FY25 – FY26
FUNDING PROGRAM TITLE:	[to be added by Secretariat]
PROJECT MANAGERS:	
RM I – TAX POLICY:	Cebreiro Gomez, Ana - T2
SM II - MANAGING PUBLIC FINANCES:	Albarran, Virginia Alonso – M2 (Lead)
ESTIMATED BUDGET	\$681,385
BUDGET FOR ENDORSEMENT:	\$345,606

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*ECUADOR***ACRONYMS**

CD	Capacity development
COPLAFIP	2020 Organic Code on Planning and Public Finance
FAD	IMF's Fiscal Affairs Department
EFF	IMF's Extended Fund Facility
PFM	Public financial management
PIM	Public investment management
PIMA	Public investment management assessment

*ECUADOR***I. PROJECT PURPOSE**

The macroeconomic and fiscal outlook remains challenging amid an ongoing security crisis in Ecuador. In December 2022 (after the completion of a 27-month IMF Extended Fund Facility (EFF) Arrangement), political uncertainty, a security crisis, and exogenous shocks to oil revenue and interest rates led to a sharp macroeconomic and fiscal deterioration. The authorities implemented swift and bold measures in early 2024 to address the fiscal and liquidity challenges and requested a new EFF program to support their policy plans and advance an ambitious structural reform agenda. A [Staff-level agreement](#) was reached in April 2024 for a new \$4 billion 4-year EFF.

The authorities requested a new capacity development (CD) project to support their structural reform agenda during the 2024 Spring Meetings. This new CD project will focus on public financial management (PFM) and tax policy to support the authorities' efforts to implement core aspects of the 2020 Organic Code on Planning and Public Finance (COPLAFIP) that represents a modern PFM system, as well as the country's domestic revenue mobilization efforts. These activities will contribute to the implementation of the IMF program objectives. The main areas of this CD project will be treasury and budget management, fiscal risks, and tax policy.

The estimated budget for this two-year project is \$681,385, including \$345,606 in the first year of implementation (FY25).

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II. BACKGROUND

Macro-fiscal situation

Ecuador is facing renewed fiscal vulnerabilities, worsening economic conditions, and a near depletion of buffers due to political uncertainty and other shocks. A challenging political landscape led to early general elections in August 2023 and a run-off presidential election in October 2023. Economic conditions have also worsened, reflecting lower revenue collection (mainly due to lower oil production and prices), significant increases in interest payments on external public debt, and the global monetary policy tightening cycle. In addition, national power outages weighed on economic activity starting in late-2023. The fiscal position, thus, has weakened, and treasury deposits and foreign exchange reserves declined, with government buffers almost depleted by end-2023. Furthermore, a severe security crisis is exacerbating fiscal and economic challenges. In this environment, economic growth has significantly slowed down, from 6.2 percent real GDP growth in 2022 to 2.4 percent in 2023.

Ecuador needs further efforts and assistance to overcome this delicate macro-fiscal situation and make further progress with the reform plan. Supported by the IMF program (completed in December 2022), Ecuador advanced on fiscal and structural reforms, helping put the country's public finances on a more sustainable path and strengthened domestic institutions and policy frameworks. However, further efforts are needed to advance with the country's fiscal and institutional structural reform plan. The Ecuadorian authorities have reached a staff-level agreement on a set of policies to underpin a 48-month arrangement under the EFF in the amount of SDR 3 billion (about US\$4 billion and 430 percent of quota). This arrangement, which is subject to IMF Management and Executive Board approval, would provide support for Ecuador's economic policies over the next four years. The proposed CD project will complement this program by supporting the government's fiscal reform agenda to address the fiscal challenges with a focus on protecting the most vulnerable and promoting sustainable growth.

Country engagement and alignment to reform priorities

PFM reforms are underway since 2020, need sustained support to overcome implementation challenges on structural issues. The IMF's Fiscal Affairs Department (FAD) has provided CD since 2020 on the COPLAFIP design, treasury management, fiscal risks, medium-term frameworks, public investment management assessments (PIMA) and Climate PIMA (C-PIMA). The modalities of support have been a long-term expert (till August 2024) and several HQ missions (remote and in-person), including a PIMA / C-PIMA mission (2023). CD support is continuously needed to deliver on important areas that will contribute to more sustainable and transparent public finances. During the 2024 Spring Meetings, the vice-minister of finance requested CD for continuing the implementation of the COPLAFIP reform and delivering the structural benchmarks included in the forthcoming IMF program. These areas are broad and cover fiscal risks management, including public private partnerships; budget management, including medium-term capital spending; treasury and arrears management; and strengthening the medium-term fiscal framework. The priority and sequencing of these areas will be fine-tuned as the program unfolds.

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FAD has provided CD on tax policy, but additional assistance is needed to mobilize quality revenues. Missions in 2019 and 2020 supported the authorities in evaluating tax expenditures (revenue forgone estimates) and recommended measures to increase revenue collection efficiently and equitably. In the lead-up to the 2021 elections, the brackets for the marginal rates for the personal income tax were raised and higher deductions for personal expenses were provided. In 2023, many new tax incentives were legislated that did not follow good practice (including tax holidays), and a very generous tax amnesty was provided. In February 2024, emergency and temporary measures were adopted, including a surcharge on corporate income tax, a contribution from financial institutions, and an increase in the value-added tax rate (from 13 to 15 percent, as recommended by FAD in 2020). Many of the recommendations in FAD TA have not been implemented, including streamlining tax expenditures. Personal income tax reform should be also considered as part of a broader package that considers equity issues, including improving the taxation of capital income at the personal level.

III. PROJECT MODULES - DESCRIPTION

This proposal will provide CD support to Ecuador in the areas of managing public finances and tax policy. FAD CD will support improvements within the strategic objectives presented in Table 1 below:

Table 1. Summary of Objectives covered by the Proposal

Component	Module	Objective
Revenue	RM I / Tax Policy	Strengthen Policy Monitoring, Evaluation, and Institutions – TPM
Spending	SM II / Managing Public Finances	Strengthened budget management - PBM

A. RM I – Tax Policy

Scope

In the context of the need for sustainable fiscal consolidation as a priority for the government and the IMF program under negotiation, mobilizing quality revenues is key. The tax policy module of the project will deliver CD focusing on broadening the tax base by supporting a comprehensive tax expenditure diagnosis to identify those that could be streamlined. This support will also include training of key staff on the topic. In addition, the program will undertake a broader tax policy review with the objective to modernize the tax system.

Program Objectives

The module will focus on supporting authorities to undertake a general tax policy review to identify reform areas and develop capacity for analyzing tax expenditures, including analyzing the methodology to estimate, monitor and evaluate them. It is expected that through this assistance not only will sources of revenue mobilization be identified, but also tax policy will be more transparent.

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Expected Results (outcomes)

The tax policy module is expected to strengthen tax policy capacity by assessing tax expenditures. The result of this analysis is expected to be used as input in policy formulation by providing concrete and evidence-based tax policy reform options.

B. SM II – Managing Public Finances

Scope

The project is aligned to both government's priorities and an IMF program, as it aims to support structural reforms to make public finances more sustainable and transparent. On expenditure management (PFM module), in FY25, the proposed project will deliver: (i) virtual and in-person HQ missions to quickly assist Ecuador authorities on delivering IMF program prior actions that would help stabilize the macro-fiscal situation (budget and treasury management); and (ii) hands-on support on treasury and fiscal risks management. The first mission will help to evaluate the CD needs to support the deliverables under the IMF program. During FY26, this CD project will continue supporting the areas of fiscal risks, treasury and expand to medium-term budgeting with online and in-person support. Remote work will be needed to maintain continuous assistance to the ministry of finance, together with in-person missions.

Program Objectives

The CD Project will support reinforcing the ministry of finance capacity to make public finance more transparent, sustainable, and credible, focusing on strengthening core PFM functions that includes fiscal risks, treasury, budget control and medium-term budgeting in particular capital.

Expected Results (outcomes)

The needs in PFM are extensive and the recommendations need time to be implemented, which is why this program aims to facilitate progress over time in three areas:

- Implementation of commitment and accrual quotas and improved cash flow projections to control budget execution and its alignment with the availability of cash, so that financing with arrears is avoided.
- Strengthened the new fiscal risks unit with the capacity to identify, monitor, and report on among others, fiscal risks from PPP projects, and SOEs.
- Improved investment budgeting from implementation of medium-term budget ceilings, projects prioritization, and clarification of the budget allocation process and financing, in accordance with the PIMA recommendations.

IV. ORGANIZATIONAL ARRANGEMENTS

A. Country Engagement

FAD has provided CD in recent years to strengthen core PFM areas, starting with the legal framework and then with hands-on support with a long-term expert for about three years. FAD has also provided CD on tax policy, including tax expenditures and options to increase revenues in an equitable and efficient manner. Reform progress is underway albeit slowly due to political challenges and

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liquidity constraints. The minister of finance and the vice-ministers of finance and economy are highly committed with the reform agenda, understand the issues and have already formally requested FAD to accompany the reform process with continuous CD. In the new EFF country engagement context, FAD CD will support it.

B. Delivery Modalities

CD will comprise of a mix of remote and in-person activities. Virtual deliveries will be used to provide efficiencies to in-person support, including pre-engagement meetings and post-follow-up meetings. The following CD activities will be delivered as a package:

- **Headquarters-led (HQ) missions and staff visits** to provide strategic recommendations, conduct regular follow-ups, assess progress, ensure STX work is aligned to plans, coordinate with other CD providers, and adjust reform implementation plans.
- **Short-term expert (STX) visits** to help implement the recommendations delivered by the HQ missions; a limited number of STXs will be assigned to provide specialized assistance in specific areas of revenue administration and public financial management.
- **Workshops**, during the HQ missions, staff visits, or STX visits, to share experiences, provide stakeholders with a view of progress achieved and challenges faced, and discuss with the managers and staff their views on the reforms and particular technical subjects.

C. Coordination / Cooperation

The coordination is ensured from planning to execution of this CD program by the project managers. When designing specific country-based activities and workplans, this program will seek internal coordination with the IMF's area department and functional departments, and externally with the World Bank, Inter-American Development Bank and the US Treasury.

Coordination			
Partner	Type of coordination	Area of coordination	Frequency
IMF's area department country team; IMF Resident Representative; IMF's Monetary and Capital Markets department; and FAD's revenue administration, tax policy, and PFM divisions	Supporting program benchmarks, CD design and delivery, joint CD support	Support to identify and monitor structural benchmarks on PFM, Tax Policy. Support to identify priority reform areas for the program and provide timely support to the authorities to implement them.	Monthly, quarterly
Cooperation			
Partner	Type of coordination	Area of coordination	Frequency
Inter-American Development Bank, World Bank, US Treasury	Exchange information / agree on areas to be covered by each institution	Mapping technical assistance and CD activities on PFM and tax policy across TA providers to identify synergies and complementarities.	Quarterly, annual

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V. RISK ASSESSMENT AND MITIGATION

General or Module	Description	Risk Assessment	Mitigation Measures
Political Support			
RM I	Increased political instability and security concerns could make passing critical legislation more uncertain	Medium	Closely work with the IMF Resident Representative to monitor the political environment and timely identify risks. Maintain regular high-level meetings in parallel to the engagement with senior management and technical staff to keep momentum for reforms. Support the government with stakeholders' consultations.
RM I and SM II	Elections in February 2025 may prompt delays in politically sensitive reforms	Medium	Consult with IMF country team to assist authorities in recognizing the relevance of reforms and preparing policy options before the elections. Renew contact with the new authorities after elections and prepare a visit.
Management and Technical Staff Support and Commitment			
RM I and SM II	Competing demands for key staff's attention might result in low engagement on tax policy measures and PFM	Low	Discuss with authorities to establish clear priorities.

VI. CD DELIVERY PLAN

Table 2. Summary of Indicative CD Delivery

CD Modalities (Remote or Field-based CD)	FY25	FY26	FY27	FY28	Grand Total
RM I – Tax Policy					
HQ led CD mission	1	2	-	-	3
Total	1	2	-	-	3
SM II – Managing Public Finance					
HQ led CD mission	2	2	-	-	4
STX	1	1	-	-	2
Total	3	3	-	-	6

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Note:

- Collectively the blend of CD delivery proposed over the duration of this project/program reflects the optimal balance of in-person, remote, and hybrid activities needed to achieve the project/program outcomes taking into account the needs of the country and the resources available.

Table 3. First year workplan

Timing	CD Modality	CD Delivery	Proposed Topics of CD
RM I – Tax Policy			
Q2/FY25	Field-based work	1 HQ mission	Comprehensive tax expenditure analysis and Tax Policy Review
SM II – Managing Public Finance			
Q2-Q3/FY25	Remote	1 HQ mission	Arrears management, fiscal framework in support of program prior actions
Q2-Q3/ FY25	Field-based work	1 STX	Improving fiscal risks management
Q3-Q4/FY25	Field-based work	1 HQ mission	Improving budget and fiscal risks management (or program CD support)

VII. PROGRAM FINANCIALS

	FY25	FY26	FY27	FY28	FY29	Total
RM I – Tax Policy	\$88,618	\$99,234	-	-	-	\$187,852
SM II – Managing Public Finances	\$234,377	214,579	-	-	-	\$448,956
Subtotal	\$322,995	\$313,813	-	-	-	\$636,808
Trust fund management fee (7%)	\$22,611	\$21,967	-	-	-	\$44,577
Total	\$345,606	\$335,780	-	-	-	\$681,385

The estimated budget for this three-year project is \$681,385, but endorsement is requested for \$345,606 through FY25. Endorsement for future plans will be requested at a later date as funding for the program is secured and reform plans gain traction.

VIII. TARGETED LOGICAL FRAMEWORK

A. RM I – Tax Policy

Objective	
Strengthen Policy Monitoring, Evaluation, and Institutions - TPM	
Outcome(s)	Indicator(s)
Improved structures (e.g., tax policy units) or capacity (e.g., models and tools) related to tax policy advice and analysis.	Improved models to evaluate tax policy adopted

B. SM II – Managing Public Finances

Objective	
Strengthened Budget Management - PBM	
Outcome(s)	Indicator(s)
Strengthened identification, monitoring, and management of fiscal risks	Improved preparation and disclosure of fiscal risk statement
Strengthened asset and liability management processes	Strengthened effectiveness and timeliness of cash flow forecasting and cash balance management including for capital spending (DEMPA DPI 11, PEFA PI-21.2)
Strengthened budget execution and control processes	Improved effectiveness of budget execution and controls for non-salary expenditure including capital spending and priority areas (Record Score: PEFA PI-25. PIMA 12a)