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ECUADOR

IDB GROUP COUNTRY STRATEGY WITH ECUADOR (2018-2021)

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ABBREVIATIONS

CAF	Andean Development Corporation
CDC	Country Development Challenges
CIBV	Centros Infantiles del Buen Vivir [“Good Life” Early Childhood Centers]
CPE	Country Program Evaluation
ECLAC	Economic Commission for Latin America and the Caribbean
EIB	European Investment Bank
ENAS	Estrategia Nacional de Agua y Saneamiento [National Water and Sanitation Strategy]
ENEMBDU	Encuesta Nacional de Empleo, Desempleo y Subempleo [National Employment, Unemployment, and Underemployment Survey]
EPMAPS	Empresa Pública Metropolitana de Agua Potable y Saneamiento [Metropolitan Public Water and Sanitation Company]
FLAR	Fondo Latinoamericano de Reservas [Latin American Reserve Fund]
GDP	Gross domestic product
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
INEC	National Statistics and Census Institute
INEVAL	Instituto Nacional de Evaluación Educativa [National Institute for Educational Evaluation]
JMP	Joint Monitoring Program (UNICEF-WHO)
MIDUVI	Ministry of Urban Development and Housing
OECD	Organization for Economic Cooperation and Development
OVE	Office of Evaluation and Oversight
PPP	Public-private partnership
SBU	Unified basic salary
SERCE	Segundo Estudio Regional Comparativo y Explicativo [Second Regional Comparative and Explanatory Study]
SMEs	Small and medium-sized enterprises
TERCE	Tercer Estudio Regional Comparativo y Explicativo [Third Regional Comparative and Explanatory Study]
TFFP	Trade Finance Facilitation Program
VPC	Vice Presidency for Countries
WEO	World Economic Outlook

EXECUTIVE SUMMARY

Economic and social context	From 2000 to 2014, Ecuador experienced an extended period of growth and stability, enabling significant declines in the rate of poverty and inequality. However, since late 2014, the country has been suffering from the effects of a macroeconomic shock brought about by a fall in international oil prices and leading to a sharp slowdown in economic growth. At present, the Ecuadorian economy shows signs of recovery, and 2017 closed with 3% expansion in GDP. Nevertheless, this recovery process could prove fragile, since the macroeconomic imbalances resulting from the shock have yet to be resolved.
The IDB Group in Ecuador	The IDB Country Strategy with Ecuador 2012-2017 prioritized the following areas: (i) energy; (ii) transportation and logistics; (iii) social development; (iv) access to finance; (v) fiscal management; (vi) urban sustainability; (vii) rural development; and (viii) natural disaster risk management. The strategy addressed the topics of diversity and of climate change and environmental sustainability as crosscutting issues. Approvals included 25 sovereign-guaranteed loan operations for a total of US$3.141 billion and 45 non-sovereign guaranteed operations for a total of US$509.8 million. The MIF approved 25 operations for a total amount of US$16.9 million.
Priority areas	In the country strategy for the 2018-2021 period, the IDB Group intends to work in three areas: (i) strengthening of public finances; (ii) support for productivity and private sector development as drivers of growth; (iii) deepening of the social advances of the last decade. The actions envisaged under this strategy are aligned with the National Development Plan 2017-2021, the strategic objectives of which include consolidating the sustainability of the economic system, boosting productivity and competitiveness for growth, and ensuring a life of dignity with equal opportunities for all.
Lending framework	Approvals for the 2018-2021 period are projected at US$2.000 billion. Sovereign-guaranteed disbursements are estimated at US$1.531 billion. This will be coupled with the resources to be provided by IDB Invest and the MIF for private sector projects.
Risks	The main risks affecting implementation of the country strategy are related to: (i) the macroeconomic situation facing the country; (ii) Ecuador's vulnerability to natural disasters; and (iii) the institutional weakness of some executing agencies.
Strategy validity period	The Country Strategy with Ecuador for the 2018-2021 period will be in effect from its approval date until 24 May 2021.

I. CONTEXT[1]

1.1 The GDP of Ecuador is close to US$103.000 billion, making the country the seventh-largest economy in Latin America and the Caribbean. With a population of 16.7 million, its GDP per capita is US$6,170 in current dollars and US$11,300 at purchasing power parity. While the oil sector employs less than 1% of the economically active population and represents 11% of GDP, in the last decade it accounted for more than 50% of exports and nearly one third of State revenues; thus, the sector greatly influences the country's macroeconomic performance. In 2000, Ecuador adopted the dollar as its currency, putting an end to decades of monetary instability but at the same time limiting the macroeconomic stabilization tools available to the authorities.

1.2 **Following the financial crisis late in the last century, Ecuador entered an extended period of growth coupled with macroeconomic stability.** Between 2001 and 2005, GDP expanded at an average real rate of 4.2%, substantially higher than the average of 2.5% in the 1980s and 1990s. In addition, and again in clear contrast to the two previous decades, the inflation rate remained at single-digit levels since 2002. The factors that contributed to this positive macroeconomic performance include: (i) the monetary stability framework provided by the formal dollarization of the economy; (ii) the positive shock to the terms of trade resulting from the high prices of crude oil between 2004 and 2014; (iii) the investment efforts by the State, which since the end of the last decade have prioritized the provision of infrastructure as one of the pillars of the national development strategy.

1.3 **In parallel, there was a sharp drop in the incidence of poverty and inequality.** Between 2005 and 2015, monetary poverty fell from 42.2% to 23.3%, and the Gini coefficient declined from 0.54 to 0.48, making Ecuador the number three country in the region in terms of improving income distribution.[2] This improvement is partly due to the marked increase in social investment by the State, which went from 4.2% of GDP in 2006 to 9% of GDP in 2014. However, the decline in poverty in the last decade is mostly attributable to the evolution of labor income, driven by a government policy of minimum wages, the fight against informality, and a growth model that made intensive use of low-skilled labor. Despite these advances, there are persistent gaps between the rural and urban environments and between the indigenous, Afro-Ecuadorian, mestizo, and white population groups. Similarly, the fact that almost 40% of Ecuadorians are in the vulnerable middle class suggests that the social advances achieved in the last decade may be fragile, especially if a low economic growth scenario becomes protracted. There are no significant gender differences observed in most of the main poverty indicators. However, as will be seen below, a gender gap is emerging in the labor market and there are challenges in terms of violence against women and teenage pregnancy.

1.4 **The collapse in the price of crude oil in 2014 was a powerful adverse shock to the public finances and the balance of payments.** The average price of Ecuadorian crude fell from US$96/barrel in 2013 to US$85/barrel in 2014, US$42/barrel in 2015, and US$35/barrel in 2016. As a result, oil revenues for the

[1] The link to the CDC provides a more detailed description of the context and includes the source of data.

[2] Source: ECLAC (2015) Social Panorama of Latin America.

nonfinancial public sector declined over that period from an amount equivalent to 12% of GDP in 2013 to the equivalent of 5.5% of GDP in 2016. Over the same period, the value of crude oil exports decreased by nearly 8.8% of GDP. Unlike other commodity exporters, Ecuador did not have its own currency. Consequently, the exchange rate not only did not help to cushion the blow but had the opposite effect. In fact, the dollar's appreciation against the currencies of some of Ecuador's main competitors was another factor adversely affecting the country's macroeconomic performance.

1.5 **In April 2016, an earthquake with a moment magnitude of 7.8 Mw devastated the coastal province of Manabí.** The disaster caused 673 fatalities and close to 5,000 injuries, and more than 80,000 people were displaced. It is estimated that the fiscal cost associated with reconstruction of the affected areas amounts to nearly US$2.250 billion.[3] The rapid disbursement of resources from the IDB's contingent line of credit for natural disasters was key to enabling Ecuador to address the immediate humanitarian tasks in response to the earthquake, given the government's tight liquidity position at the time.

1.6 **The oil shock, the policy response to its effects, and the earthquake led to a sharp slowdown of the economy.** In 2015, the government was forced to cut back on primary spending by close to 5% of GDP, an adjustment effort that lasted until mid-2016. Also in 2015, the authorities imposed temporary tariff surcharges (balance-of-payment surcharges) that remained in effect until June 2017 and were aimed at containing nonoil imports. It is estimated that the Manabí earthquake reduced the 2016 economic growth by approximately 0.7%.[4] In this context, the Ecuadorian economy went from growing by 4.9% in 2013 and by 3.8% in 2014 to expanding by only 0.1% in 2015 and contracting by 1.6% in 2016. Between 2015 and 2016, the country had five consecutive quarters of decreases in GDP, the longest recorded recession in Ecuador since the start of dollarization.

1.7 **Since late 2016, the Ecuadorian economy has been showing signs of recovery.** The GDP has been growing since the final quarter of 2016, having grown by 3% in 2017. This impetus is based on several factors, including the partial recovery of Ecuadorian crude oil prices, the increase in aggregate demand resulting from the easing of the fiscal consolidation effort, and the growth in exports, partly due to the entry into force of a trade agreement with the European Union, and the recent weakness of the dollar.

1.8 **However, the macroeconomic imbalances arising from the oil shock have yet to be resolved.** The nonfinancial public sector has now had five consecutive years of deficits exceeding 4% of GDP (5.3% of GDP in 2017). As a result, according to the IMF, the consolidated debt burden on the GDP has increased from 21.1% in 2013 to 45% as of year-end 2017. While the weakness in domestic demand and the measures adopted by the authorities succeeded in halting the deterioration of the current account balance in 2016, the overall balance of payments continues to show a deficit, which in a dollarized economy such as Ecuador's means an outward drainage of domestic liquidity.

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[3] Source: ECLAC and Senplades. 2016. "*Evaluación de los Costos de Reconstrucción: Sismo de Ecuador*" [Evaluation of Reconstruction Costs: Ecuador Earthquake].

[4] Idem.

1.9 **The growth projections for the validity period of the next country strategy are modest.** Given the country's complex macroeconomic context, it is likely that Ecuador will need to relaunch its fiscal consolidation effort, which in the short term could once again slow down the economy. This helps to explain the modest growth projections currently being used for the validity period of the next country strategy. In its latest World Economic Outlook update (April 2018), the IMF projected growth of 2.5% in 2018 and 2.2% in 2019, 1.7% in 2020, and 1.8% in 2021. Given that the annual population growth is nearly 1.5%, the materialization of this scenario would mean slow growth of real GDP per capita in the coming years.

1.10 **Ecuador faces the challenge of returning to a path of robust growth so as to sustain and deepen the social advances achieved since the turn of the century.** This requires completing the fiscal and macroeconomic consolidation process while trying to minimize its impact on growth. At the same time, it requires driving a change in the composition of economic growth by increasing the share of private investment at a time when there is limited room for continued expansion of public expenditure and investment. In this transition toward a new pattern of growth, social policy should also pay a vital role with a view to mitigating the risk that the difficult situation facing the country will lead to a rise in the incidence of poverty.

II. THE IDB GROUP'S PRESENCE IN THE COUNTRY

2.1 **The IDB Group country strategy with Ecuador 2012-2017.** The Country Strategy with Ecuador 2012-2017 was aimed at contributing to inclusive and sustainable economic development in Ecuador by supporting the country's efforts to overcome the long-term constraints on economic growth and the structural barriers to overcoming poverty. To this end, the strategy prioritized the following areas: (i) energy; (ii) transportation and logistics; (iii) social development; (iv) access to finance; (v) fiscal management; (vi) urban sustainability; (vii) rural development; and (viii) natural disaster risk management. The topics of diversity and of climate change and environmental sustainability were addressed as crosscutting issues.

2.2 Under this strategic framework, the Bank approved 25 **sovereign-guaranteed** loan operations for a total amount of US$3.141 billion, including a programmatic policy-based loan of US$500 million to support the modernization of the energy sector, a contingent loan for development sustainability (US$300 million), and an increase in a contingent line of credit for natural disasters, which proved essential in addressing the humanitarian emergency caused by the earthquake of April 2016.[5]

2.3 In accordance with the sectors prioritized by the 2012-2017 strategy, these approvals were distributed as follows: (i) in energy, eight operations for an aggregate amount of US$1.333 billion, primarily focusing on reinforcing electricity transmission and distribution systems; (ii) in the transportation and logistics sector, one operation for US$60 million; (iii) in the social sector, three operations for an amount of US$478 million; (iv) in the fiscal management sector, four operations for an aggregate amount of US$598 million, with an emphasis on reinforcing the human

[5] For purposes of this document, sovereign guaranteed operations are understood as those signed with central government entities, or with other entities, provided that they have a sovereign guarantee. Non-sovereign guaranteed operations are understood as those signed with private sector entities or those that do not have a sovereign guarantee.

talent of public servants; (v) in the urban sustainability sector, four operations for an amount of US$450 million, notably including the Quito Metro operation; (vi) in rural development, one operation for US$15 million; and (vii) in natural disaster risk management, three operations for US$192 million.

2.4 In addition, a border crossings operation for US$16 million was approved during the strategy period since, despite not being aligned with any of the priority areas under the strategy, it was consistent with the Bank's institutional strategy by contributing to regional integration. Total disbursements during the 2013-2017 period amounted to US$3.035 billion, with a positive cash flow for the Bank of US$1.720 billion.

2.5 The Bank approved 45 **non-sovereign guaranteed** operations for a total amount of US$509.8 million, as follows: (i) US$190.5 million for the corporate segment; (ii) US$131 million to improve access to finance through a partnership with financial intermediaries; (iii) US$77 million aimed at the infrastructure sectors to promote energy generation from renewable sources as well as to operate and maintain assets associated with the provision of water and sewer services; and (iv) US$111.3 million to support foreign trade for Ecuadorian companies. In particular, the Bank supported 781 individual foreign trade operations for a total of US$180.3 million thanks to 14 "A" loans for US$102 million, the issuance of 3 credit guarantees for US$6.8 million, and Trade Finance Facilitation Program (TFFP) syndicated loans that mobilized a total of US$71.5 million with the participation of eight international investors. The MIF approved 25 operations for a total of US$16.9 million, primarily targeting the priority areas of access to finance and rural development under the country strategy for 2012-2017.

2.6 Lastly, the Bank approved 82 **nonreimbursable technical-cooperation operations** for a total of US$35.1 million. For the most part, these technical cooperation operations complemented the loan operations, although some of them also allowed the Bank to maintain a presence in the dialogue areas identified in the country strategy: competitiveness and innovation; labor markets; and citizen security.

A. Main outcomes of the IDB Group country strategy with Ecuador 2012-2017

2.7 During the validity period of the previous country strategy, the IDB was an important partner for the Government of Ecuador, solidifying its status as the government's main multilateral lender and positioning itself in the policy dialogue on essential reforms for the country's development. This close relationship with Ecuador developed despite the confluence of several exogenous factors that hindered execution of the portfolio, including the macroeconomic shock of late 2014, the earthquake of April 2016, and the frequent changes of authorities at some of the executing agencies.

2.8 The interventions supported by the Bank led to significant advances in some of the priority areas under the country strategy, particularly energy and natural disaster management. In the energy sector, the financing and technical assistance provided by the Bank were essential in moving forward on the energy matrix transition prioritized by the government. In the natural disaster management sector, the Bank was a key actor in addressing the immediate consequences of the April 2016 earthquake and the rehabilitation of the affected areas, as was widely acknowledged by the national authorities. Below is a description of some of the main advances achieved by sector during the previous strategy's validity period.

2.9 **Energy.** The electricity sector was the most active for the Bank during the strategy period in terms of both financing amounts and number of operations, which primarily focused on transmission and distribution projects. In transmission, the Bank financed works that made it possible to supply 60% of the incremental demand created during the period (62,000 MWh/month). The Bank also financed 184 km of the subtransmission network and 3,254 km of the distribution network. In addition, it helped to improve the operation and maintenance of the electric power distribution companies, which made it possible to reduce electricity losses in the country from 23% in 2011 to 12% in 2016. The Electrification Program for Rural and Marginal Urban Areas in Ecuador benefited more than 122,000 households, 45,000 of which obtained electricity service for the first time. The Bank's support for power integration in the Andean region in the framework of the Andean Electric Interconnection System (SINEA) is partly responsible for enabling Ecuador to export electricity to its neighboring countries.

2.10 Through investment loans, the country expects to save approximately 580,000 tons of liquified petroleum gas (LPG) and reduce CO_2 emissions by approximately 5 million tons per year. IDB Invest interventions in the renewable energy area lowered CO_2 emissions by 120,700 metric tons per year. Through the MIF, 2,000 agricultural producers were trained in the adoption of clean energy solutions on the Galapagos Islands, and 54 isolated Amazonian indigenous communities were provided access to energy with solar panels.

2.11 **Transportation and logistics.** The Bank's interventions in the transportation sector were aimed at reducing the average travel time between cities and within cities. In this sector, the Quito Metro operation is emblematic, involving coordinated efforts with other multilateral lenders (World Bank, Andean Development Corporation (CAF), and European Investment Bank (EIB)) to improve urban transportation. The project is expected to mobilize 369,000 passengers per day starting in 2020. Equally noteworthy are the Bank's technical contributions on road maintenance issues in the primary network with the implementation of an innovative model for service-level contracts covering 883.7 km of corridors. In addition, during the execution period of the previous strategy, the Bank supported the construction of a bridge over the Babahoyo River, the main access to the city of Guayaquil, and financing for construction of the Quito Mariscal Sucre Airport.

2.12 **Social development.** The intersector coordination of social ministries was strengthened through the physical grouping and integration of processes and systems. In addition, the provision of social services was improved through the construction and equipping of 15 entire schools and 6 children's centers, training of more than 1,400 professionals, support for the policy of generational turnover of teachers via teacher retirement incentives, and appointment of new teachers with a better academic profile. The Bank also financed the delivery of more than 350 million food rations in public schools, youth and adult education, teacher training, and evaluation of education quality through support for the National Institute for Educational Evaluation (INEVAL). Similarly noteworthy is the completion of Cerrando Brechas [Closing Gaps], one of the most innovative studies in the field of education, which identifies successful teaching practices by monitoring more than

17,000 students and evaluating close to 2,700 teachers. IDB Invest provided access to new or improved homes to nearly 1,350 families and granted basic health service packages to 870 beneficiaries.

2.13 **Access to finance.** Through IDB Invest projects, the IDB Group helped to finance nearly 400,000 micro, small, and medium-sized enterprises (MSMEs), finance 781 transactions in support of international trade, and mobilize investments valued at US$210 million.[6] In addition, the MIF achieved successful results in financial inclusion with a gender approach, with more than 39,000 women obtaining access to financing and close to 1,000 women being trained in financial and business management. In addition, more than 2,000 businesswomen benefited through access to financing in vulnerable areas of Guayaquil.

2.14 **Fiscal management.** In the fiscal area, the IDB provided crosscutting support to the process of restructuring institutional management and addressed process optimization needs at key institutions. The outcomes of these interventions notably include the implementation of a variable remuneration system for senior civil servants, the use of a monitoring mechanism for the development plan, and the implementation of interoperability among the planning, public investment, and budget systems. In addition, the Bank's interventions helped to improve the quality of expenditures and of citizen services in terms of accessibility and timeliness. Particularly noteworthy in this regard is the support provided to the civil registry, which led to a reduction in waiting times for the delivery of birth certificates (from 4 hours to 15 minutes) and ID cards (from 8 hours to 45 minutes).

2.15 Through the Development Sustainability Contingent Credit Line, amounting to US$300 million and activated and disbursed in February 2015, the IDB supported the country in addressing the fall in oil prices and mitigating the potential impact of this shock on social spending. Together with the MIF, the IDB supported the government in building capacity for the implementation of public-private partnerships (PPPs) through workshops and the preparation of manuals and guidelines for a new regulatory framework for this type of public investment. The Bank also provided technical assistance to support a feasibility analysis of infrastructure projects under a PPP modality in the water, transportation, and energy sectors.

2.16 **Urban sustainability.** The Bank's support focused on building affordable housing, with more than 10,950 subsidies being granted for housing purchase, construction, and/or improvement, targeting the lowest two income quintiles and prioritizing the allocation of resources to households headed by women or including members with disabilities. In addition, the Bank helped to expand the coverage of water, sanitation, and solid waste management services, financing approximately 100 systems. Particularly noteworthy was the rehabilitation and expansion of the Esmeraldas system, which will benefit more than 400,000 inhabitants. Moreover, the Bank developed AquaRating in coordination with the International Water Association (IWA). AquaRating is an innovative rating system that comprehensively assesses the performance of water and sanitation service providers and has successfully been applied to Quito's Empresa Pública Metropolitana de Agua Potable y Saneamiento [Metropolitan Water and Sanitation Public Company] (EPMAPS). EPMAPS

[6] In addition, in June 2017, IDB Invest joined Ecuador's Sustainable Finance Protocol as a strategic partner to support the initiative of developing a banking cluster with the aim, among other objectives, of boosting competition and competitiveness in the financial system.

participated in the pilot phase of AquaRating in 2016, becoming the first company worldwide to complete the system's audit process and obtain certification.

2.17 **Rural development.** More than 148,000 forest plants were planted, and eight irrigation systems were optimized and rehabilitated, in the province of Chimborazo, giving access to better agricultural services to about 1,300 families. The Bank also supported the regularization of land tenure in 50 cantons, benefiting more than one million rural properties. Through IBD Invest, access to agricultural services and investments was provided for nearly 2,500 farmers. The MIF supported more than 1,000 cocoa and chocolate producers with a view to raising their productivity levels and linking them to international markets. In addition, the Bank worked with 1,800 small producers in the dairy value chain through workshops on good practices and technical assistance, and with 200 small agricultural producers on the southern border to link them to value chains. Through support to the Conquito Municipal Agency, the Bank strengthened the organizational capacity of 350 microenterprises with inclusive businesses to provide access to markets.

2.18 **Natural disaster risk management.** The Bank's support was highlighted by the assistance to the country following the April 2016 earthquake. However, the Bank's rapid response to that disaster (disbursement of US$160 million just six days after the earthquake) would not have been possible had the Bank not done proactive and preventive work with the country in the preceding years. In 2012, the Bank approved the Contingent Credit Facility for Natural Disaster Emergencies for US$100 million, which in August 2014 was increased to US$300 million, including floods as a potential trigger event. The outcomes of the program include: (i) the establishment of 28 shelters that served more than 11,511 victims; (ii) more than 30,000 beneficiaries of housing accommodation and rental vouchers; (iii) 412,637 students benefiting through the installation of 25 schools and the repair of more than 700 schools; (iv) two mobile medical units and 20 hospital care centers rehabilitated, which made it possible to treat more than 600,000 patients; (v) 60 km of roads and nine bridges rehabilitated; and (vi) the rehabilitation of six drinking water systems, 12 wastewater treatment plants, and five water treatment plants.

2.19 Support for the above-described rehabilitation work was complemented by the approval of the Immediate Response Facility (IRF) (US$19 million) and the Program for the Reconstruction of Electricity Infrastructure (US$60 million). In addition, support is being provided for strengthening the national early warning system and boosting the resilience of the country's public infrastructure through the approval of a loan operation and a technical cooperation project.

2.20 At the same time, the MIF supported the creation of the Junto a Ti [By Your Side] Trust and the Resiliencia [Resilience] Trust. These vehicles are being used to implement an innovative response to natural disasters, involving the private sector in rebuilding its value chains and the business fabric and encouraging companies and communities to be more resistant to future crises. It is expected that 7,000 micro and small enterprises (MSEs) affected by the earthquake in the provinces of Manabí and Esmeraldas will benefit from this intervention.

B. Current portfolio status

2.21 The **outstanding sovereign-guaranteed portfolio** is comprised of 30 operations for US$2.496 billion (US$1.826 billion already disbursed), primarily concentrated on strengthening of public management (25%), energy (33%), transportation (10%), and water and sanitation (11%).[7] The outstanding IDB Invest portfolio totals US$318.1 million, distributed among 24 operations supporting SMEs and foreign trade through financial intermediaries (61%), competitiveness in the manufacturing sector (25%), investments in transportation, energy, and telecommunications infrastructure (10%), and agribusiness (4%). The outstanding technical cooperation portfolio includes 43 operations for a total of US$42.1 million, mainly in water and sanitation (52%), social protection (22%), and strengthening of public management (7%). The MIF has a portfolio of 16 operations for a total approved amount of US$12.5 million, as follows: 14 technical cooperation operations for a total of US$8.7 million, one MIF loan for US$1.9 million, and one equity investment operation for US$2 million. It is worth noting that the 14 technical cooperation projects include three regional projects managed from Ecuador, for a total of US$2.6 million.

C. Lessons learned

2.22 The main lessons learned during the implementation of the country strategy for 2012-2017 with regard to sovereign-guaranteed operations are the following: (i) the Bank is more relevant and makes a greater impact when it targets its financing resources on a limited number of sectors, but above all when the financing is aimed at strategic government programs, such as the national energy matrix transition strategy; (ii) maintaining an open and continuous dialogue with the Ministry of Economy and Finance through its focal point makes it possible to boost the performance of projects with budgetary and/or technical difficulties; (iii) the Bank can play a leading role as a catalyst of resources from other institutions, having reached cofinancing agreements for US$265 million in recent years; (iv) proper use of technical cooperation operations can help the IDB Group to position itself as a key actor on issues that are a priority for the government, as was the case, for example, with the issue of PPPs.

2.23 The main lessons learned with regard to non-sovereign guaranteed operations are the following: (i) performing extensive assessments of geological and environmental risks that consider the biodiversity of the areas of execution of the relevant projects and the likelihood of occurrence of natural disasters is essential in order to ensure the success of projects in the energy sector; (ii) the performance vulnerability of private-sector operations to unexpected changes in local and international markets, including changes in commodity prices, underscores the need to design more elaborate credit risk mitigation strategies for future operations; and (iii) to achieve a systemic impact on SME access to financing, it is advisable to partner with financial institutions with a significant presence in the country as well as to scale existing financing arrangements in value chains that can boost the earnings of small producers.

2.24 This country strategy takes into account the recommendations of the Country Program Evaluation: Ecuador 2012-2017 (CPE) prepared by the Office of Evaluation and Oversight (OVE):[8] (i) support proposals by the Government of Ecuador that facilitate consolidation of the public finances; (ii) seek opportunities to support private sector development in areas that enhance competitiveness and accelerate

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7 Cutoff date: 28 February 2018.

8 The detailed recommendations and Management’s response are set out in Annex 4.

the diversification of production; (iii) continue strengthening the capacities of subnational entities. In fact, as will be seen in the following section, the areas of action prioritized in this country strategy are clearly aligned with the OVE recommendations.

III. PRIORITY AREAS[9]

3.1 **Strategic focus.** The country strategy for the 2018-2021 period will prioritize spurring economic growth to consolidate and deepen the social advances achieved since the turn of the century. To this end, the Bank will support the government in its effort to overcome the macroeconomic imbalances currently affecting the country, move toward a growth model in which private initiative takes on a more prominent role, and mitigate the potential adverse impacts of this process on the most vulnerable groups. This strategic approach will be based on three pillars: (i) strengthening of public finances; (ii) support for productivity and development of the private sector as engines of growth; (iii) deepening of the social advances achieved over the last decade.

3.2 This strategic approach is aligned with: (i) the objective of overcoming the main development challenges identified in the IDB document "Ecuador. Country Development Challenges. 2017"; (ii) the OVE recommendations set out in the CPE; and (iii) the government's development plan. The intervention sectors will be served through the existing portfolio, knowledge products, technical cooperation operations, and new loan and guarantee operations. The supplementary use of these instruments will allow the IDB and IDB Invest to work on the priority areas in a consistent and coordinated manner, taking advantage of synergies among the interventions.

3.3 **National development strategy.** The National Development Plan (NDP) 2017-2021 includes three action pillars and nine strategic objectives. The areas of intervention proposed in this strategy are aligned with the PNBV, particularly with the following strategic objectives: (i) consolidate the sustainability of the social and solidarity-based economic system and reinforce dollarization (objective 4); (ii) boost productivity and competitiveness for redistributive and solidarity-based sustainable economic growth (objective 5); (iii) ensure a life of dignity with equal opportunities for all (objective 1); and (iv) develop the productive and environmental capacities to achieve food sovereignty and comprehensive rural development (objective 6).

A. Strengthening of public finances

3.4 Ecuador's fiscal position has been greatly affected by the drop in the price of crude oil, which helps to explain the high nonfinancial public sector deficits for several years in succession (5.2% of GDP in 2014, 5.1% of GDP in 2015, 7.4% of GDP in 2016, and 5.3% of GDP in 2017) and the rapid growth of public debt (the burden of which increased by nearly 24 percentage points of GDP between December 2013 and December 2017).[10] While aggregate public debt is still at a sustainable level (47% of GDP, according to the Ministry of Economy and Finance's debt bulletin

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[9] All references may be found in the CDC (Annex I), along with a detailed analysis of the development challenges addressed in this document.

[10] Source: International Monetary Fund (October 2017 WEO). These data refer to the consolidated debt of the nonfinancial public sector.

published in April 2018),[11] the government may, in order to correct its recent trajectory, be forced to initiate a process of fiscal consolidation that could last several years. To increase its chances of success, this process should be gradual and preannounced, and should address the underlying causes of the fiscal decline in recent years, including certain shortcomings of the fiscal management framework and the weight of energy subsidies. In addition, to mitigate the potential adverse short-term impacts of this public finance strengthening process, Ecuador should continue to reinforce the country's institutions to obtain efficiency gains and increase the quality of expenditure.

3.5 **Fiscal management.** The recent deficit and debt trajectories suggest that the framework of fiscal responsibility in effect since the end of the last decade has not imposed a rigid budgetary restriction on public finances, nor has it moderated the procyclical nature of public spending.[12] In fact, the structural balance of the NFPS showed a deficit in all years of the period from 2008 to 2017. The deficit was particularly high in 2013 (8.7% of GDP) and 2014 (9.4% of GDP),[13] when the Ecuadorian economy still benefited from high oil prices (US$96/barrel and US$85/barrel, respectively) and grew at a relatively robust rate (4.9% and 3.8%, respectively). Given the limited fiscal space available to Ecuador at the time of the oil shock, in 2015 the government was forced to reduce primary spending, contributing to the rapid economic slowdown that year and the next. The procyclical nature of public finance is particularly significant in the case of Ecuador because, being a dollarized economy, its government has few macroeconomic stabilization instruments in its toolkit.

3.6 Other than the contingent instruments provided by multilateral organizations, the Ecuadorian government has not used any tools to mitigate the risk exposure of the country's public finances arising from their dependence on oil revenues, which prior to the shock accounted for one third of the State's resources. In fact, since 2008, the country has not had oil stabilization funds; in contracts with private operators, the full impact of price drops is borne by the public sector; and the government has not done any risk hedging through the financial derivatives markets. It is therefore evident that Ecuador has a great deal of room to reinforce its management of the fiscal risks facing the country.

3.7 Although in the years prior to the oil shock, Ecuador achieved a significant increase in tax revenues (from 10% of GDP in 2006 to 14.2% of GDP in 2015), these revenues are still below the Latin American average (21.7% of GDP), and very far from the level reached by countries such as Argentina or Brazil (31.2% and 33.4%

[11] This figure does not include "other obligations" for the Ecuadorian government, i.e. treasury certificates, advance sales of oil, floating debt, IMF Special Drawing Rights, letters of credit for derivative imports, accumulation of oil services contracts, current liabilities of Petroamazonas, current liabilities of Schlumberger, and awards. The total of these obligations amounts to 9.7% of GDP, bringing total debt to around 56.7% of GDP.

[12] Upon the approval of the Organic Public Planning and Finance Code in 2010, two fiscal rules came into effect in Ecuador: (i) except for extraordinary health, education, and justice expenditures, ongoing expenditures may be financed only with ongoing revenues, limiting the ability to allocate resources from public debt or the development of nonrenewable natural resources to current expenditure; and (ii) total consolidated public debt (not including liabilities associated with the advance sale of oil or short-term debt) may not exceed 40% of GDP.

[13] Source: IMF (October 2017 WEO).

of GDP, respectively). Contributing factors include the country's high tax expenditure, which in 2016 was around 4.6% of GDP, and high evasion of certain taxes.[14] Also worth noting is the low volume of own revenue generated by subnational governments due to their limited jurisdictional authority and an insufficient level of fiscal effort. Indeed, Ecuador has one of the smallest proportions of subnational tax collection to total tax collection of any country in the world, exacerbating the financial dependence of provinces and municipalities on central government transfers for the performance of their duties.[15]

3.8 **Energy.** In the absence of energy subsidies, Ecuador would have had substantially more fiscal space to address the oil shock. Indeed, depending on the calculation method employed, fossil fuel subsidies absorbed from 4.3% to 11.4% of GDP between 2007 and 2014.[16] In 2016, as a result of the decline in the global prices of derivatives, subsidies fell to the equivalent of 2.2% to 4.8% of GDP (again, depending on the calculation method employed). Thus, in the short term, eliminating fuel subsidies would free up a more limited amount of resources. However, the current low-price environment also provides a window of opportunity, since moderating the effect of the reform on consumers would help to mitigate any opposition to the reform. To date, no substantial changes have been introduced in the pricing mechanisms for derivatives used by the residential and transportation sectors, which generate more than three fourths of energy subsidies in Ecuador, and the current government has at no time expressed its intent to adopt measures of this nature.[17]

3.9 Over the last few years, a strategy has been implemented to boost power generation capacity and change the composition of the energy matrix, shifting away from fossil fuel-based thermal plants (mostly subsidized and imported) in favor of renewable sources of generation, primarily newly built hydroelectric power plants. This reform is expected to increase the country's electricity generation capacity from approximately 20,000 GWh in 2013 to close to 35,000 GWh in 2023, raising the share of hydroelectricity in the energy matrix from 57% to 80%.[18] This policy makes it possible to reduce the use of fossil fuels to generate power and promote electricity as a substitute for fuel consumption in various areas (e.g., cooking, public

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[14] In 2005, the Servicio de Rentas Internas [Internal Revenue Service] (SRI) estimated income tax and value-added tax evasion at 56% and 20%, respectively. Somewhat more recently, the Inter-American Center of Tax Administrations (CIAT) estimated average tax noncompliance in the 2006-2010 period at 63.5% in the case of income tax (Pecho Trigueros et al., 2012). Since that time, tax noncompliance in Ecuador may have been reduced by the various measures adopted by the government to fight tax fraud. However, given the high initial evasion levels, it is also likely that there is still ample room to strengthen evasion prevention policies and thereby increase the State's tax revenues.

[15] Source: Díaz-Cassou, J., C. Carpizo, and H. Viscarra Andrade. 2016. "*Descentralización, Finanzas Subnacionales y Ecualización Fiscal en Ecuador*." Inter-American Development Bank, IDB-MG-496. In 2016, illustrating the low level of tax collection by local governments, total real estate tax revenues amounted to a mere US$124 million, approximately 0.12% of GDP. By contrast, real estate tax revenues are close to 0.3% of GDP in the region as a whole and 2% of GDP in OECD countries.

[16] In addition, this expense item is highly regressive, disproportionally benefiting households in the wealthiest quintiles (Arze del Granado et al., 2010; Hurtado, 2008).

[17] In October 2015, Petroecuador was authorized to transfer all of its commercial and industrial fuel importing, distribution, and marketing costs to the selling price of these products, thereby eliminating the subsidy for this market segment.

[18] Source: Master Electrification Plan 2016-2025.

transportation, and the oil industry), allowing the State to lower its energy subsidies without affecting end users while at the same time improving the energy supply and the quality of service. The authorities estimate that US$5.420 billion, US$1.113 billion, and US$3.568 billion will be needed respectively in generation, transmission, and distribution investments between 2016 and 2025 to support the transition of the energy matrix.[19]

3.10 While the transmission and distribution functions are, with some exceptions, carried out by public companies, the private sector is authorized to participate in the power generation chain and therefore can also contribute to the transition of the energy matrix and to reducing the weight of fossil fuel subsidies.[20]

3.11 **Institutional strengthening.** A better functioning public sector could mitigate the effects of fiscal consolidation and boost its likelihood of success.[21] Throughout the last decade, the Ecuadorian authorities undertook an effort to modernize the State and increase its planning, management, regulatory, redistributive, and development promotion capacities, achieving notable results in some areas. Indeed, between 2011 and 2015, Ecuador (along with Panama) raised its score on the IDB's Civil Service Development Index the most of any country, going from a score well below the regional average to one that slightly surpassed it. In addition, according to the World Bank's Worldwide Governance Indicators (WGI), between 2008 and 2015 Ecuador was the Latin American country, and one of the 10 countries worldwide, that advanced the most in the government effectiveness indicator.

3.12 Despite these advances, Ecuador continues to rank below average for Latin American and Caribbean countries in government effectiveness, and is very far from the average for OECD countries in this regard.[22] The possible reasons for this lag include the absence in Ecuador of an effective system of performance indicators that would make it possible to analyze spending quality and use this information in the budget process.[23] In addition, there is room to improve coordination between the development plan and the budget, implement results-based budget instruments, and deploy a system of independent assessments of government programs and policies. With regard to the public investment system, despite recent progress, Ecuador is below the regional average in the functioning of preinvestment processes, while the country's bid award, internal control, and audit processes exhibit weaknesses.[24]

3.13 Between 2010 and 2015, annual investments executed through PPPs amounted to a mere 0.06% of GDP, compared to the region's average of about 0.46% of GDP.[25] In 2015, to partially offset the potential contraction in the amount of public investment executed directly by the State due to the fiscal consolidation process, a new law on

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[19] Ibid.

[20] See "*Desafíos y Oportunidades para el Desarrollo en Ecuador: Una Perspectiva del Sector Privado*." IDB Invest, 2017 for a description of the participants in each of the components of the sector.

[21] As empirical evidence of this relationship, see, for example: OECD, 2010; Angelopoulos et al., 2008; IMF, 2015; Heylen et al., 2013.

[22] In 2015, Ecuador was ranked in percentile 38.5 out of 215 countries, while the average for the region was the 50.6 percentile, and the OECD average was percentile 87.7 (Source: WGI).

[23] Source: PRODEV evaluation (SEP).

[24] Source: Armendariz and Contreras (2017). "*El gasto de inversión pública en América Latina: cuánto y cuán eficiente*." Unpublished document. Fiscal and Municipal Management Division, IDB.

[25] Source: IMF (Investment and Capital Stock Database, 1960-2015).

PPPs was approved with the aim of encouraging new operations of this type in the country. However, the legal and institutional framework established to implement the PPP program is still in the maturation phase and shows weaknesses. This was made evident in the most recent Infrascopio report, in which Ecuador ranked 18th out of 19 countries in the region.[26] To mitigate the potential risks associated with the PPP program, it is particularly important to strengthen the capacity of the Ministry of Economy and Finance to evaluate the fiscal implications of any approved projects.

3.14 **Proposed actions.** To address the public finance challenge, the IDB Group will support: (i) the establishment of instruments that reinforce fiscal stability, offer scope for the application of countercyclical fiscal measures, and make it possible to face fiscal risks associated with high dependence on crude exports; (ii) the investments needed to move forward with the energy reform and reduce the weight of fossil fuel subsidies, including support for the private sector through IDB Invest to reinforce the energy supply with greater clean energy resources (such as hydropower, geothermal energy, wind energy, and natural gas-based generation); (iii) the processing of modernization of the State, prioritizing initiatives that generate efficiencies and improve the quality of expenditures; and (iv) strengthening the country's framework for PPPs and strategic partnerships, coupled with technical and financial support for the development of sustainable projects under this framework.

3.15 The proposed actions in this strategic area contribute to the following objectives of the Update to the Institutional Strategy 2010-2020: create a more distributive fiscal policy; strengthen the capacity of the State; establish smart institutional frameworks; strengthen institutional capacity and the rule of law; eradicate extreme poverty; and provide inclusive infrastructure and infrastructure services. The priorities set forth for this strategic area are also aligned with the priority areas of the IDB Invest 2017-2019 Business Plan, particularly support for the infrastructure segment through the energy, transportation, water and sanitation, and social infrastructure sectors.[27]

B. Productivity and private sector

3.16 The growth of the Ecuadorian economy from 2002 to 2014 was largely attributable to a positive shock to the terms of trade and to the behavior of public expenditure, both of which came to a sudden end with the collapse of crude oil prices in 2014. In the medium-term, these factors are unlikely to drive an economic recovery, especially since international commodity prices are expected to stabilize at lower levels than those of 2014 and the fiscal consolidation process could extend over a period of several years. In this context, in order to continue to move forward on the path of development, Ecuador faces the challenge of modifying its growth pattern by giving productivity and private initiative a more vital role as engines of growth. Advancing toward the achievement of this goal requires adopting measures to correct the causes behind the slow growth in productivity and private investment in recent years. These causes notably include the existence of frictions hindering an efficient reallocation of the factors of production, a weak business climate, and the

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[26] Source: Economist Intelligence Unit (2017).

[27] These proposed actions are also aligned with the approved 2018 Business Plan Update (document CII/GA-77-4).

presence of structural obstacles that prevent Ecuadorian business people from participating more actively in the global markets.

3.17 **Market and governance failures.** Total factor productivity contributed a mere 7% of Ecuador's economic growth between 2001 and 2014.[28] In addition, despite the advances made during the last decade, labor productivity (measured as GDP per worker) is now close to its level in the early 1980s and is lower than that of many of the countries in the region. In addition, a firm-level analysis shows that no business productivity gains were recorded between 2010 and 2015 in most sectors of the economy, with some sectors (such as manufacturing) actually losing productivity.[29] There is also great fragmentation in the productivity of Ecuadorian businesses, even those operating within the same production sector.

3.18 According to the literature, the existence side by side of companies with very different levels of productivity in tightly limited sectors of the economy points to market and governance failures that hinder an efficient reallocation of factors of production from the least productive to the most productive enterprises.[30] This absence of intrasector convergence of productivity levels is compounded by the fact that the process of structural transformation that the Ecuadorian economy is going through is slow. In fact, less than 9% of the increase in value added per worker between 2007 and 2015 was attributable to the transfer of workers between productive sectors, which is possibly further evidence of the existence of frictions hindering an efficient allocation of factors.[31]

3.19 Various successive industrial policy strategies have failed to achieve a substantive transformation of the country's productive structure. These initiatives have primarily been based on a provision of horizontal public goods (such as education and infrastructure) and market interventions (such as subsidies or tax exemptions), rather than vertical public goods that address the specific problems of productive sectors with the greatest growth potential. One of the reasons for the failure to deploy an effective system to stimulate production is the weakness of the mechanisms for dialogue and coordination between the public and private sectors.

3.20 It is important that any production stimulus policies deployed in Ecuador also consider the specific challenges faced by participants in the popular and solidarity-based economy.[32] This sector employs 55% of the working-age population, mainly in the lowest two income quintiles (25.6% in quintile 1, and 29.2% in quintile 2).[33] Therefore, invigorating the popular and solidarity-based economy and

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[28] To obtain this data, growth was broken down using information from the Conference Board. This information confirms that Ecuador's GDP growth was primarily driven by the accumulation of factors of production (57% capital and 36% labor).

[29] The methodology and data used for this analysis are described in the CDC.

[30] Pagés, C. 2010. The Age of Productivity: Transforming Economies from the Bottom Up. Inter-American Development Bank.

[31] Source: Author's calculations (see CDC for more details on the method used).

[32] According to the Organic Law of the Popular and Solidarity-based Economy, this sector is defined as "a form of economic organization, the members of which individually or collectively organize and carry out processes of production, exchange, marketing, financing, and consumption of goods and services to meet needs and generate income based on relationships of solidarity, cooperation, and reciprocity."

[33] Source: Instituto Nacional de Economía Popular y Solidaria [National Institute of Popular and Solidarity-based Economy], "*Caracterización de la población inserta en la Economía Popular en el Ecuador*."

better integrating it into the rest of the economy could have a significant social impact. Also, given that this sector is comprised mostly of women (58% of the total), stimulating it could help to combat Ecuador's persistent gender gap.

3.21 **Business climate.** From 2005 to 2015, the weight of private investment in Ecuador fell from 14.5% of GDP to 11.5% of GDP.[34] This is a substantially lower investment amount than the average for the region, which is approximately 16.4% of GDP.[35] Over the same period, net foreign direct investment flows into Ecuador accounted for an average of 0.8% of GDP, compared to 3% of GDP in Latin America and the Caribbean as a whole.[36] Thus, if the volume of private (including foreign) investment could be made to converge toward the regional average, it could become a significant driver of economic growth in Ecuador.

3.22 The low level of gross private capital formation in Ecuador is partly due to the weakness of the business climate. Ecuador is ranked 91st out of 138 countries in the latest edition of the Global Competitiveness Report. According to this and other international indices, the areas with the most pronounced shortcomings are related to the legal and regulatory framework and its instability. In fact, in terms of quality of the regulatory framework, the country is in the 13-percentile range under the Worldwide Governance Indicators (World Bank), compared to a 55-percentile average for the region as a whole.

3.23 Ecuadorian business people identify labor regulations as the main obstacle to doing business in the country, which could also help to explain the low level of private investment.[37] Demonstrating the rigidities that characterize labor regulations, Ecuador has the second highest dismissal costs in the region in terms of weekly wages, and the second-highest ratio of minimum wage to value added per worker. These rigidities help to explain the persistently high level of informality in the country (more than half of active workers do not contribute to social security), a variable that the literature finds to be negatively correlated with labor productivity.[38] A sizeable proportion of Ecuadorian firms and workers elect to remain in the informal sector because the costs of being part of the formal economy are high.[39]

3.24 Furthermore, the comparatively low development level of the Ecuadorian credit and capital markets makes it difficult to mobilize the financial resources needed for private investment. Credit to the private sector is approximately 27% of GDP, a figure far below the average for the group of upper middle-income economies in which the World Bank includes Ecuador (112.7% of GDP), for the Asian emerging markets (141% of GDP in South Korea, 125% of GDP in Malaysia, 151% of GDP in Thailand), and for Latin America and the Caribbean as a whole (49.8% of GDP). In 2011, the capitalization of Ecuadorian securities markets was 7.1% of GDP, compared to 126% of GDP in Chile, 63% of GDP in Colombia, and 51.8% of GDP in Peru. Thus, it is likely that lack of access to financing limits private investment, as

[34] Source: International Monetary Fund, Investment and Capital Stock Database.

[35] Ibid.

[36] Source: World Bank, World Development Indicators.

[37] Source: Global Competitiveness Report, 2016-2017.

[38] See, for example, A. Chong, J. Galdo, and J. Saavedra (2008). “Informality and productivity in the labor market in Peru.” Journal of Economic Policy Reform, Volume 11, 2008.

[39] World Bank. 2012. “Ecuador: The Faces of Informality.” 67808-EC.

further suggested by the fact that business people identify this factor as the second greatest obstacle to doing business in Ecuador.[40]

3.25 Small and medium-sized enterprises (SMEs) face greater constraints on access to financing. Less than half of these enterprises have access to bank loans, despite the fact that SMEs generate one third of all formal jobs in Ecuador.[41] Limited access to financing is associated with: (i) a weak appetite for risk on the part of financial institutions, exacerbated by administrative controls that affect bank profits; (ii) a disincentive to innovate in the provision of financial services arising from a concentration of assets in the financial system; and (iii) funding for private banks, which is primarily achieved through deposits, 95% of which are demand deposits or time deposits for less than 360 days.[42]

3.26 The cooperative, associative, and communal sector, which in Ecuador is known as the popular and solidarity-based economy, also faces particularly pronounced restrictions in terms of credit access. In fact, despite employing more than 50% of the working-age population, this sector's share of total deposits and loans in the financial system is a mere 2.2% and 4%, respectively.[43]

3.27 **Export obstacles.** Ecuadorian companies that export are almost 30% more productive than those that do not,[44] while also generating an influx of foreign currency that helps to sustain the dollarization of the economy. Despite the evident importance of the export sector, the sector is small and has barely grown in recent years.[45] One of the factors that may have helped to hold back the growth of exports is the problem of access to the major markets. Thus, while the recent entry into effect of an agreement with the European Union has ameliorated this problem, Ecuador continues to have one of the lowest percentages of exports eligible for preferential treatment of any country in the region.

3.28 In addition, Ecuador's foreign exchange appreciation vis-à-vis its main competitors and the fact that wages have risen at a far brisker pace than productivity put the country's exporters at a competitive disadvantage.[46] This is coupled with the cost overruns borne by the sector due to the comparatively high and volatile tariff burden. Lastly, despite some recent advances such as the creation of a single foreign trade window in 2013, there is room to boost the effectiveness of the trade facilitation and export promotion tools made available by the country.

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[40] Source: Global Competitiveness Report, 2016-2017.

[41] ECLAC, 2016 "*Inclusión Financiera de las PYMEs en el Ecuador*." Financing for Development Series 260; and Enterprise Surveys, World Bank, 2010.

[42] "*Desafíos y Oportunidades para el Desarrollo en Ecuador: Una Perspectiva del Sector Privado*." IDB Invest, 2017.

[43] Source: National Development Plan 2017-2021; National Institute of Popular and Solidarity-based Economy.

[44] Source: Author's calculations based on INEC data (Labor and Business Dynamics Laboratory).

[45] The weight of nonoil exports from Ecuador has barely changed in the last 15 years, having gone from 11.4% of GDP in the 2000-2002 period to 11.7% of GDP in the 2013-2015 period.

[46] According to the adjusted real effective exchange rate, which considers the exchange rate not only of the country's trade partners but also of its competitors, Ecuador has suffered the most adverse foreign exchange movements in 2015 and 2016 of any country in the region. Labor productivity, measured as real GDP per worker, grew by 3.6% between 2006 and 2012, compared to the 20% growth in wages over the same period.

3.29 The Ecuadorian nonoil export basket has low industrialization levels and is therefore of limited economic complexity.[47] Agroindustrial exports, which are second in importance after oil-related external sales, have specialized in a limited set of products with moderate industrialization and innovation levels, offering opportunities for improvement in terms of better adaptation to existing technology and current consumption patterns.[48] It is also worth noting that the expected rise in temperature of 3 degrees Celsius above current levels by the end of the century poses a grave threat to the production and export of commercial banana crops, one of the country's main nonoil exports. As a result of climate change, a greater amount of intense rainfall is expected throughout the Ecuadorian coast, where a good deal of banana production is concentrated.[49]

3.30 The limitations of the Ecuadorian logistics system are yet another barrier to producer access to the global markets. In fact, the Logistics Performance Index developed by the World Bank continues to rank Ecuador 74th out of 160 countries overall and in 6th place out of 10 South American countries, suggesting that there continues to be significant room for improvement. Ecuador's lag with respect to its peers in the region is particularly pronounced in relation to international interconnection nodes and quality of logistics service, where it ranks ahead of only Bolivia and Venezuela. Another problem facing the country is the insufficient draft in the port of Guayaquil, preventing it from attracting large, Post-Panamax vessels. This forces a large part of Ecuador's international trade to go through the port of El Callao in Peru or Buenaventura in Colombia. In addition, the lack of sufficient logistics equipment in the country raises shipping costs, thus eroding the competitiveness of exports.

3.31 **Proposed actions.** In this area, the IDB Group will support the country in: (i) designing and executing a policy agenda that mitigates the obstacles that currently hinder an efficient reallocation of the factors of production and hold back private investment; (ii) deepening the financial markets through IDB Group operations designed to expand medium- and long-term financing by local banks as well as offer financial products to alleviate credit constraints in segments such as MSMEs, agroindustry, and the popular and solidarity-based economy; (iii) defining and implementing a market access and export promotion strategy, as well as financing business projects through IDB Invest that support integration into new international markets and/or contribute to the complexity of the export basket; (iv) supporting infrastructure projects that improve local and international connectivity and reduce logistics costs, attempting to maximize synergies between the Bank and IDB Invest.

3.32 The proposed actions in this strategic area contribute to the following objectives of the Update to the Institutional Strategy 2010-2020: include all segments of the population in financial markets; establish smart institutional frameworks; improve

[47] Economic complexity is defined as the amount of capacities and knowledge incorporated into the production of a specific good (Hausmann, R. and C. Hidalgo "The Building Blocks of Economic Complexity" (2009). PNAS 30 June 2009. 106 (26) 10570-10575; https://doi.org/10.1073/pnas.0900943106).

[48] For example, more than three fourths of coffee and cocoa production are exported as raw material (80% and 88%, respectively; IDB-CTI calculations based on Comtrade).

[49] Source: Elbehri, A., G. et al. (2015). *Cambio climático y sostenibilidad del banano en el Ecuador: Evaluación de impacto y directrices de política*. Food and Agriculture Organization of the United Nations (FAO), Rome, Italy.

regional infrastructure; converge integration policies and instruments; and provide adequate knowledge and innovation ecosystems. These initiatives also contribute to the strategic priorities of the IDB Invest 2017-2019 Business Plan of supporting infrastructure development, building the capacities of the corporate sector, and creating partnerships with the financial sector to work in the priority areas of action, such as support for SMEs.[50]

C. Deepening of social advances

3.33 In the last decade, Ecuador obtained some of the best results in the region in terms of reducing poverty and inequality.[51] However, these advances have not been uniform. In fact, the incidence of poverty continues to be much higher in rural environments than in urban areas (35.3% compared to 16.4% in 2014, measured by consumption). There is also a large difference in the incidence of consumption poverty between the indigenous population (64.8% in 2014) and the Afro-Ecuadorian (29.6%), mestizo (21.2%), and white (17.7%) populations.[52] The fact that close to 75% of the indigenous population lives away from urban centers suggests that the factors currently preventing the rural economies from taking off could be among the causes of the two main poverty gaps (urban-rural and indigenous-nonindigenous) persisting in the country.[53]

3.34 Despite the above-mentioned advances, income poverty and the GINI coefficient have practically not fallen since 2014, suggesting that the recent macroeconomic situation has been far less conducive to social progress than the situation prior to the oil shock. This is coupled with the fact that nearly 40% of the Ecuadorian population (the highest percentage of any country in the entire region) belongs to the vulnerable middle class, elevating the risk that part of the citizenry will fall into poverty.[54] In this context, in order to consolidate the social advances achieved in the last decade, the country faces the challenge of complementing the economic stimulus agenda with an effective social policy aimed at providing quality public services to the population most in need of them.

3.35 **Rural poverty.** Given that 68% of the economically active population that resides away from urban centers is engaged in agriculture, improving the performance of this sector is essential for reducing poverty in rural areas. At the same time, ENEMBDU data show that 44% of the rural population engaged in agriculture is poor, far exceeding the incidence of poverty at the national level.

3.36 Although the agricultural sector is not uniform, farm productivity in Ecuador increases at a slower pace than in the rest of the region, and some of the country's

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50 These proposed actions are also aligned with the to the approved 2018 Business Plan Update (CII/GA-77-4).

51 Using comparable data, while the income poverty rate (income of less than US$5 per day) in 2007 was 42.5% in Ecuador, compared to an average of 35.3% in Latin America and the Caribbean, in 2014 it was 27.2%, the same level as in the region as a whole (Source: IDB, Harmonized Data Bank of Household Surveys from Latin America and the Caribbean).

52 Source: INEC-World Bank. 2016. Consumption Poverty Report. Ecuador 2006-2014.

53 Source: Quality of Life Survey 2013-2014.

54 Source: IDB, Harmonized Data Bank of Household Surveys.

main crops have a comparatively low yield.[55] This may help to explain the high rate of chronic malnutrition in children under five years of age, particularly in the indigenous population (see paragraph 3.38). The problems underlying the low performance level of the agricultural sector notably include the following: (i) deficient irrigation infrastructure;[56] (ii) dearth of adequate instruments to manage agricultural risk; (iii) insufficient investment, partly the result of lack of access to credit, legal uncertainty as to land ownership rights, low production scale, and imperfect access to both input and end product markets;[57] (iv) underprovision of public goods such as agricultural research, phytosanitary controls, and the aforementioned land ownership rights. Climate change could have noticeable effects on the Ecuadorian agricultural system, giving rise to greater rainfall on the coast (where banana production is concentrated) and reducing the productivity of coffee and cocoa crops.[58]

3.37 As international experience has shown (IFAD, 2016), promoting nonfarm employment should be part of a country's strategy to reduce rural poverty. To this end, the State should ensure the provision of public services and infrastructure (i.e. education, water and sanitation, electrification, and broadband access). In the case of Ecuador, close to 42% of the rural population is engaged in nonfarm activities, compared to an average of 45% in the region as a whole. This suggests that there may be room for stimulating the nonfarm economy even away from urban centers, which would have a positive impact on labor income and rural poverty.[59]

3.38 **Access to quality public services.** Between 2007 and 2014, demonstrating the importance assigned by the State to poverty reduction, the Government of Ecuador doubled its social investment in terms of GDP, with noticeable effects in terms of coverage of public services.[60] This effort had noteworthy outcomes, especially in the education sector. A comparison between the results of SERCE tests (2006) and TERCE tests (2013) shows that Ecuador is among the Latin American countries that

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55 Between 2001 and 2012, output per worker increased at a rate of 1.7% in Ecuador, compared to an average increase of 2.7% in the region as a whole (Nin-Pratt et al., 2015). Even in the case of products of which Ecuador is a major exporter, the yield per hectare is well below that of the country's main regional competitors. For example, in the 2011-2014 period, the cocoa yield is estimated to have been 0.44 metric tons per hectare (mt/ha), compared to 0.73 mt/ha in Peru, and the banana yield is estimated to have been 35.2 mt/ha, compared to 51 mt/ha in Costa Rica.

56 Merely 12.5% of farmland in Ecuador is effectively irrigated.

57 The agricultural sector accounts for nearly 5.8% of the loan portfolio in the financial system, despite contributing approximately 9% of the GDP.

58 A gradual rise in temperature could bring about a decline in the productivity of coffee, banana, and cocoa crops, which in 2015 accounted for 20% of the country's agricultural economy. It is projected that banana production, which is the largest contributor to the agricultural GDP, would suffer the sharpest economic losses under the reviewed climate scenarios (ECLAC, 2012, "*La economía del Cambio Climático en Ecuador*").

59 The simulations performed by Lanjouw (1999) showed that a 10% shift in Ecuadorian agricultural workers toward nonfarm activities could generate increases in labor income of up to 14%, with noticeable effects on the poverty rate.

60 To illustrate this expansion in the coverage of social services: the early childhood center attendance rate for children 12 to 36 months of age rose from 15% in 2006 to 31% in 2014; the percentage of children 3 and 4 years old enrolled in preschool doubled; the primary school net enrollment rate went from 90% in 2007 to 94% in 2014; the lower secondary school attendance rate increased from 64% to 77%; in the area of health, the percentage of pregnancies with five or more checkups rose from 55% in 2004 to 82% in 2012, and the number of ambulatory visits at the primary level of healthcare tripled.

have achieved the greatest improvements in student performance.[61] However, there is still ample room for improvement in learning. In fact, most Ecuadorian students continue to attain basic performance levels in mathematics and reading, with greater lags in girls than in boys in some subjects.[62] In addition, in terms of early childhood development, despite the significant improvement in the coverage of services provided by the “Good Life” Early Childhood Centers, service quality is low.[63] On the other hand, the services provided by the itinerant program Creciendo con Nuestros Hijos [Growing with Our Children] have yielded more satisfactory results.[64]

3.39 In the area of health, progress has been less uniform than in other areas of social policy. From 2006 to 2015, infant mortality fell from 23.7 to 18.4 per 1,000 live births. However, it is still higher than in other countries in the region with similar income levels as Ecuador, such as Colombia (13.6 per 1,000 live births) and Peru (13.1 per 1,000 live births). In addition, maternal mortality is slowly declining, having gone from 47.7 to 44.6 per 100,000 live births between 2008 and 2015. Chronic malnutrition (or stunting) in children under five years of age has fallen from 33.5% in 2004 to 25.3% in 2015 but continues to be well above the levels in Colombia and Peru, respectively 14.9% and 18.4%.[65] Also worth noting is the fact that the incidence of chronic malnutrition in children of indigenous parents is almost 20 percentage points higher than the national average.

3.40 Since the current fiscal situation makes it difficult for social investment to continue to grow at the pace of recent years, the government should focus its efforts on improving quality, generating efficiencies, and protecting those investments that have been proven to yield high rates of return or have a significant redistributive component. There is ample room to continue to deepen the recent advances in student learning and enhance the quality of early childhood development services. To this end, it is essential to strengthen the governance of the social sectors and prioritize improving the profile of civil servants and the processes and practices they employ, in lieu of the emphasis on infrastructure that has prevailed in recent years. For example, classroom processes and insufficient knowledge of childhood development on the part of the sector’s professionals have been identified as some of the main factors contributing to the low performance level of the CIBV day-care centers.[66] In addition, the teacher training systems fail to put enough emphasis on

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[61] In the SERCE tests given in 2006, Ecuadorian students in the third and sixth grades placed substantially below the regional average in mathematics and reading comprehension performance, while in the TERCE tests they attained a performance level on a par with the Latin American average.

[62] Source: Carnero, Cruz-Aguayo, and Schady (2017).

[63] With regard to the quality of early childhood development services, see Rosero and Oosterbek (2011) and Araujo et al. (2015).

[64] Source: Leer, J., Lopez Boo, F., Perez Expósito, A., Powell, C. (2016). A Snapshot on the Quality of Seven Home Visit Parenting Programs in Latin America and the Caribbean. IDB Technical Note IDB-TN-1083. IDB, Washington, D.C.

[65] Source: Freire W.B., M.J. Ramírez-Luzuriaga, P. Belmont, M.J. Mendieta, M.K. Silva-Jaramillo, N. Romero, K. Sáenz, P. Piñeiros, L.F. Gómez, and R. Monge. 2014. “*Tomo I: Encuesta Nacional de Salud y Nutrición de la población ecuatoriana de cero a 59 años*.” National Statistics and Census Institute and Ministry of Public Health. ENSANUT-ECU.

[66] Source: Araujo, M.C., F. López-Boo, R. Novella, S. Schodt, and R. Tomé. 2015. “*La Calidad de los Centros Infantiles del Buen Vivir en Ecuador*.” Inter-American Development Bank, IDB-PB-248.

developing the teaching skills that really help in planning and implementing effective processes inside the classroom.

3.41 There is also room to fine-tune the targeting of certain public services, which in addition to generating efficiencies, could boost the impacts of these interventions. This is particularly true of early childhood development services, which are currently not targeted to the poorest households. At present, the enrollment rate in CIBVs is only slightly higher among the poorest quintiles of the population than among the rest; this is a problem, since the empirical evidence shows that the rates of return on early childhood investments rise when the investments are aimed at children with greater lags.[67] This targeting process should also take into account that fact that the likelihood of attending a CIBV is significantly lower for Afro-descendant and Montubio children than for Mestizo children, which suggests that these groups may require special attention.[68]

3.42 The unequal progress in health is partly due to the challenges posed by the sector's governance structure, arising from the Ministry of Public Health's insufficient capacity to fulfill its stewardship mandate and the persistent problems of coordination among participants both within the public network and between the public and private networks. The high avoidable hospitalization rates, higher than in other countries of the region, are also evidence of inefficient health spending and could be corrected through greater prevention and resolution capacity at the primary level of healthcare.[69] Lastly, it is worth noting that the health system does not yet have a mechanism to monitor and continuously improve the quality of processes, and there are no rigorous data on aspects such as the quality of services or the degree of patient satisfaction.

3.43 **Water and sanitation.** Between 2010 and 2014, national water system coverage increased from 80.4% to 86.4%, while sanitation coverage went from 64.5% to 73.1%. Despite this increase, there continue to be pronounced differences in coverage between urban and rural areas (95% vs. 74% in water, and 72% vs. 65% in sanitation). At the same time, certain ethnic groups have greater access to these services than others.[70] Another problem affecting the sector is that more than 70% of the wastewater is discharged without any type of treatment into water sources used for human consumption, creating serious environmental and social implications.

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[67] See Carnero and Heckman (2003) and Heckman (2006).

[68] Source: Hermida, P., S. Barragán, and J.A. Rodríguez. 2017. "*La educación inicial en el Ecuador: margen extensivo e intensivo*." Analitika Revista de Análisis Estadístico, Vol. 14 (2). The study shows that, unlike the case of Afro-descendant and Montubio children, indigenous children are more likely to attend a CIBV than Mestizo children.

[69] Source: Guanais, F., R. Gómez-Suárez, and L. Pinzón. 2012. "Series of Avoidable Hospitalizations and Strengthening Primary Health Care. Primary Care Effectiveness and the Extent of Avoidable Hospitalizations in Latin America and the Caribbean." Inter-American Development Bank. IDB-DP-266.

[70] Of Ecuadorians who define themselves as Mestizos, 89.2% have access to network-supplied water, compared to 82.9% of the indigenous population and 82.4% of Afro-descendants. Only 4.3% of Mestizos have no access to any type of sanitation, compared to 7.9% of Afro-Ecuadorians and 22.8% of the indigenous population.

3.44 It is estimated that an investment of approximately US$7.300 billion would be required to establish universal access to water and sanitation services.[71] The difficulty of mobilizing an amount of this size is accentuated by the country's fiscal situation; by the weakness of the existing preinvestment processes, itself a result of the insufficient institutional capacity of the municipios (which have jurisdiction) and of the Autoridad Única del Agua [Water Authority]; and by the fledgling participation of private enterprise in this area. The local management models are also problematic, as illustrated by the fact that only a small percentage of municipios collect water and sanitation fees in sufficient amounts to cover the operation and maintenance of the systems.[72]

3.45 **Housing.** There is work to be done in terms of housing, since it is estimated that the housing deficit affects nearly half of the country's households (41% in urban areas and 66% in rural areas).[73] In the urban environment, approximately 10% of households are affected by a quantitative deficit, while 31% of households suffer from a qualitative deficit. This problem is aggravated by the significant imbalance between housing demand and supply in Ecuador. Between 2010 and 2016, around 105,000 new households were created per year, while only 76,000 formal housing units were completed per year. In addition, it is estimated that more than 2 million homes are located in at-risk areas, including climate change- and natural disaster-related hazards.[74] Therefore, there is a need to foster access to a safer and more sustainable habitat for a large number of Ecuadorian families.

3.46 The housing deficit hits lower-income households harder. Six of every 10 households belonging to the lowest income quintile have some housing deficit, while in the wealthiest quintile of the population this ratio decreases to less than 2 of every 10 households.[75] At the same time, low-income households allocate a much higher proportion of their earnings to housing expenses than higher-income households.[76] The current system of housing incentives fails to mitigate this problem, in part because it is not well targeted: subsidies do not efficiently serve the poorest quintiles of the population, while benefiting households with sufficient payment capacity to find solutions in the commercial housing market.[77]

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[71] Source: SENAGUA. 2016. "*Estrategia Nacional de Agua y Saneamiento (ENAS)*." The need to invest in the sector would be even greater if it included investments in wastewater treatment in Quito, Guayaquil, and Cuenca, as well as safe access to water and sanitation, which is the new sector approach at the international level according to the Sustainable Development Goals.

[72] As reported by the ENAS, only 35% of providers managed to cover at least 60% of their administration, operation, and maintenance expenses by collecting fees for their services.

[73] MIDUVI (2015). National Report on Ecuador: Habitat III - Third United Nations Conference on Housing and Sustainable Urban Development. Quito.

[74] Ibid.

[75] Bouillon, C.P. (2012). Room for Development: Housing Markets in Latin America and the Caribbean. Washington D.C.: IDB.

[76] Tenant households with an income of less than 0.5 Unified Basic Salaries (SBU) allocate 45.1% of their income to housing expenses, while this proportion falls to 11.6% for households earning two to four SBUs and merely 5.2% for households with an income of at least eight SBUs. Owner households with an income of less than 0.5 SBU allocate 33.9% of their income to housing expenses, compared to 10.9% in the case of households earning more than eight SBUs (Source: author's calculations based on the Quality of Life Survey).

[77] Source: Marcano, L. 2010. *La política de vivienda social y su impacto en el bienestar: el caso de Ecuador*. Inter-American Development Bank.

3.47 **Proposed actions.** In the social area, the IDB Group will support: (i) improving agricultural productivity and the welfare of the rural population through the provision of public goods and services and the support of IDB Invest for the development of climate-smart agriculture and access to financing for small producers under value chain arrangements; (ii) improving the management and quality of social services, particularly education, healthcare, and early childhood development, including improving the skills of the human talent that provides services to users and continuously improving processes; (iii) improving the targeting and coverage of social expenditure, paying special attention to the indigenous population, Afro-Ecuadorians, girls, and adolescents; (iv) strengthening the preinvestment and investment processes for water and sanitation projects at the subnational and central government levels, ensuring financial and institutional sustainability; and (v) reducing the housing deficit.

3.48 The proposed actions in this strategic area contribute to the following objectives of the Update to the Institutional Strategy 2010-2020: eradicate extreme poverty; provide inclusive infrastructure and infrastructure services; develop quality human capital; provide urban planning and rural infrastructure; and address the economic and social impacts of climate change adaptation and mitigation. These initiatives also contribute to the strategic priorities of the IDB Invest 2017-2019 Business Plan of supporting the development of infrastructure, including energy and water and sanitation; the priority area of agroindustry; and establishing partnerships with financial intermediaries and value chains to work in the priority areas of action, such as social mobility for vulnerable groups.[78]

D. Crosscutting themes and areas of dialogue

3.49 The topics of: (i) gender and diversity; (ii) natural disaster risk management and climate change; and (iii) strengthening of the institutional capacity of local counterparts will be addressed as crosscutting issues.

3.50 The Bank will try to include a **gender and diversity perspective**, particularly in interventions related to the areas of deepening social advances and productivity and the private sector. It has already been emphasized at various points in this document that Ecuador's social indicators show gaps between ethnic groups that should be taken into account in the design of interventions to be supported by the Bank. Despite the absence of noticeable gender differences in many of these social indicators, women continue to have lower workforce participation rates, higher underemployment, and lower salaries than men.[79] This gender gap in the job market will be taken into account as a crosscutting issue in the design of Bank operations,

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[78] These proposed actions are also aligned with the approves 2018 Business Plan Update (document CII/GA-77-4).

[79] At year-end 2016, women's workforce participation rate was 54.8%, compared to 80.6% for men. Along the same lines, the underemployment rate was 20.4% for women and 19.1% for men.

following past practice in the energy and modernization of the State sectors and in the private sector area through both the MIF and IDB Invest.[80]

3.51 In addition, it is estimated that six out of 10 Ecuadorian women have been victims of gender violence at some point in their lives, more than 3.2 million women have suffered some form of violence by virtue of being women, and one in four women has been the victim of sexual violence.[81] It should also be noted that teen pregnancy rates are high, due in part to the high incidence of gender-related domestic violence and in part to the initiation of sexual activity without information.[82] To address this problem, the Bank will seek to support the legal and institutional development of the comprehensive national system to prevent and eradicate violence against women.[83]

3.52 As evidenced by the 7.8-magnitude earthquake that affected the country's north coast on 16 April 2016, Ecuador is a high-risk country due to its exposure to natural disasters.[84] In addition, the country is highly exposed to the consequences of climate change, mainly the effects on rainfall patterns and marine currents.[85] For this reason, **disaster risk management and climate change** is included as a crosscutting area of this country strategy.

3.53 As an illustration of how a crosscutting approach can be applied to these sectors, in the public-finance strengthening area the Bank will consider that ex ante investments tend to be more cost-effective than ex post expenditures, thus justifying the maintenance and deepening of risk management and adaptation investment programs even in a context of fiscal consolidation. In addition, the Bank could

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80 For example, in the context of operation EC-L1223, the Bank contemplated implementing an action plan to promote gender equity in the various entities that make up the energy sector. The civil registry operation financed the delivery of more than 7.7 million identification documents to women, facilitating their entry into the labor market. In addition, support programs for the renewal of human resources in the State have made it possible for women to account for more than 50% of the teachers who entered the civil service. In the private sector area, the gender equality tool has been promoted at 75 companies in the 2016 edition, and at 91 companies in the 2017 edition, applying the Women's Empowerment Principles in partnership with UN Women and the Global Compact. Another initiative promoted by the IDB in Ecuador is the Women's Training Program for Corporate Governance and Senior Management (a joint initiative with the IDE Business School), which has been implemented since 2015 in Quito and Guayaquil and in which nearly 240 women have participated. The Bank has also supported the initiative "El talento no tiene género" [talent has no gender] and promoted the signing of the "Pacto Empresarial" [Business Compact], an agreement under which the private sector undertakes to ensure gender equality and promote inclusion and equal opportunities for men and women.

81 Source: *Encuesta Nacional de Relaciones Familiares y Violencia de Género contra las Mujeres* [National Survey of Family Relationships and Gender-based Violence against Women] (2011).

82 Of births in Ecuador in 2015, 20.2% were from mothers aged 15 to 19, and 0.8% from mothers aged 10 to 14.

83 According to the Comprehensive Organic Law on Preventing and Eradicating Violence against Women, approved in February 2018, this system is defined as an organized and coordinated set of institutions, provisions, policies, plans, programs, mechanisms, and activities aimed at preventing and eradicating violence against women through comprehensive prevention, care, protection, and redress regarding the violation of the victims' rights.

84 Ecuador is ranked 61st out of 171 countries in the World Risk Index developed by the United Nations University and is therefore considered a high-risk country. The World Risk Index combines a series of variables that capture a country's exposure to earthquakes, storms, floods, droughts, and sea-level rises, as well as the social, economic, and ecological conditions influencing a country's potential damage from these natural hazards.

85 According to an index developed by the Center for Global Development, Ecuador is ranked 64th out of 233 states in terms of the magnitude of potential adverse impacts of climate change (Wheeler, 2011).

continue to explore reinforcing the contingency mechanisms, which have proven to be key in expediting the normalization of public services as well as in expediting the normalization of productive and social activities after a disaster. In the social and productive areas, the Bank will take the estimated impact of disasters into account and incorporate this into the planning and implementation of social and economic activities. Similarly, the additional impact of climate change will also be considered, particularly the effects of global warming, especially in rural areas and the agricultural sector. Lastly, interventions supporting the housing sector will consider the need to promote access to a safe and sustainable habitat for the population, reducing household vulnerability to climate change- and natural disaster-related hazards.

3.54 **Dialogue areas.** In recent years, Ecuador has made significant efforts to reduce violence, lowering homicide rates over the 2008-2016 period from 18.9 to 5.9 per 100,000 inhabitants. Similarly, robbery rates have declined in the last two years. However, victimization has grown steadily, while security-related business spending and losses exceed the regional average. The Bank will engage in a dialogue with the country regarding citizen security, focused mainly on improving the quality of public expenditure in this sector. Another area of dialogue will center on support for articulating an effective productive development policy based on mechanisms for dialogue and collaboration with the private sector and stakeholders in the popular and solidarity-based economy. Lastly, the strengthening of the national innovation system through improvements in public institutions and promotion of private research and development is included as a dialogue area under this strategy.

IV. ESTIMATED LENDING FRAMEWORK

4.1 According to the 2018-2021 four-year budget plan, the central government's projected gross funding needs for the coming years will continue to be high, although on a downward trend, declining from close to US$9.900 billion in 2018 to US$5.600 billion in 2021. The government is likely to cover these needs through various means, including the issuance of bonds in international markets, domestic placements to be acquired primarily by public entities (Ecuadorian Social Security Institute), and financing from bilateral and multilateral lenders. Following the country's return to the international financial markets in June 2014, sovereign bond issues have become the State's principal source of financing.

4.2 The estimated demand scenario for sovereign financing assumes average annual approvals of US$500 million or US$2.000 billion for the 2018-2021 period. This level of approvals, together with the expected disbursements, is consistent with the government's fiscal consolidation and indebtedness strategy and would allow the Bank to maintain a share of the country's multilateral debt of close to 55% and a share of total debt of approximately 10%. Net lending flows are projected to be positive throughout the strategy period. To achieve this approvals level, the Bank will emphasize technical support in the strategic areas.

V. STRATEGY IMPLEMENTATION

5.1 **Coordination within the IDB Group.** Coordination among the IDB, IDB Invest, and the MIF will observe the following parameters: (i) joint implementation of this strategy; (ii) planning of joint engagement missions with the authorities, especially in areas that require policy reforms and/or show evident synergies for collaborative work; (iii) organization of joint dissemination activities; (iv) maximization of operational synergies; and (v) joint knowledge products that are relevant for operational dialogue with clients.

5.2 **Donor coordination.** The Bank foresees close collaboration with: (i) multilateral banks (World Bank, CAF, and European Investment Bank) for the Quito Metro project; (ii) the European Investment Bank for the Government Platform for Social Development project; (iii) the Korea Trade-Investment Promotion Agency (KOTRA) and the Japan International Cooperation Agency (JICA) in the energy sector; (iv) the French Development Agency (AFD), the Spanish Agency for International Development Cooperation (AECID), and the World Bank in the water and sanitation sector.

5.3 **Country systems.** At present, the Bank fully uses the budget, treasury, and information procurement subsystems. The accounting and reports, shopping (standard goods and services), partial national competitive bidding, and advanced national competitive bidding subsystems are used on a partial basis. Over the strategy period, the Bank expects to support the government on fiduciary management initiatives related to: (i) improvements in the budget preparation and execution processes; (ii) improvements in Single Treasury Account processes and controls; (iii) generation of timely, quality financial information allowing proper accountability; (iv) improvements in the interoperability of the new Integrated Financial Information System (SIIF) with other government software; (v) convergence toward International Public Sector Accounting Standards; (vi) update of technical audit standards for the Office of the Comptroller General, improvements in its auditing processes and the interoperability of its systems, etc.

5.4 In addition, the Bank expects to support the government in: (i) optimizing the software tools and improvements of the Sistema Oficial de Contratación del Estado [Official State Procurement System] (SOCE); (ii) management of procurement control; (iii) standardizing supervision criteria for procurement procedures; (iv) defining guidelines and mechanisms to address reports of violations or complaints; (v) the skill certification program for civil servants in government procurement; and (vi) improving the preparation of reference budgets, time frames, experience requirements and conditions, and other aspects of precontracting procedures aimed at optimizing the use of resources in the country's projects. These interventions seek to boost the institutional capacity of the government and improve the quality, transparency, and timeliness of information and accountability in line with objectives of the Government of Ecuador's National Development Plan.

5.5 The following table summarizes the level of use of the country fiduciary systems as of 31 December 2017:

System	2017 baseline	2021 estimated use	Planned actions
Budget	100%	100%	Initiatives focused on improving the budget preparation and execution processes
Treasury	100%	100%	Initiatives focused on improving Single Treasury Account processes and controls
Accounting and reports	40%	50%	Initiatives aimed at generating financial reports on projects in the new SIIF
Internal audit	0%	0%	No actions are planned
External control	0%	0%	Improvements in the regulatory framework, processes, and interoperability of systems
Information system	100%	100%	No actions are planned
Individual consulting	0%	0%	No actions are planned
Shopping (standard goods and services)	19%	25%	Promote the use of the Sistema Nacional de Contrataciones Públicas [National Public Procurement System] (SNCP) in new operations
Partial NCB	19%	25%	Promote the use of the SNCP in new operations
Advanced NCB	19%	25%	Promote the use of the SNCP in new operations

VI. RISKS

6.1 **Macroeconomic risks:** As underscored earlier in this document, the public finances of Ecuador are in a delicate situation. Even assuming the launch of a fiscal consolidation process, the country's gross financing needs over the coming years are high. There is a risk that the public sector will face problems in covering these needs, potentially forcing the authorities to make sharp cuts in fiscal spending or accumulate arrears with suppliers. If a scenario of this nature were to materialize, it could bring about another economic recession, as occurred in the quarters following the oil shock of 2014. In view of this, the choice of the three priority areas under this country strategy is linked to the macroeconomic challenges faced by the country (see paragraph 3.1). To minimize these risks, the IDB Group's efforts are aimed at strengthening the country's public finances, fostering a change in the pattern of economic growth in favor of a more prominent role for the private sector, and supporting social programs that target vulnerable population groups. In addition, the Bank will closely monitor the aforementioned risks by means of the macroeconomic monitoring instruments at its disposal.

6.2 **Natural disaster risks:** The devastating earthquake that struck the province of Manabí in April 2016 showed once again that Ecuador is highly exposed to natural hazards and that this exposure is aggravated by the country's vulnerability to the effects of global warming. If a large-scale natural disaster were to take place during the new strategy period, it could have adverse effects on the Ecuadorian development process, lead to shifts in government priorities, and affect the execution of Bank-financed projects. To mitigate this risk, disaster risk management and climate change were included as a crosscutting area in this country strategy. Thus, the Bank will try to ensure that the operations approved during the new strategy period incorporate and/or consider disaster risk reduction measures. In addition, the Bank will continue its ongoing dialogue with the authorities on how to further strengthen the political, institutional, and community framework and improve the performance of disaster risk management, which was very relevant during the execution of the previous strategy.

6.3 **Execution risks:** The frequent turnover of officials gives rise to institutional weakness at some of the executing agencies involved in Bank-financed operations, which is another risk faced in executing the Bank's portfolio in Ecuador. To mitigate this risk, the Bank will emphasize both the monitoring of operations through a continuous portfolio review system and maintaining a close dialogue with the Ministry of Economy and Finance through its focal point. In addition, the Bank's own resources will be used to provide technical support for the execution of specific projects that show weaknesses in the respective execution units.

6.4 Non-sovereign guaranteed operations face additional risks: (i) market fluctuations associated with the demand for financing of business investment projects; and (ii) the confluence of market failures reinforcing a period of low productivity and limited investment. These risks mean that the origination and execution of private-sector operations could encounter various obstacles capable of hindering IDB Group support to businesses. To mitigate the execution risks for non-sovereign guaranteed operations, IDB Invest will seek to strengthen the management capacity of its direct clients as well as of the clients of the financial institutions it supports. In addition, with a view to better meeting the needs and expectations of its clients in Ecuador, IDB Invest will focus on opportunities that show the greatest bankability while at the same time closing priority development gaps.

ANNEX I: RESULTS MATRIX

Government priority	Priority areas	Strategic objective	Expected outcomes	Indicators	Baseline, source, and year
Consolidate the sustainability of the social and solidarity-based economic system and reinforce dollarization	Strengthening of public finances	Mitigate the fiscal risk associated with oil price volatility	Boost nonoil public revenue	NFPS tax revenue as a percentage of GDP	14% (BCE, 2017)
		Generate efficiencies and increase the quality of public expenditure	Boost government effectiveness	Governmental effectiveness (percentile range)	38.5 (Worldwide Governance Indicators, 2016)
		Increase the private share of investment in infrastructure and other public goods	Reinforce the PPP framework	Infrascopio index	40/100 (Economist Intelligence Unit, 2018)
			Increase private investment in public infrastructure	Amount of committed investment in public infrastructure that has achieved financial closing during the year and includes private investment	US$776.4 million (World Bank, Private Participation in Infrastructure Database, 2016)
		Move forward on Ecuador's energy reform	Shift away from fossil fuel consumption in favor of renewable energy sources	Fossil fuel consumption as a percentage of total energy consumption in the industrial, commercial, and residential sectors	52% (Ministry of Electricity and Renewable Energy, 2015)
Boost productivity and competitiveness for redistributive and solidarity-based sustainable economic growth	Productivity and private sector	Boost the contribution of private investment and productivity to economic growth	Improve the investment climate	Global Competitiveness Index	3.9 (World Economic Forum, 2017)
		Facilitate access to investment financing	Increase credit to the private sector	Credit to the private sector as a percentage of GDP	28% (BCE, 2017)
		Foster access to export markets	Boost nonoil exports	Nonoil exports as a percentage of GDP	12.1% (BCE, 2017)
			Improve logistics performance	Logistics Performance Index	2.78 (World Bank, 2016)

Government priority	Priority areas	Strategic objective	Expected outcomes	Indicators	Baseline, source, and year
Ensure a life of dignity with equal opportunities for all citizens	Deepening of social advances	Improve the management and quality of social services	Improve learning among Ecuadorian students	Percentage of students in the fourth grade of general basic education with insufficient learning in language and literature	22.5% (INEVAL, 2017)
				Percentage of high school students with insufficient language fluency	13.5% (INEVAL, 2017)
			Improve the health of the Ecuadorian population	Maternal mortality rate	64 per 100,000 live births (World Development Indicators, 2016)
				Infant mortality rate	17.8 per 1,000 live births (World Development Indicators, 2016)
		Foster access to housing	Reduce the housing deficit	Quantitative housing deficit	22.2% (Quality of Life Survey, INEC, 2014)
				Qualitative housing deficit	35.7% (Quality of Life Survey, INEC, 2014)
		Improve and increase the provision of agricultural public goods and services	Reduce the poverty rate of the rural population engaged in agriculture	Income poverty rate of the rural population engaged in agriculture	44.4% (ENEMBDU, 2017)
			Increase the earnings of the rural population engaged in agriculture	Per capita income of the rural population engaged in agriculture	US$3,195 (ENEMBDU, 2017)
		Strengthen and support water and sanitation investment projects	Increase access to safely managed drinking water services	Percentage of the population that uses safely managed water services	74.4% (JMP, 2015)
			Increase access to safe sanitation services	Percentage of the population that uses safely managed sanitation services	42.4% (JMP, 2015)

COUNTRY SYSTEMS MATRIX

Strategic objective	Expected outcome	Indicator	Measurement unit	Baseline	Base year	Main objective	Time distribution	CRF alignment
Increase the use of country systems	Increased use of the accounting and reports subsystem	Outstanding portfolio using the accounting and reports subsystem	Percentage of the outstanding portfolio	40%	2017	50%	End of strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality
	Increased use of the procurement subsystem	Outstanding portfolio using the shopping subsystem	Percentage of the outstanding portfolio	19%	2017	25%	End of strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality
		Outstanding portfolio using the partial NCB subsystem	Percentage of the outstanding portfolio	19%	2017	25%	End of strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality
		Outstanding portfolio using the advanced NCB subsystem	Percentage of the outstanding portfolio	19%	2017	25%	End of strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality
Strengthening of country systems	Closing of gaps with international standards (IPSAS)	Progress on the IPSAS implementation plan	Percentage of progress on the IPSAS implementation plan	5%	2017	35%	End of strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality
	Updating of the CGE technical rules	Technical rules updated	Technical rules updated	0	2017	1	End of strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality

	Updating of the SOCE software tools	Software tool updated	Software tool updated	0	2017	1	End of strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality
Improve the operational efficiency of the Bank portfolio	Implementation of the new integrated financial information system	Integrated financial information system implemented	Integrated financial information system implemented	0	2017	1	End of strategy period	- Institutional capacity and rule of law - Productivity and innovation - Social inclusion and equality

ANNEX II: ESTIMATED SOVEREIGN DEBT SCENARIO

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Average 2018-2021	Total 2018-2021
Approvals	498.8	350.0	495.0	946.0	580.0	482.3	460.0	500.0	500.0	500.0	500.0	500.0	2,000.0
Disbursements	393.7	330.2	372.2	460.7	1,296.1	570.1	335.8	463.6	359.2	323.8	384.4	382.7	1,531.0
Repayments	147.1	155.0	156.5	167.4	157.9	166.3	191.1	272.5	269.6	254.9	229.1	256.5	1,026.1
Net flows	246.5	175.2	215.6	293.4	1,138.1	403.8	144.7	191.1	89.6	68.9	155.3	126.2	504.8
Subscriptions and contributions	10.3	2.3	11.0	2.9	0.0	4.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net loan flow	236.3	172.9	204.6	290.5	1,138.1	399.1	144.7	191.1	89.6	68.9	155.3	126.2	504.8
Interest and charges	76.9	74.5	73.6	72.6	79.3	112.9	119.6	133.5	127.5	129.1	132.0	130.5	522.1
Net cash flow	159.3	98.4	131.0	217.8	1,058.9	286.2	25.1	57.6	-37.9	-60.2	23.3	-4.3	-17.3
IDB debt	2,330	2,503	2,714	3,046	4,204	4,640	4,785	4,976	5,066	5,134	5,290	5,116	
Multilateral debt	5,292	5,866	6,014	6,560	7,928	8,247	8,714	9,000	9,189	9,362	9,627	9,294	
External debt	10,055	10,872	12,920	17,582	20,225	25,679	30,645	34,694	38,301	41,435	44,682	39,778	
Total debt	14,562	18,652	22,847	30,140	32,771	38,137	45,607	47,887	49,898	51,706	53,383	50,718	
IDB debt/ Multilateral debt (%)	44.0%	42.7%	45.1%	46.4%	53.0%	56.3%	54.9%	55.3%	55.1%	54.8%	54.9%	55.1%	
IDB debt / External debt (%)	23.2%	23.0%	21.0%	17.3%	20.8%	18.1%	15.6%	14.3%	13.2%	12.4%	11.8%	12.9%	
IDB debt/ Total debt (%)	16.0%	13.4%	11.9%	10.1%	12.8%	12.2%	10.5%	10.4%	10.2%	9.9%	9.9%	10.1%	

Notes: (i) Future disbursements are approximated on the basis of projections of existing portfolio operations and assuming that new operations are disbursed in line with the country curve according to Convergence; (ii) an interest rate of 3.5% is assumed for the strategy period; (iii) the sovereign debt set forth in this table is aggregate debt, which unlike consolidated debt includes central government liabilities with other public institutions, such as the Ecuadorian Social Security Institute (IESS); (iv) the fiscal balance projections used for arriving at the aggregate debt projection were obtained from the IMF (October 2017 WEO), assuming (as the IMF does) that the deficit will be financed with external rather than domestic debt and thereby bringing domestic debt in line with the amortizations estimated for each year of the projection; and (v) the multilateral debt is projected assuming that the CAF and IFAD exposure increases by 2% per year; that the World Bank exposure increases by 10% per year; and that the FLAR exposure remains constant at the 2011-2016 average.

ANNEX III: SOCIAL AND ECONOMIC INDICATORS

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Social indicators											
Population (millions)	14.2	14.5	14.7	15.0	15.3	15.5	15.8	16.0	16.3	16.5	16.8
Life expectancy at birth (years)	74.5	74.7	74.8	75.0	75.2	75.4	75.6	75.9	76.1		
Adult literacy (%)	84.2		84.2	91.9	91.6	92.1	93.3	94.2	94.5	94.4	
Unemployment (%)	5.0	6.0	6.5	5.0	4.2	4.1	4.2	3.8	4.8	5.2	4.6
Adequate employment (%)	43.2	44.8	39.2	44.7	45.5	46.5	47.9	49.3	46.5	41.2	42.3
					(Percentage change or as otherwise indicated)						
Production and prices											
Real GDP	2.2	6.4	0.6	3.5	7.9	5.6	4.9	4.0	0.2	-1.5	1.5 (p)
CPI (average)	2.3	8.4	5.2	3.6	4.5	5.1	2.7	3.6	4.0	1.7	0.4
CPI (end of period)	3.3	8.8	4.3	3.3	5.4	4.2	2.7	3.7	3.4	1.1	-0.2
External sector											
Exports	13.7	33.9	-19.8	34.3	17.4	5.0	6.1	2.4	-21.4	-18.9	13.2 (p)
Imports	14.7	29.5	-25.2	22.9	27.2	7.5	2.7	5.1	-27.7	-8.8	7.4 (p)
Current account balance (% GDP)	3.7	2.9	0.5	-2.3	-0.5	-0.2	-1.0	-0.5	-2.1	1.5	
International reserves (US$ billio	3.5	4.5	3.8	2.6	3.0	2.5	4.4	3.9	2.5	4.3	2.5
Monetary sector											
Monetary liquidity (M2)	16.0	22.6	8.2	19.4	19.7	16.4	13.4	14.4	-1.1	16.5	8.8
Credit to private sector	11.9	27.3	-2.5	22.6	22.2	14.9	9.0	10.9	-6.3	6.5	22.1
					Percentage of GDP						
Nonfinancial public sector											
Total revenues	26.7	35.8	29.4	33.3	39.3	39.3	39.2	38.4	33.8	30.7	32.6
Oil revenues	6.5	14.0	8.3	11.3	16.3	13.9	12.0	10.7	6.4	5.5	5.8
Primary expenditures	15.9	22.8	21.7	23.7	27.0	27.0	27.3	27.5	26.3	25.4	26.1
Primary balance	2.7	0.6	-3.6	-1.4	-0.1	-0.2	-3.5	-4.2	-3.8	-5.8	-3.2
Overall balance (deficit: -)	4.4	1.7	-3.0	-0.8	0.5	-0.9	-4.6	-5.2	-5.1	-7.4	-5.4
Debt											
Total external debt	34.2	27.5	21.7	20.1	19.3	18.2	19.7	23.7	28.0	34.4	
Aggregate public debt	27.2	22.2	16.3	19.2	18.4	21.2	24.1	29.6	32.7	39.0	45.9
Domestic	6.4	5.9	4.5	6.7	5.7	8.8	10.5	12.4	12.5	12.7	14.7
External	20.8	16.3	11.8	12.5	12.7	12.4	13.6	17.2	20.2	26.3	31.2
Memo items											
Nominal GDP (US$ billions)	51.0	61.8	62.5	69.6	79.3	87.9	95.1	101.7	99.3	98.6	100.5 (p)
GDP per capita (US$)	3588.3	4267.5	4241.9	4633.2	5192.9	5664.9	6030.5	6347.0	6099.4	5966.2	5988.7

(p) BCE forecast; Note: in its latest update, the IMF estimates 2017 growth at 2.7%.
Source: BCE, INEC, Ministry of Economy and Finance, World Bank, IMF.

ANNEX IV: MANAGEMENT'S RESPONSE TO COUNTRY PROGRAM EVALUATION: ECUADOR 2012-2017

OVE recommendation	Management's response
Recommendation 1:	**Agree.**
Support proposals by the Government of Ecuador that facilitate consolidation of the public finances. Specifically, and based on the new government's policy choices, the Bank could support initiatives aimed at developing a fiscal responsibility framework. The IDB could support sector proposals that improve the efficiency of public spending, prioritizing interventions to improve service quality. The IDB could also place greater emphasis on the sustainability of investments, including mechanisms to ensure the operation and maintenance of infrastructure works.	The country development challenges (CDC) document that informs the Bank's strategy with the country finds that Ecuador faces challenges in terms of strengthening its public finances. Addressing this challenge is a priority for ensuring the sustainability of its public debt. Based on this diagnostic, in the framework of dialogue with the country to prepare the 2018-2021 strategy, the IDB Group will try to promote initiatives that help strengthen the country's fiscal position. Also, to mitigate the impact of the fiscal consolidation process on the government's capacity to provide public goods and services, the Bank will offer the government the opportunity to prioritize the programs and policies that generate efficiencies. These efforts will be particularly important in the realm of social policies, to minimize the risk that a difficult macroeconomic environment could partially reverse the gains made in reducing poverty in recent years. To mitigate the risk that, in a context of fiscal austerity, the State might fail to invest enough to maintain its assets, thus accelerating the rate of depreciation and generating losses for the country, the IDB Group will continue, in its dialogue with the government, to emphasize the sustainability of the investments the country has made in recent years. In this regard, the Bank recently approved a technical operation project to strengthen the system for managing government assets.
Recommendation 2:	**Agree.**
Seek opportunities to support private sector development in areas that enhance competitiveness and accelerate the diversification of production. In particular, the Bank could support the implementation of government-led reforms to improve the business climate and the environment for production. The Bank could also assist the government in defining its strategies for financing through public-private partnerships, supporting disciplined management of the fiscal risks associated with these operations, as well as their alignment with sector policies.	In line with this recommendation, in the framework of dialogue with the government on preparing the 2018-2021 Strategy, the IDB Group will emphasize the importance of supporting the development of the private sector, which the CDC identifies as one of the country's main development challenges. The IDB Group will emphasize its willingness to support Ecuador in: (i) improving the investment climate; (ii) mitigating the obstacles that prevent the country's businesses from participating more actively in international markets; and (iii) articulating a policy for productive development and support for

OVE recommendation	Management's response
Lastly, the private sector windows should continue financing the nonoil (exporting) productive sector with a view to furthering the diversification of production.	effective innovation. For their part, IDB Invest and the MIF will be key instruments for business development, especially in sectors with export potential. The dialogue with the new government has already identified a number of actions that would be in line with this recommendation. In September 2017, the IDB Group began working with the Ministry of Industries and Productivity to identify critical elements for redesigning productive development policy.
Recommendation 3:	**Agree.**
Continue strengthening the capacities of subnational entities. The Bank has invested significant amounts of resources to support the institutional capacity of subnational governments in the sectors that fall under their remit. Accordingly, OVE recommends that new mechanisms should be explored in the future to continue to support these governments in their efforts to improve delivery and funding of the social and production-related services for which they are responsible.	Management agrees on the importance of bolstering the capacities of subnational governments, especially considering that they are responsible for some policy areas that are priorities as far as the development challenges facing the country, such as fiscal challenges and productive development. The IDB Group's support modalities in this area will be defined based on dialogue with the government in the framework of preparation of the new strategy. However, the country's fiscal context could mean that support will be focused on the central government.

ANNEX V: DEM

COUNTRY STRATEGY: DEVELOPMENT EFFECTIVENESS MATRIX

In August 2008, the Board of Directors approved the Development Effectiveness Framework (GN-2489) to increase the evaluabiliy of all Bank development products.

The Development Effectiveness Matrix for Country Strategies (DEM-CS) is a checklist of the elements that are necessary to evaluate a country strategy. It is based on the evaluation criteria developed by the Evaluation Cooperation Group of the Multilateral Development Banks in the "Good Practice Standards for Country Strategy and Program Evaluation."

COUNTRY STRATEGY

STRATEGIC ALIGNMENT
Refers to the degree to which the design and objectives of the CS are consistent with the country development challenges and with the government's development plans and priorities.
EFFECTIVENESS
This measures whether the country strategy is likely to achieve its intended objectives, through an examination of three dimensions: (i) the quality of the diagnostics on which Bank action is based in each area of work; (ii) the quality of the results matrix for the strategy; (iii) the use and build up of country systems.

Effectiveness dimensions	
I. Country Diagnosis - Country Development Challenges (CDC)	Yes/No
- The CDC cleary identifies the main development challenges prioritized by the EBP	Yes
- The CDC's main development challenges are based on empirical evidence	Yes
II. CS Priority Areas Diagnostics**	%
- identify the **priority area's** main contraints and challenges	100%
- identify the **main factors/**causes contributing to the specific constraints and challenges	100%
III. Results matrix*	%
- The strategic objectives are clearly defined	100%
- The expected outcomes are clearly defined	100%
- The strategic objectives and expected results are directly related to the main constraints identified in the Diagnosis	100%
- The indicators are outcome indicators and are SMART	100%
- The indicators have baselines	100%
IV. Vertical logic	
- The CS** has vertical logic	Yes

* The Results Matrix is composed by indicators that are meaningful to, and capture progress towards, the expected results. The expect results stem from the strategic objectives.

** CS includes the CDC

CS Diagnostic:
As part of the country strategy a country development challenges diagnostic was presented (see CDC annex). The CDC diagnostic is comprehensive and based on empirical evidence.The CDC diagnostic identifies 3 priority areas for the Bank's intervention public finances, social progress and productivity/private sector development.

-The diagnostic clearly identifies and dimensions, based on empirical evidence, of priority area's specific contrains and challenges.
-The diagnostic clearly identifies and dimensions, based on empirical evidence, the main factors or causes contributing to the specific constrains and challenges for the priority areas.
-The diagnostic provides policy recommendations for Bank actions, that are based in empirical evidence.

Results matrix: The section of the results matrix corresponding to the new strategic area includes 11 strategic objectives for Bank action, 16 expected results and 16 indicators to measure progress.

100% of the Strategic Objective(s) are clearly specified.
100 % of the expected result(s) are clearly specified.
100% CS Objectives are directly related to the main constraints identified in the Diagnosis.
100% of the indicators used are SMART.
100% of the indicators have baselines.

Country Systems: Diagnostics were performed for all financial management sub-systems. We will continue to use 100% of the sub-systems of budget and treasury, partly the sub-system of accounting and the reports, and we expect to work on strengthening internal and external control sub-systems. In terms of procurement, there is a diagnosis of the information system available; We are expected to work on strengthening all procurement sub-systems.

The CS has vertical logic.

RISKS. *The main risks facing the implementation of the EBP are related to: (i) the macroeconomic situation and the possibility that the government does not manage to cover its financing needs; (Ii) the natural disasters risk; and (iii) - weak management of some of the Executing Agencies for the implementation of investment projects. The CS identifies specific mitigation and monitoring measures for each risks.*