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Report No: PD000125

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A

PROPOSED LOAN

IN THE AMOUNT OF US$700 MILLION TO

REPUBLIC OF ECUADOR
FOR THE

Ecuador Carbon-Conscious Fiscal and Growth Development Policy Financing

July 3, 2024

Macroeconomics, Trade, and Investment
Latin America and Caribbean

Republic of Ecuador

GOVERNMENT FISCAL YEAR

January 1–December 31

CURRENCY EQUIVALENTS

Currency Unit

US$1.00

ABBREVIATIONS AND ACRONYMS

BCE	Central Bank of Ecuador (*Banco Central del Ecuador*)
BDH	Human Development Bonus (*Bono de Desarrollo Humano*)
CAF	Development Bank of Latin America
CPF	Country Partnership Framework
DPF	Development Policy Financing
EFF	Extended Fund Facility
e-SIGEF	*Sistema Integrado de Gestión Financiera*
GAD	*Gobierno Autonomo Decentralizado,* Subnational Government
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GoE	Government of Ecuador
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
IFI	International Finance Institution
IMF	International Monetary Fund
IPF	Investment Project Financing
LDP	Letter of Development Policy
MAG	Ministry of Agriculture and Livestock (Ministerio Agricultura y Ganadería)
MAATE	Ministry of Environment and Water and Ecological Transition (*Ministerio del Ambiente, Agua y Transición Ecológica*)
MEF	Ministry of Economy and Finance (*Ministerio de Economía y Finanzas*)
MEM	Ministry of Energy and Mines (*Ministerio de Energía y Minas*)
MIES	Ministry of Economic and Social Inclusion (*Ministerio de Inclusión Económica y Social*)
MRV	Measurement, Reporting and Verification
MSP	Ministry of Public Health (*Ministerio de Salud Pública*)
MW	Megawatt
NAP	National Adaptation Plan
NCRE	Non-Conventional Renewable Energy
NDP	National Development Plan
NFPS	Non-Financial Public Sector
PA	Prior Action
PDO	Program Development Objective
PFM	Public Financial Management
PLR	Performance and Learning Review
PPP	Public-Private Partnership
RI	Result Indicators
SDR	Special Drawing Rights
SCD	Systematic Country Diagnostic
SOE	State-Owned Enterprise
SNP	National Secretariat for Planning (*Secretaria Nacional de Planeación*)
STA	Single Treasury Account
WB	World Bank
WBG	World Bank Group
VAT	Value-Added Tax

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REPUBLIC OF ECUADOR

Ecuador Carbon-Conscious Fiscal and Growth Development Policy Financing

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The team appreciates the excellent collaboration with the Government of Ecuador. It acknowledges the coordination efforts of the Ministry of Economy and Finance, and the valuable support of Paula Suarez Buitron, Advisor to the Executive Director.

SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Operation ID	Programmatic
P505747	No

Proposed Development Objective(s)

The Program's Development Objective (PDO) is to support reforms by the Government of Ecuador (GoE) to enhance fiscal sustainability and to enable private investment and female labor force participation.

Organizations

Borrower:	Republic of Ecuador
Implementing Agency:	Ministry of Economy and Finance

PROJECT FINANCING DATA (US$, Millions)

Maximizing Finance for Development

Is this an MFD-Enabling Project (MFD-EP)?	Yes
Is this project Private Capital Enabling (PCE)?	Yes

SUMMARY

Total Financing	**700.00**

DETAILS

World Bank Group Financing

International Bank for Reconstruction and Development (IBRD)	700.00

PRACTICE AREA(S)

Practice Area (Lead)

Macroeconomics, Trade and Investment

Contributing Practice Areas

Energy & Extractives; Finance, Competitiveness and Innovation; Governance; Gender

CLIMATE

Climate Change and Disaster Screening

Yes, it has been screened and the results are discussed in the Operation Document

OVERALL RISK RATING

Overall Risk	Substantial

RESULTS

Indicator Name	Baseline	Target
RI#1. VAT revenues as a result of the permanent increase in the VAT rate (USD million).	$8,444.30	At least an additional $400 million
RI#2. Expenditures on gasoline subsidies	$644 million	Less than $100 million
RI#3. Tax expenditures in new investment contracts	$300 million	$105 million
RI#4. GAD and SOE wage bills	$1,536 million	Less than $1,400 million
RI#5. Number of projects registered in the PPP registry	0	At least 10 projects
RI#6. (Non-Hydro) Renewable Energy Capacity Enabled by private sources (MW).	310MW	At least 672 MW by 2028
RI#7. Number of firms with 50 and more employees with verified adoption of practices for a gender-inclusive workplace.	0	At least 100

IBRD PROGRAM DOCUMENT FOR A PROPOSED ECUADOR CARBON-CONSCIOUS FISCAL AND GROWTH DEVELOPMENT POLICY LOAN TO THE REPUBLIC OF ECUADOR

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Ecuador Carbon-Conscious Fiscal and Growth Development Policy Financing (DPF) supports key reforms to enhance fiscal sustainability and enable private investment and female labor force participation.** Fiscal reforms supported by this operation are projected to reduce Ecuador's financing needs by a cumulative 2 percent of gross domestic product (GDP) in 2024 and 2025, which is critical to safeguard fiscal sustainability and address bottlenecks to growth.[1] To mitigate a potential impact on vulnerable households, additional financing is provided for the WB Social Safety Net Project which will extend cash transfers to about 100,000 families by the end of 2025. In addition to the country's structural deficit, growth studies on Ecuador generally identify the country's barriers to private sector investment, and low female labor force participation as main impediments to growth[2]—areas that this program addresses. The DPF also supports reforms that are critical for Ecuador's energy transition by raising the total price of carbon and opening the electricity sector to investments in renewable energy. Finally, these reforms will help the diversification of energy sources and increase climate resilience of the sector under increasing droughts.

2. **The proposed stand-alone DPF loan of $700 million benefitted from a swift engagement with the new administration that took office in November 2023** and sustained analytical and technical assistance and lending engagements by the World Bank Group (WBG) in support of fiscal and structural growth reforms in Ecuador.[3] This DPF is part of a package of coordinated financial assistance from international partners, including the International Monetary Fund (IMF), the Inter-American Development Bank (IDB), and the Development Bank of Latin America and the Caribbean (CAF).[4] The proposed operation is aligned with the Green, Resilient, and Inclusive Development (GRID)[5] framework, and the World Bank Group's Roadmap for Climate Action in Latin America and the Caribbean.[6] It also supports the operationalization of the Ecuador Country Climate and Development report (forthcoming) by supporting the fuel subsidy reform, Ecuador's adaptation to climate shocks and the energy transition.

3. **Ecuador's government is grappling with a challenging trilemma: an unprecedented security crisis, fragile public finances, and sluggish economic growth.** Ecuador's homicide rate more than doubled in 2023, becoming one of the highest in the region, leading to the declaration of a state of internal armed conflict in January 2024. Climate events and historically low investment in the electricity sector led to widespread electricity rationing in the last quarter of 2023. Amid these challenges, snap elections led to a fragmented National Assembly and an interim government with an 18-month mandate. When this government assumed office in November 2023, it faced a challenging fiscal situation caused by budget rigidities, spending pressures due to the El Niño weather

[1] The DPF is fully aligned with the National Development Plan 2024–2025 (*Plan de Desarrollo para el Nuevo Ecuador 2024-2025*, NDP), *Plan Económico 2024/25*, and the Country Partnership Framework (CPF) FY2019–FY2023, extended by the Performance and Learning Review (PLR) to FY2025.
[2] World Bank. 2024. Country Economic Memorandum, *Ecuador: Growing Resilient for a Better Future*; World Bank. 2016. *Ecuador: Country Economic Memorandum: Productivity Growth under Adverse Global Conditions.* Unpublished report.
[3] World Bank. 2024. Country Economic Memorandum, *Ecuador: Growing Resilient for a Better Future*.
[4] The IMF's 48-month arrangement under the Extended Fund Facility (EFF) with access available to US$4 billion, the IDB about $1.3 billion in 2024, and CAF about $500 million in 2024.
[5] World Bank. 2021. From COVID-19 Crisis Response to Resilient Recovery – Saving Lives and Livelihoods while Supporting Green, Resilient and Inclusive Development (GRID).
[6] World Bank Group. 2021. Climate Change Action Plan 2021–2025: Supporting Green, Resilient and Inclusive Development.

phenomenon and the security crisis, declining oil prices and production, legislative demands in a context of political instability, and a slowing economy. Economic growth has been tepid at 2 percent over the last decade, which compounds the difficulty of addressing a sustained structural central government's fiscal deficit in a context where many social demands remain unmet. Adding to the fiscal and growth challenges, a referendum in August 2023 mandated the cessation of oil extraction in the Yasuni National Park by the end of August 2024, affecting one-tenth of the national oil production, a key source of fiscal revenues and access to foreign reserves. President Noboa acted decisively following a series of violent, highly visible gang-related attacks, which bolstered his popular support and enabled him to push for stringent anticrime measures through a referendum. However, voters rejected other reforms that could have spurred growth, such as the legalization of hourly contracts and the international arbitration of commercial disputes.

4. **The Noboa administration has taken important steps to tackle a challenging fiscal situation, including by implementing reforms—supported by this Development Policy Loan (DPL)—on domestic resource mobilization and spending efficiency.** Non-oil revenues as a share of GDP are low compared to other countries due to low value added tax (VAT) rates and high tax expenditures (World Bank 2019). The government, therefore, rapidly enacted important revenue reforms, such as raising the VAT rate permanently from 12 to 13 percent (Priority Action #1, PA#1) and temporarily to an additional two percent. Additionally, with World Bank (WB) technical assistance, the government rationalized gasoline subsidies (PA#2), saving about 0.5 percent of GDP; passed a wage bill reform (PA#4), saving at least 0.2 percent of GDP; and curbed tax incentives (PA#3), saving about 0.2 percent of GDP. The government is also improving spending efficiency by limiting exceptions to competitive procurement, adopting private sector managerial practices in major state-owned enterprises (SOEs) like PetroEcuador, and improving customs revenue collection. Together, these reforms are expected to yield fiscal savings of a cumulative of about 2 percent of GDP in 2024 and 2025, while reducing the fiscal risks related to economic fluctuations and commodity price shocks. These fiscal reforms are critical for addressing the structurally high central government's fiscal deficit, a necessary condition for Ecuador's return to international capital markets at reasonable costs.[7]

5. **Enabling private capital investment is critical for boosting potential growth within a fiscally constrained environment.** The competitive expansion of the private sector is essential toward reducing state dominance in markets that are important drivers of growth, increasing competitiveness, and alleviating the burden on public finances (World Bank 2024).[8] In this context, the DPL supports critical improvements in Ecuador's legal and regulatory framework, increasing regulatory certainty, and removing distortions that have caused state dominance. These efforts have been closely coordinated with the International Finance Corporation (IFC) in an effort to leverage the reforms for potential IFC transactions in support of private sector investment. In particular, the DPL supports a reform of the public-private partnership (PPP) law (PA#5), which has benefitted from one WBG technical assistance. If technically feasible, IFC would structure three PPP road project transactions and lead efforts to bring them to market, thereby attracting private investment of more than 0.2 percent of GDP. Reforms that increase the price of carbon and support increased electricity demand from renewable sources have opened

[7] Despite a relative low debt, Ecuador has one of the highest risk rates in the region. This risk level could be explained, among other things, by political instability and a structural central government's fiscal deficit of about 5 percent of GDP. This operation is supporting measures that would allow the country to close this structural fiscal deficit by about 1.1 percent of GDP per year.
[8] The Middle-Income Trap, World Development Report, World Bank (2024, forthcoming).

the scope for IFC investments in the electrification of productive units. Following the removal of the shrimp farm diesel subsidies supported by the previous DPL program, the IFC invested in the electrification of one of the major shrimp farms. The ongoing energy crisis is directly impinging on growth. This program unlocks private investment to expand generation and transmission capacities (PA#6). Additionally, it aims to diversify the power generation matrix through integrating more non-hydro renewables, given the high dependence on hydropower for electricity generation which accounted for 85 percent of electricity production in 2022. The high dependence on hydropower presents a risk to energy security given the vulnerability to droughts and recurrent El Nino events. Moreover, the recently enacted law underpins these efforts by allowing additional market participants, including joint ventures in which the state has the majority interest, to enter the electricity market, including two key instruments created by this same law: a short-term electricity market and a national investment fund for energy efficiency investments (PA #6).

6. **The program also supports reforms to enhance female labor force participation and foster green jobs.** In Ecuador, only 54.2 percent of working-age women participate in the labor market. Also, working women are confined to low-productivity sectors and have limited access to managerial positions. To boost quality employment opportunities for women, firms will be mandated to adopt gender-equality action plans and encouraged to seek gender-equality certifications (PA#8). Additionally, the PPP reform and the new energy competitiveness reform aim to attract private investment to the renewable energy sector, thereby generating numerous green job opportunities and contributing to the transition toward a sustainable and low-carbon economy.[9]

2. MACROECONOMIC POLICY FRAMEWORK

7. **The macroeconomic framework is deemed adequate for this operation.** In 2022, Ecuador achieved its first balanced fiscal accounts in 14 years, marking one of the most significant post-pandemic consolidations in South America, alongside Brazil, Chile, and Peru. This consolidation and debt renegotiations with bondholders in 2020 and China in 2020 and 2022 have contributed to a decline in the public debt from 63.1 percent of GDP in 2020 to 57.0 percent in 2022. However, the country was not able to regain access to international capital markets due to its previous default and a structurally high central government's fiscal deficit. In 2023, political pressures combined with challenges arising from natural disasters (earthquakes, landslides, and increased precipitation), a deteriorating security situation and high international interest rates led to an increase in the fiscal deficit and dampened economic growth. The incoming Government of Ecuador (GoE) swiftly enacted a series of reforms to reduce the fiscal deficit and resume the downward trend in public debt. Contrary to previous fiscal reform efforts,

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[9] According to a recent International Labuor Organization (ILO) and Inter-American Development Bank (IDB) study, a decarbonization-focused recovery could generate 15 million jobs in Latin America. Studies have identified that infrastructure investment paths can be compatible with full decarbonization, and they do not need to cost more than more polluting alternatives (Rozenberg. 2019. *Beyond the Gap: How Countries Can Afford the Infrastructure They Need While Protecting the Planet*). With the right policies, investments of 4.5 percent of GDP would enable low- and middle-income countries to achieve the infrastructure-related sustainable development goals and stay on track to limit climate change to 2°C. In Chile, the Ministry of Finance led a study (the 2020 Green Growth Opportunities for the Decarbonization Goal for Chile), concluding that implementing a mitigation policy package, jointly proposed by the ministries of energy, environment, and agriculture, can have a positive impact on the economy, which could mean an additional growth of 4.4 percent of its GDP by 2050 (Hepburn, C., O'Callaghan, B., Stern, N., Stiglitz, J., and Zenghelis, D. 2020. Will COVID-19 fiscal recovery packages accelerate or retard progress on climate change? Oxford Smith School Working Paper 20-02). In addition, 2019 data from the International Renewable Energy Agency (IRENA) shows that all renewable energy technologies generated 89,236 direct and indirect jobs in Spain; 97,868 new jobs in Mexico; 17,493 in Chile; and 12,448 new positions in Ecuador.

these more recent fiscal and growth-enhancing reforms benefitted from strong congressional support. It also agreed to a four-year program with the IMF approved in May 2024 which supports critical reforms to promote efficient and sustainable management of public resources and to ensure fiscal and debt sustainability. The GoE has also initiated a popular campaign to address the security crisis and curb crime, with further security policies ratified in April's referendum. The current account surplus remains substantial, and the financial sector is overall resilient to adverse macro-financial shocks. The 24-year-old dollarization policy enjoys broad support across all socioeconomic levels and is anticipated to remain a key stabilizing factor. Macroeconomic prudence is likely to be bolstered by limited access to external financing and some institutional anchors, including a prohibition on Central Bank financing to the public sector introduced by the 2021 Organic Law Reforming the Organic Monetary and Financial Code and a medium-term debt ceiling established by the 2020 Organic Code of Public Finances and Planning. Nevertheless, the macroeconomic framework warrants close surveillance, as uncertainties surrounding the upcoming elections could lead to a slower than projected fiscal consolidation and delays in the return to international capital markets.

2.1. RECENT ECONOMIC DEVELOPMENTS

8. **Ecuador has been making progress in reducing macroeconomic imbalances.** Ecuador faced severe macroeconomic imbalances after the last oil price boom. Cut off from international capital markets after its 2008 default and a structurally high central government's fiscal deficit, Ecuador embarked on a gradual fiscal consolidation after 2016, which was primarily achieved through reduced capital spending. Growth came to a standstill, and poverty rose as private investment only partially offset the short-term contractive effect of fiscal consolidation. When the COVID-19 pandemic struck, Ecuador faced one of the highest death per capita rates in the world. In response, the GoE implemented one of the fastest vaccination campaigns in Latin America and offered targeted fiscal support to the most vulnerable. Despite these challenges, between 2020 and 2022, public debt declined by more than 10 percent of GDP, the fiscal deficit turned into balance, international reserves doubled, and domestic arrears declined. Poverty (US$6.85 PPP) declined from 34.6 percent in 2020 to 29.9 percent in 2023 as labor force participation increased from 60 to 65 percent. However, reforms to bolster growth by enabling broad-based private investment remained limited, hampered by political instability polarization and vested interests, and private investment remained low. As most new jobs were informal, informality rose from 53.4 to 55.7 percent as a challenging business environment, rigid labor regulation, and above-inflation minimum wage increases hampered formal job creation.

9. **In 2023, Ecuador grappled with an unprecedented security crisis, an energy crisis, and a challenging fiscal situation.** Gang-related violence led to one of the highest homicide rates in the world, prompting the declaration of multiple states of emergency. In addition to a moderate earthquake, the country was hit by heavy rains that worsened the regressive erosion of the Coca River, forcing authorities to interrupt operations of the main crude pipelines. In addition, Ecuador experienced the most severe drought in the past 50 years, which led to historically low water supplies for power generation and rolling blackouts throughout the country. Political uncertainty increased after President Lasso dissolved the National Assembly and called for early elections in October 2023, establishing an interim government until upcoming elections in February 2025. As domestic demand contracted, growth fell from 5.3 percent year-on-year in the second quarter to –1.2 percent in the fourth quarter. Lower revenues, due to dampened economic activity and a partial reversal of the 2021 tax reforms,[10]

[10] The tax reform modified the income tax brackets for individuals, lowering the non-taxable minimum, and significantly reduced expenditure deductions, which were reversed.

combined with growing spending pressures, increased the fiscal deficit from 0 percent of GDP in 2022 to 3.6 percent in 2023. Spending escalated from 38.7 to 40.2 percent of GDP due to additional security spending, higher interest payments, higher fuel and electricity imports amid the energy crisis, emergency spending, and higher expenditures ahead of the elections. With net external funding close to zero and limited external liquidity, the GoE financed the fiscal deficit from domestic sources, mainly the reduction of public deposits in the Central Bank and the accumulation of arrears, undermining private sector confidence. As the GoE use its deposits to finance its deficit, public debt fell from 57 percent in 2022 to 55 percent in 2023 due to the limited external and domestic financing and the debt for nature swap that reduced external debt by about 0.8 percentage points of GDP.

Table 1. Selected Economic and Financial Indicators

	2021	2022	2023	2024e	2025f	2026f	2027f
Annual percentage change, unless otherwise indicated							
National Accounts							
GDP at constant prices, percent 1/	9.8	6.2	2.4	0.3	1.6	2.2	2.5
Consumption	9.1	6.3	1.8	0.1	0.9	1.6	2.2
Investment	30.4	9.7	−0.3	−1.5	2.4	4.6	4.2
Exports of goods and services	9.4	7.3	2.3	1.2	2.4	2.2	2.2
Imports of goods and services	21.5	10.5	−0.9	−0.9	0.9	2.3	2.7
Sectoral contribution to growth, percentage points							
Agriculture	0.8	0.2	0.4	0.3	0.3	0.3	0.3
Industry	3.8	1.4	−0.2	0.1	0.3	0.5	0.5
Services	5.3	4.5	1.4	−0.1	0.9	1.3	1.6
Prices, Annual Percentage Change							
GDP deflator	2.0	2.2	-0.4	1.6	1.2	1.1	1.1
Consumer prices (average)	0.1	3.5	2.2	2.2	1.8	1.4	1.4
Selected Monetary Accounts							
Banks' credit to the government	47.3	−7.1	−4.5	−4.5	−4.5	−4.5	−4.5
Banks' credit to private sector	14.8	14.9	9.1	4.0	3.3	3.6	3.9
Broad money (M2)	9.8	7.5	6.7	2.5	3.4	3.7	4.0
External sector							
Goods exports	29.8	23.8	−3.6	1.6	2.1	2.2	2.2
Goods imports	41.5	28.2	−4.4	0.8	2.5	3.2	3.6
Terms of trade	2.0	−0.5	−2.1	−1.3	−1.8	−0.9	−0.9
Percent of GDP, unless otherwise indicated							
Current account	2.9	1.8	1.9	1.8	1.6	1.3	1.0
Foreign investment	−0.6	−0.8	−0.3	−0.3	−0.9	−1.5	−1.3
Debt							
Public debt (external and domestic) 2/	61.6	57.0	55.3	56.8	57.5	57.0	55.9
External debt 3/	72.1	67.3	64.5	65.9	66.4	65.7	64.4
Public debt service	13.6	9.7	9.6	8.6	7.2	7.9	7.7
Fiscal Accounts							
Total revenue and grants 4/	35.8	38.7	36.7	38.8	38.0	38.3	38.1
Total expenditure and net lending	37.4	38.7	40.2	40.9	39.5	38.6	38.3
Overall fiscal balance (with grants)	-1.6	0.0	−3.6	−2.1	−1.5	−0.4	−0.2
Memo Items							
GDP per capita (%)	6,036.4	6,476.6	6,533.4	6,591.2	6,707.1	6,864.0	7,040.3
Gross reserves (US$ millions, EOP)	7.9	8.5	4.5	5.3	6.6	8.5	9.9
In months of next year's imports)	2.6	2.9	1.5	1.8	2.2	2.7	3.0
Nominal GDP (US$ billion)	107.4	116.6	118.8	121.1	124.5	128.7	133.3
Oil price, Brent (US$ per barrel) 5/	70.4	99.8	82.6	80.0	76.0	75.1	75.1

Sources: BCE, MEF, IMF, and World Bank staff calculations.

Note: As of June 20, 2024. (1) Historical growth figures were changed as the authorities have recently rebased the national accounts. (2) The Non-Financial Public Sector (NFPS) debt includes the outstanding balance for advanced oil sales, treasury certificates, Central

Bank loans, other liabilities, and domestic floating debt. (3) External debt includes public and private external debt. (4) The NFPS figures are based on the data released by the Ministry of Economy and Finance (*Ministerio de Economía y Finanzas*, MEF), where SOEs' operations are recorded in each line and oil derivatives financing account (CFDD, *Cuenta de Financiamiento de Derivados Deficitarios*) as part of the oil revenues and the purchase of goods and services. In the previous DPF series, the SOE operative balance was registered as other revenue, the CFDD revenues were part of other revenues, and the CFDD expenditures were part of other expenditures. (5) Between 2021 and 2023, the average Brent has been US$13 higher than average Ecuador's crude oil export price as Ecuador mainly exports heavier and higher-sulfur crude oils, but the correlation between this to variables attained 0.97.

Table 2. Key Fiscal Indicators

Percent of GDP	2021	2022	2023	2024e	2025f	2026f	2027f
Revenues	35.8	38.7	36.7	38.8	38.0	38.3	38.1
Oil revenues	12.2	14.5	12.2	12.4	12.4	12.8	12.3
Tax revenues	18.2	18.5	17.8	19.5	19.2	19.2	19.4
Direct taxes	4.2	4.8	4.6	5.6	4.7	4.5	4.6
Indirect taxes	8.7	8.5	7.8	8.6	9.0	9.3	9.4
Taxes on goods and services	6.6	6.5	6.2	6.8	7.0	7.1	7.2
Taxes on international trade	2.1	2.0	1.6	1.8	2.0	2.2	2.2
Social contributions	4.9	5.0	5.1	5.1	5.0	5.0	5.0
Other taxes	0.3	0.2	0.2	0.2	0.4	0.4	0.4
Non-tax revenues	4.9	5.4	5.9	6.0	5.6	5.5	5.5
Grants	0.5	0.4	0.9	0.9	0.9	0.9	0.9
Expenditures	37.4	38.7	40.2	40.9	39.5	38.6	38.3
Current expenditures	34.0	35.9	37.5	37.8	36.5	35.4	35.1
Compensation of employees	11.2	10.5	10.9	10.8	10.5	10.1	9.9
Use of goods and services	11.4	14.3	14.2	14.3	13.3	12.6	12.4
Subsidies and transfers	7.3	6.8	7.7	7.7	7.6	7.5	7.6
Social benefits	2.8	2.7	2.6	2.6	2.5	2.5	2.5
Interest payments	1.3	1.5	2.2	2.5	2.6	2.7	2.6
Capital expenditure	3.3	2.8	2.7	3.0	2.9	3.2	3.2
Overall balance (NFPS)	–1.6	0.0	–3.6	–2.1	-1.5	–0.4	–0.2
Primary balance	–0.3	1.6	–1.4	0.4	1.2	2.3	2.4
NFPS financing	1.6	0.0	3.6	2.1	1.5	0.4	0.2
External, net	2.6	1.8	0.1	2.4	1.8	0.9	0.7
Domestic net	–1.0	–1.8	3.5	–0.4	–0.3	–0.6	–0.5

Sources: BCE, MEF, IMF, and World Bank staff calculations.
Note: As of June 20, 2024. (1) The Non-Financial Public Sector (NFPS) figures are based on the data released by the MEF, where SOEs' operations are recorded in each line and CFDD as part of the oil revenues and the purchase of goods and services. In the previous DPF series, the SOE operative balance was registered as other revenue, the CFDD revenues were part of other revenues, and the CFDD expenditures were part of other expenditures.

10. **The financial sector remains resilient, but tighter global financial conditions pose challenges.** Despite the adverse effects of an increase in arrears on local liquidity, the money supply (M2) grew by 6.7 percent in 2023, supported by the current account surplus and a reduction of public deposits at the Central Bank. Deposits in private banks continue increasing, although the challenging economic and political context reduced their growth from 8.3 percent in 2022 to 6.0 percent in 2023. This increase in money supply, coupled with a reduction in liquidity from 26 to 23 percent of short-term liabilities, helped to boost domestic credit to the private sector by 8.9 percent. Moreover, the return on equity and capital adequacy ratio have remained around 9.5 and 14.5 percent, respectively. However, due to the slowdown, nonperforming loans rose from 2.7 percent in December 2022 to 5.1 percent in April 2024. Moreover, while the financial sector is overall resilient to adverse macro-financial shocks, the dollarization constrains the Central Bank's capacity to provide liquidity, and the vulnerabilities of some institutions, including public banks and small cooperatives, need to be addressed. The IMF EFF is

supporting measures to implement Ecuador's financial policy agenda, such as the establishment of a Financial Stability Committee, and measures to strengthen the effectiveness of the anti-money laundering and combating the financing of terrorism framework.

Table 3. Public and Publicly Guaranteed Debt Stock and Service

	Debt stock, end of period			Debt service			
	2024			2025	2026	2025	2026
	US$ billion	Percent of total	Percent of GDP	US$ billion		Percent of GDP	
Total PPG Debt	68.8	100.0	56.8	8.9	10.2	7.2	7.9
Domestic Debt	17.8	25.8	14.7	3.7	3.9	3.0	3.0
Treasury bills	2.2	3.2	1.8	2.4	2.4	2.0	1.9
Treasury bonds 1/	5.1	7.4	4.2	0.7	1.0	0.5	0.7
Others 2/	10.5	15.3	8.7	0.6	0.5	0.5	0.4
External Debt	51.1	74.2	42.2	5.9	7.0	4.8	5.4
Multilateral creditors 3/	29.3	42.5	24.2	3.6	3.7	2.9	2.9
Bilateral creditors	4.2	6.1	3.4	0.9	0.9	0.7	0.7
Paris Club	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-Paris Club	4.2	6.1	3.4	0.9	0.9	0.7	0.7
Commercial creditors 4/	17.6	25.6	14.6	1.4	2.4	1.1	1.9
Memo items							
SOE guaranteed external debt	0.6	0.9	1.2				
External Arrears	0.0	0.0	0.0				

Sources: BCE, MEF, IMF, and World Bank staff calculations.
Note: As of June 20, 2024. The NFPS debt includes the outstanding balance for advanced oil sales, treasury certificates, Central Bank loans, other liabilities, and domestic floating debt. (1) It includes Treasury Certificates (CETES), short term instrument monthly held by the Deposit Insurance Corporation (COSEDE), the Bank of the Ecuadorian Social Security Institute (BIESS), other financial institutions and GADs, that are usually rolled over. (2) It includes loans and other payable accounts such as domestic arrears accumulation and clearance and liquidity agreements with the SOE outside the non-financial public sector definition. (3) It includes multilateral loans and SDRs. (4) It includes sovereign bond issuance and oil-related financing.

11. **International reserves declined in 2023.** The current account surplus remained stable at 1.9 percent of GDP, as a decline in oil exports and tourism was offset by a decrease in imports and an increase in non-oil exports, notably bananas and minerals. However, international reserves fell from 7.3 percent of GDP (3.0 months of next year imports) in 2022 to 3.7 percent (1.5 months of imports) in 2023, partially due to reduced public deposits at the Central Bank that were used to finance the fiscal deficit. Additionally, the financial sector's deposits at the Central Bank declined as the slowdown in deposits led not only to a deceleration in loans but also to a slight reduction in banks' liquidity. However, international reserves rose by US$2.3 billion in the first five months of 2024 to US$6.7 billion on the back of a recovery of small fiscal surpluses and banks' reserves. Although these international reserves cover the deposits and reserves of private banks, consistent with legal requirements set in the *Código Organico Monetario y Financiero* (COMYF, Organic Monetary and Financial Code), they remain well below the peak reached in 2022 of US$8.5 billion.

Table 4. Balance of payments financing requirements and sources

US$ billion, otherwise it is indicated	2021	2022	2023	2024e	2025f	2026f	2027f
Gross financing needs, percent of GDP	8.0	8.1	8.6	7.9	7.6	7.5	7.3
Financing Requirements	8.5	9.5	10.2	9.5	9.4	9.6	9.7
Current account deficit	–3.1	–2.1	–2.3	–2.2	–2.0	–1.6	–1.4
Debt amortization 1/	6.6	7.2	8.4	6.7	7.1	7.9	8.1
Other capital outflows (incl. deposits)	5.1	4.3	4.1	5.0	4.3	3.3	3.0
Available Financing	8.5	9.5	10.2	9.5	9.4	9.6	9.7
Foreign Direct Investment (net)	0.6	0.9	0.4	0.4	1.2	2.0	1.8

Portfolio investment (net) 2/	–0.1	–1.2	–2.9	0.2	0.2	0.2	0.2
Capital grants	0.2	–0.1	–0.1	0.0	0.0	0.0	0.0
Debt disbursement (excl. IMF) 1/	7.2	8.5	7.5	8.8	9.3	9.8	9.9
IMF credit (net)	1.8	1.6	–0.2	1.0	0.1	–0.6	–0.8
Change in reserves (– = Increase)	–0.9	–0.6	4.3	–0.8	–1.3	–1.8	–1.4
Errors and omissions	–0.2	0.3	1.2	0.0	0.0	0.0	0.0

Sources: BCE, MEF, IMF, and World Bank staff calculations

Note: As of June 20, 2024. (1) It includes flows related to both short- and long-term public and private debt; official figures do not separate long- and short-term debt, but the bulk of the external debt is long-term debt. (2) It excludes sovereign bond disbursements and amortizations that are included in the corresponding external debt flows.

12. **In the context of a dollarized economy, prices have remained stable despite inflationary pressures from climatic and global events.** After peaking at 4.2 percent in mid-2022, annual headline inflation declined to 2.5 percent in May 2024, one of the lowest in the region. The economic slowdown, declining international food prices, and the nominal anchor provided by dollarization have maintained subjacent inflation pressures under control. Additionally, fuel prices have remained frozen since October 2022, when the government interrupted the price band introduced in 2020 to reduce fuel subsidies.

13. **The new administration has taken pragmatic steps to address the country's trilemma.** The new government seeks to balance efforts to reduce the fiscal deficit while boosting private investment and jobs through targeted reforms. In April 2024, it held a referendum that led to the approval of far-reaching security measures. However, proposals to recognize international arbitration for investment disputes and allow for fixed terms and hourly contracts were not approved. The new administration has also embarked on important fiscal and growth-enhancing reforms, several of which are supported through this DPF. As a result of these measures, Ecuador's Emerging Market Bond Index (EMBI) spread declined from 2,140 basis points in mid-December 2023 to 1,130 basis points in early May 2024.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

14. **Growth is expected to rebound over the medium term after a slowdown this year.** In 2024, GDP growth is projected to fall to a mere 0.3 percent due to subdued private demand, resulting from the challenging security situation, the accumulation of government domestic arrears, political uncertainty in the lead-up to the 2025 elections, recent energy shortages, and the short-term contractive effect of fiscal consolidation. Additionally, a negative carryover and the planned unwinding of oil production in the Yasuni National Park following the 2023 referendum will adversely affect growth. However, growth is expected to accelerate to 2.5 percent by 2027, assuming post-election stability, a slowdown in fiscal consolidation, and economic gains from the implementation of growth-enhancing reforms, such as the reforms to bolster public-private partnerships and investment in nonconventional energy sources, supported by this DPF, and recent progress on trade integration. Despite these positive developments, long-term growth prospects remain subdued by inefficiencies, such as rigid labor laws, a dysfunctional insolvency framework, limited trade openness, and a lack of competition due to state-owned enterprise operations, preferential treatment for domestic firms, burdensome regulations, and price controls (World Bank, 2024). Moreover, in conjunction with lower oil prices, these constraints prevent the country from taking advantage of its large growth potential in sectors such as agriculture and tourism, and of increasing metal demand resulting from the global energy transition. With modest economic growth, however, inflation is projected to remain low despite emerging pressures generated by a higher VAT rate and lower fuel subsidies.

15. **International reserves are projected to increase, bolstered by significant current account surpluses and external public sector financing.** The current account is projected to remain in surplus, though at a slightly lower level, declining from 1.9 percent of GDP in 2023 to 1.1 percent in 2027. Growing non-oil exports and dampened imports, including lower fuel imports resulting from lower subsidies,[11] will only partially offset the effect of declining oil prices, dampened oil export volumes, and high interest payments. Multilateral financing and international bond issuance are expected to allow the government to serve increasing debt service to the IMF and restructures sovereign bonds and build up some external buffers.[12] Recovering public sector deposits at the Central Bank, with a modest resurgence in foreign investment, is projected to gradually increase international reserves from 3.7 percent of GDP (1.6 months of next year's imports) in 2023 to 7.2 percent (3.0 months) in 2027. Despite remaining relatively low, international reserves are expected to continue covering the deposits and reserves of private banks at the BCE, consistent with legal requirements set in the COMYF. Strengthening the international reserve requires the GoE to reduce the fiscal imbalance to accumulate liquidity and repay liabilities with the Central Bank. It also requires that ongoing reforms help to regain access to the international capital market to face the expected increase of external debt service. As alternative sources of financing could only partly offset a delay in bond issuance, no renewed access to international capital markets could lead to further compression of expenditure and the accumulation of arrays, prolonging the current slowdown.

16. **The fiscal deficit is projected to narrow steadily to a near balance on the back of a mix of temporary and permanent consolidation measures, including tax and fuel subsidy reforms.** Despite a downturn in oil production and prices, the fiscal deficit is expected to decrease from 3.6 percent of GDP in 2023 to 0.2 percent in 2027. The GoE already passed a tax amnesty, increased the tax on dollar outflow (*Impuesto a la Salida de Divisas*, ISD) from 3.5 to 5.0 percent, raised the permanent VAT rate from 12 to 13 percent, introduced a temporary 2 percent point increase in the VAT, and created a temporary security contribution on firms' profits.[13] The government has recently passed a reform to reduce tax expenditures, rationalize the public wage bill in subnational governments and SOEs, and reduce gasoline and sector-specific fuel subsidies, some of which are prior actions of this operation.[14] The authorities are also advancing administrative measures to enhance public procurement efficiency and limit public wage bill growth.[15] These reforms are expected to increase tax revenues by about 2.7 percentage points of GDP in 2024, which will help reduce the fiscal deficit while allowing for some new tax incentives (0.3 percentage points) and higher social and capital expenditures (0.3 percentage points). After that, the government expects to continue the consolidation process by further rationalizing fuel subsidies, a public wage bill, and purchases of goods and services. Temporary tax measures, such as firms' security contributions and tax amnesty, are expected to contribute significantly to fiscal consolidation in the short term while the impact of permanent measures, including permanent tax measures and fuel subsidy rationalization, fully

[11] Low fuel subsidies are expected to reduce fuel demand and import by discouraging inefficient domestic demand and smuggling to neighboring countries.

[12] The GoE consolidation plan is supported by the IMF (expected to disburse US$3.8 billion between 2024 and 2028), IDB (US$2.9 billion), and the World Bank (US$2.5 billion). The government expected to supplement this external financing with additional financing from other multilaterals (US$1.8 billion), bilateral (US$2.8 billion), and international bond issuance (US$5.5 billion). All this external funding is expected only to finance a de fiscal deficit but also to refinance due sovereign bonds, reduce domestic arrears, and accumulate some external buffers.

[13] These tax reforms also include measures to tax sports prediction operators and reduce some tax expenditures.

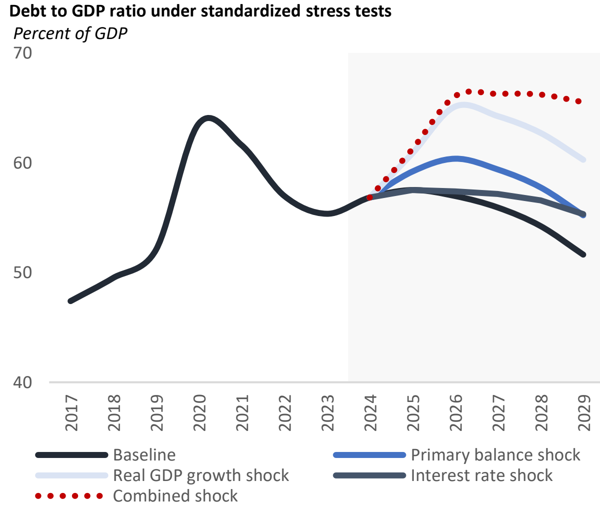
[14] Fuel subsidies amounted to US$3.4 billion in 2023: US$1.7 billion in diesel subsidies, US$712 billion in LPG subsidies, US$0.6 billion in gasoline subsidies, and US$0.2 billion in sector-specific subsidies (tuna, fishery, GLP vehicles, and others).

[15] The public procurement agency, SERCOP, is introducing guidelines to limit the use of exceptional and non-competitive procurement methods. It is also seeking to expand and facilitate the use of electronic catalogs. Finally, SERCOP is working with MEF to improve system interoperability and enable the automatic release of unutilized balances to ensure that savings in procurement processes are timely reflected into the budget as new available funds.

materialize. The GoE has also started discussing refinancing debt with China[16] and implementing a new debt-for-nature swap.[17] However, as these discussions are still very early, their potential impacts are not included in the macroeconomic projections. An improved fiscal balance will be critical not only to reduce public debt and build up some liquidity but also to regularize payment arrears, which is expected to benefit from better cash management practices applied as part of an under-preparation plan to clear them.[18]

17. **Public debt is projected to peak at 57.5 percent in 2025, significantly below pandemic levels, before resuming its downward trajectory.** Despite significant fiscal consolidation, public debt is anticipated to increase from 55.3 percent of GDP in 2023 to 57.5 percent in 2025 due to the sizeable fiscal deficit in 2023 and slow economic growth. However, public debt is projected to decline to 51.6 percent by 2029, supported by an economic rebound and continued fiscal consolidation (Figure 1).[19] However, this scenario is exposed to important downside risks. An increase of 711 basis points[20] in the average real interest rate over the projection period would result in an increase in public debt by 3.7 percentage points relative to the baseline in 2029. A worsening in the primary balance by 1.7 percent of GDP[21] in 2025 and 2026 would leave public debt also 3.6 percentage points above the baseline. A decline in GDP growth by 2.8 percentage points[22] in 2025 and 2026 would elevate public debt to 65 percent of GDP by 2026. However, it would then decrease to 60 percent by 2029, 8.6 percentage points above the baseline scenario. If all standard stress tests are combined, debt could stabilize around 66 percent of GDP between 2026 and 2029, 13.9 percentage points above the baseline in 2029. Such a scenario materializes, for example, in the context of a sizable oil price reduction, which would not only increase the fiscal deficit but also reduce growth and increase the real interest rate. Additionally, the materialization of contingent liabilities of about 5 percent, or the materialization of one-off emergency spending of a similar size due to, for example, weather-related events or other natural disasters in 2025, would elevate public debt to 65 percent in 2026 before falling to 60 percent in 2029. This scenario could reflect the impact of a catastrophic climate event, such as a devastating earthquake, a volcano eruption, or another large-scale shock on the country's electricity supply.[23]

Figure 1. Public debt under alternative scenarios



Source World Bank staff calculations.

[16] Debt stock with Chinese creditors reached US$3.0 billion, 7 percent of external debt, and its debt service is about US$0.8 billion per year on average.
[17] In 2023, the GoE implemented the first debt-for-nature swap, tied to conserving the recently created Hermandad Marine Reserve in the Galapagos that could reduce debt service despite carrying important risks.
[18] This plan is part of the medium-term program with the IMF.
[19] Consolidation should continue after the projection period to reduce debt to 40 percent by 2032, consistent with the 2020 Financial Management Code (COPLAFIP, *Código Orgánico de Planificación y Finanzas Públicas*).
[20] This is the difference between the maximum real interest rate in the last decade and its average in the projection period.
[21] This is one-half of the primary balance standard deviation in the last decade.
[22] This is the GDP growth standard deviation in the last decade, excluding the 2020 pandemic-led recession and the 2021 rebound.
[23] This facility was built during the commodity boom and provides one-third of Ecuador’s energy supply. However, since its inauguration in 2016, regressive erosion in the Coca River has accelerated, causing damage to transport infrastructure, oil pipelines, and the environment. Now, this erosion is threatening the facility operations, which have been forced to interrupt operations more frequently due to the

18. **Ecuador's macroeconomic outlook is subject to significant risks.** Political uncertainty ahead of February 2025 elections could slow fiscal consolidation and growth-enhancing reforms. Slower than expected implementation of key reform measures or tighter global financing conditions could delay the sovereign bond issuance, requiring a larger fiscal consolidation or leading to the accumulation of domestic arrears, prolonging the current slowdown. Ecuador's reliance on oil revenues also exposes it to volatile oil prices and a faster-than-projected decline in production levels. A resurgence of gang-related violence, social unrest, a tightening of monetary policy in the United States, and weaker-than-projected growth in China remain important risks. Additionally, Ecuador continues to be exposed to natural hazards such as earthquakes and volcano eruptions, climate events, and damages caused by Coca River regressive erosion, which could adversely affect economic activity. Higher oil and mining exports could alleviate fiscal pressures and boost growth in the short to medium term.

2.3. IMF RELATIONS

19. **The IMF Board approved a new 48-month Extended Fund Facility (EFF) in May 2024.** The EFF supports the authorities' economic policies with access to SDR 3 billion (US$4.0 billion), of which US$1.0 billion are disbursed immediately.[24] The arrangement has been closely coordinated with this operation and will support Ecuador's policies to strengthen fiscal and debt sustainability, protect vulnerable groups, rebuild liquidity buffers, safeguard financial stability, and advance the structural reform agenda to lay the foundations for sustainable, inclusive, and stronger growth. Relying on revenue and spending measures, the EFF seeks to trace an ambitious but realistic path toward the sustainability of public finances. The program targets a fiscal consolidation of 5.5 percentage points of GDP between 2024 and 2028, which is required to achieve the debt targets enshrined in the COPLAFIP legislation. The IMF is providing technical assistance in the areas of tax policy, fiscal transparency, debt policy and management, and financial sector reform which complements WB technical assistance on tax expenditures, fuel subsidy reform, SOE reform, procurement, customs reform, and energy sector reform.

3. GOVERNMENT PROGRAM

20. **The National Development Plan (NDP) focuses on the country's medium- and long-term development goals of reducing poverty and increasing shared prosperity.** The plan has four pillars:

- The social pillar aims to (a) improve the living conditions of the population in a comprehensive manner by promoting equitable access to health, housing, and social welfare; (b) promote the capabilities of citizens with equitable and inclusive education of quality and promote spaces for cultural exchange; and (c) guarantee comprehensive security and citizen peace, and transform the justice security system, respecting human rights.
- The economic pillar aims to (d) stimulate the economic and public finances to boost investment and trade partnerships; (e) Foster sustainable production by improving levels of productivity; and (f) promote the creation of decent employment.
- The infrastructure, energy, and environment pillar aims to (g) ensure the responsible use of natural resources in a sustainable environment; and (h) promote connectivity as a source of development and sustainable economic growth.

accumulation of sediment and other technical problems. Moreover, in the future, regressive erosion could reach the facility infrastructure, compromising its integrity.

[24] This follows a previous EFF arrangement approved in September 2020 and completed in December 2022.

- The institutional pillar aims to (i) promote the construction of an efficient, transparent, and social welfare–oriented state.

21. **Ecuador is a signatory to the Paris Accord on Climate Change and submitted its first NDC in March 2019, defining the policies, actions, and efforts to reduce greenhouse gas (GHG) emissions and vulnerability to climate change's adverse effects.** In its first implementation plan (NDC-PI), Ecuador set an unconditional target of a 9 percent reduction in GHG emissions by 2030, compared with a business-as-usual (BAU) scenario, and a conditional target of 20.9 percent from BAU by 2030. Ecuador will need to significantly ramp up private financing to achieve its climate and environmental objectives. Estimates to meet Ecuador's NDC targets put financing needs until 2025 at US$2.7 billion (4.8 percent of 2022 GDP). The plans provide a clear view of the milestones, outputs, domestic investments, and international support needed to meet climate and development targets. Mitigation measures identified in the country's NDC-Pl target mitigation of GHG emissions from energy, waste, industrial processes, agriculture, and land use. Adaptation measures focus on agriculture, health, human settlements and vulnerable populations, food safety, water, and natural heritage.

22. **Through Executive Decree No. 59 of 2021,[25] Ecuador has committed to an ecological transition that promotes balancing growth with low-carbon development, in addition to enhancing adaptation/resilience actions as well.** Ecuador is developing an economy-wide decarbonization plan[26] to delineate a clear transition toward carbon neutrality by 2050. For both the ecological transition and the decarbonization plan, a key priority is developing clean energy, such as renewables, that promote energy efficiency and a net-zero transport sector. The ecological transition and decarbonization plan also focus on protecting and conserving land ecosystems and water resources for future generations, as well as public policies and public and private initiatives that promote less energy-intensive manufacturing.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

23. **The operation supports reforms in the economic and institutional pillars of the country's NDP.** It contributes to:

- *Enhancing fiscal sustainability.* The first pillar supports critical elements of the NDP's economic and institutional pillars, which seek to strengthen fiscal revenue resilience, improve fiscal balances of SOEs and subnational governments (GADs), promote trade and investment, and reduce tax expenditures.
- *Enabling private investment and female labor force participation.* The second pillar of this operation supports the NDP's economic pillar, which, among other things, aims to enhance the PPP framework, facilitate private investment in the electricity sector, and increase women's labor force participation.

24. **The implementation of the WBG's country program for Ecuador in recent years offers lessons that have been considered in preparing this DPF.** The four main lessons from prior DPFs are:

- **In line with the previous series, strong analytical underpinnings provide the foundation for a well-designed**

[25] https://www.fielweb.com/App_Themes/InformacionInteres/DE59AMFW.pdf.
[26] https://www.ambiente.gob.ec/ministros-firmaron-pacto-hacia-la-descarbonizacion/.

operation. Advisory Services Analytics (ASAs) helped shape the GoE's reform efforts and supported an impactful policy dialogue.

- **The provision of WB technical assistance (TA) was essential to the program's implementation.** The WB provided significant technical assistance on tax expenditures (PA#3), fuel subsidy reform (PA#2), SOE reform, sustainable procurement, pensions, PPP reform (PA#5), energy sector reform (PA#6), and transport sector reform. This TA was complemented by the TA provided by the IMF on the financial sector, tax policy, debt policy, and other fiscal policies, the Inter-American Development Bank (IADB) on tax administration, and the stakeholder analysis by the United Nations Development Programme (UNDP).
- **One WBG approach helps leverage critical reforms**. Strong collaboration across many global practices, global and regional units, and work with the IFC were critical to support a set of linked cross-cutting reforms to foster growth.
- **It is critical to support the communication of reforms across stakeholders.** The WB provided technical assistance on the communication strategy of the fuel subsidy reform (PA#2), including argumentative lines and pedagogical guidance based on international experience. The UNDP prepared a stakeholder analysis.

25. **This operation aligns with the goals of the Paris Agreement (see Appendix E for detailed discussion).** Based on the initial screening, the proposed DPF reform program is consistent with the country's climate commitments, including its National Adaptation Plan (NAP) focusing on greater resilience from access energy sources and updated Nationally Determined Contribution (NDC), where Ecuador has committed to an unconditional reduction of 9.0 percent of its GHG emissions and an unconditional target of 20.9 percent in the energy, industrial, waste, and agricultural sectors. The Prior Actions will enhance climate resilient development and promote greater access to alternative energy sources and increase the access to renewable energy sources even for most vulnerable populations in remote locations. Risks from climate hazards are not likely to have significant adverse effects on most of the PAs' contributions to the Program Development Objective (PDO). With those, climate risks can be reduced to acceptable levels. All PAs of the proposed DPL program are aligned with the adaptation and resilience goals of the Paris Agreement. None of the Prior Actions are likely to cause an increase in GHG emissions or any persistent barriers to transition to the country's resilient and low-carbon development pathways. In fact, several Prior Actions will have a positive contribution to GHG emissions reduction. Overall, Pillar 1 (PA#1 to PA#4) focuses on critical reforms to enhance the fiscal sustainability of the public sector through an increase in tax revenues, a reduction of expenditures and vehicle GHG emissions, a reduction of the wage bill of the SOEs and GADs, and the definition of a ceiling for tax expenditures introduced by investment contracts and established by a methodology to prioritize investment contracts. Pillar 2 (PA#5 to PA#7) supports critical reforms to enable private sector investment by enabling PPPs and facilitating private investment in the electricity sector. Therefore, all PAs of the proposed DPL are aligned with the mitigation and adaptation goals of the Paris Agreement (are either neutral or contribute to GHG emissions reduction). In conclusion, all PAs of the proposed DPL program are aligned with the adaptation and resilience goals of the Paris Agreement.

26. **The country also aims to enable private investment in non-conventional renewable energy (NCRE) generation.** As with other growth-enhancement efforts, green and resilient growth can unlock and leverage private investments and create new green jobs to support economic recovery, as other countries in the region have done.[27] The DPL operation will also support the implementation of CCDR recommendations regarding the need for Ecuador to implement reforms that can strengthen macroeconomic and fiscal management, enhance

[27] Hepburn, C., O'Callaghan, B., Stern, N., Stiglitz, J., and Zenghelis, D. 2020. Will COVID-19 fiscal recovery packages accelerate or retard progress on climate change? Oxford Smith School Working Paper 20-02. In addition, 2019 data from IRENA show that all renewable energy technologies generated 89,236 direct and indirect jobs in Spain, 97,868 new jobs in Mexico, 17,493 in Chile, and 12,448 new positions in Ecuador: https://www.irena.org/Statistics/View-Data-by-Topic/Benefits/Renewable-Energy-Employment-by-Country.

competitiveness, promote green jobs, and use decarbonization techniques to increase access to clean energy. Given limited domestic natural gas resources, Ecuador is seeking to meet its growing energy needs and climate objectives mainly through greater investments in renewable energy and energy efficiency. The proposed operation will align with Ecuador's commitment to reducing emissions in the energy and transport sector and contribute to the NAP by increasing overall resilience to the most vulnerable people. Regarding mitigation goals, none of the prior actions are likely to cause an increase in GHG emissions or any persistent barriers to transition to the country's resilient and low-carbon development pathways. In fact, several prior actions will have a positive contribution to GHG emissions reduction.

4.2. PRIOR ACTIONS, RESULTS, AND ANALYTICAL UNDERPINNINGS

27. **The stand-alone DPF proposes two pillars to support the government agenda to enhance fiscal sustainability and enable private sector investment and female labor force participation:**

- **Enhancing fiscal sustainability.** The first pillar supports critical reforms to enhance fiscal sustainability of the public sector by raising revenues, reducing the wage bill of SOEs and subnational governments, and reducing tax expenditures. Combined, these measures are expected to reduce the Non-financial Public Sector Deficit by US$800 million (about 0.7 percent of GDP) in 2024 and US$1,500 million (about 1.3 percent of GDP) in 2025. The proposed reforms are complemented by other reforms in the government program to protect vulnerable households where needed (See Appendix D).

- **Enabling private sector investment and female labor participation.** The second pillar supports critical reforms to enable private sector investment by enabling PPPs and facilitating private investment in the electricity sector. Together, these reforms are expected to enable at least US$1 billion in private investment once the economic and security situation improves. The pillar also supports an increase in female labor force participation that leads to an expansion of labor supply and entrepreneurship, which may result in enhanced productivity and economic growth.

Pillar 1 Enhancing Fiscal Sustainability

28. **Pillar 1 focuses on critical reforms to enhance fiscal sustainability.** The program focuses on revenue and spending measures that yield sizeable fiscal savings in 2024 and beyond, are unlikely to have a negative impact on growth or poverty reduction and are implementable in the current political context. On the revenue side, the DPL supports an increase in VAT and reduction in tax expenditures and fuel subsidies. On the spending side, the DPL covers reforms to reduce the wage bill of SOEs and GADs. These concerted measures are anticipated to generate significant fiscal savings, estimated at a cumulative 2 percent of GDP in 2024 and 2025.

Strengthening fiscal revenues resilience

Prior Action DPF	PA#1. To increase tax revenues, the Borrower has increased the VAT rate from 12 to 13 percent. (Completed). Evidence: Paragraph 2 of the First Reformatory Provision of the *Ley Orgánica para Enfrentar el Conflicto Armado Interno, la Crisis Social y Económica,* as published in Official Gazette (*Suplemento*) No. 516 on March 12, 2024.

29. **Rationale and Background. Ecuador's tax revenue collection is low compared to its peers.** In 2023, total tax revenues amounted to 17.8 percent of GDP, about one-half the level of the Organization for Economic

Co-operation and Development (OECD) countries. The WB Public Finance Review (2019) identified that the low VAT rate represented a key constraint to tax revenue growth. In 2023, Ecuador's VAT rate was at 12 percent, among the lowest in Latin America and significantly lower compared to its neighboring countries. Given the low VAT rate, an increase is expected to have a limited impact on growth.[28] The VAT also taxes fossil fuels in Ecuador.

30. **Substance of Prior Action (PA#1). The GoE enacted the *Ley Orgánica para Enfrentar el Conflicto Armado Interno, La crisis Social y Económica,* which increased the VAT rate to 13 percent and allows the President to increase the VAT rate up to 15 percent based on fiscal needs subject to an opinion by the Ministry of Economy and Finance**. As a result of this reform, prices of gasoline and diesel have increased, among other goods and services.

31. **Expected results and Indicators.** The abovementioned law will increase the VAT tax revenues by at least US$400 million per year due to the increase in the VAT rate from 12 percent to 13 percent. This estimation is based on the current VAT revenues and the analysis of the WB's Public Financing Review (2019).[29] On March 15, President Noboa issued decree 198, which raised the VAT rate from 13 percent to 15 percent in April 2024, yielding an additional 0.4 percent of GDP in tax revenues in 2024.[30]

Align the price of gasoline to international market levels.

Prior Action DPF	**PA#2.** To reduce expenditures and vehicle GHG emissions, the Borrower has increased the prices of gasoline to international market levels and established a price smoothing formula to protect consumers from excessive price volatility. Evidence: Section 2.2, the Second General Provision, and the First Transitory Provision of Executive Decree No. 308 issued on June 26, 2024.

32. **Rationale and Background.** Ecuador has one of the highest fuel price subsidies in Latin America and the Caribbean (LAC), and as a result, gasoline and diesel are among the cheapest in the region for end-consumers. The subsidies are estimated to have amounted to between 1.0 and 8.4 percent of GDP per year over the past few decades. In 2023, fuel subsidies in Ecuador cost US$3.2 billion,[31] equivalent to 3.0 percent of GDP, of which gasoline subsidies for extra and *ecopais* fuels cost US$644 million in 2023(MEF 2024).These subsidies negatively impact the already precarious fiscal and macroeconomic situation of the country. More resources are spent on fuel subsidies than on all social transfers. The resources could be instead spent on social and climate resilient programs at a time when the government has significant fiscal constraints, climate impacts are more intense and frequent, and social needs are high.

33. Furthermore, they incentivize inefficient and high consumption of fossil fuels in Ecuador, contributing to local pollution and increased greenhouse gas emissions (GHG), and subsidize drug production. The transport sector's emissions increased by 35 percent since 2012, faster than any other subsector. Fossil fuels—gasoline, diesel, and liquified petroleum gas—account for 80 percent of Ecuador's total energy consumption, of which one-half came from the transport sector in 2021. Subsidies not only lead to an overconsumption of fossil fuels but also fuel the illicit economy: the GoE estimated that about 1 percent of GDP in fuel is being smuggled to other

[28] Gunter et al.2019. "Policy Implications of Non-linear Effects of Tax Changes on Output," World Bank Policy Research Working Paper 8720.
[29] World Bank. 2019. "Ecuador Public Finance Review: Phase Two." Washington, DC. http://hdl.handle.net/10986/32359 License: CC BY 3.0 IGO.
[30] IMF's EFF macroeconomic framework assumes that VAT rate of 15 percent will remain throughout the entire program.
[31] *Ministerio de Economia y Finanzas*. 202). "Subsidios a los combustibles: Plan de acción y hoja de ruta de implementación de reforma." April 2024.

countries.

34. The GoE's Action Plan and Roadmap for implementing the fossil fuel subsidy reform envisions a phased approach, starting with the removal of gasoline subsidies. This staged approach is expected to obtain greater political and social support for such adjustments compared to earlier reform attempts. Against this background, the DPF is supporting the first phase of this action plan (gasoline subsidy reform), building upon the previous DPF that supported the phasing out of shrimp sector subsidies. As per Executive Decree No. 306, the only remaining gasoline subsidies are provided as cash transfer to owners of taxis, lightweight transport/freight vehicles and motorized tricycles. Each month, these transport providers receive a fixed amount per type of vehicle and a monthly base price informed by the MEM. The aim is to temporarily help prevent price increases for the poorest transport users. The government will review and adjust this mechanism every 6 months. The government also plans to extend the cash transfer programs to 100,000 eligible families by the end of 2025. No additional compensation measures for firms or other stakeholders are planned, but all end users will benefit from the price band that lessens the impacts of price volatility.

35. **Substance of Prior Action (PA#2).** To reduce expenditures and vehicle GHG emissions, Executive Decree (*Decreto Ejecutivo*) No. 308 issued by the Borrower on June 26 aligns the gasoline prices for extra and *ecopais* (extra with ethanol) fuels to international prices and establishes a price smoothing formula to protect consumers from excessive price volatility. This new pricing approach would increase gasoline prices to reach cost-reflective levels and will allow prices to fluctuate by a maximum of 5 percent upwards or 10 percent downward to prevent transmission of price shocks greater than that and engender greater social buy-in for these reforms.[32] [33] This approach is consistent with global and regional experience, where successful energy subsidy reform have been combined with social protection measures, including climate-related disasters and resilient development planning,[34] that have been crucial to the success of these programs. This approach will allow for greater price signaling to promote more efficient fuel consumption behaviors.

36. **Expected results and Indicators (RI#2).** The decree will reduce the gasoline subsidies from US$644 million in 2023 to less than a US$100 million in 2025. The transport sector will require major electromobility efforts and a modal shift toward mass transportation. Such fuel subsidy reduction will further disincentivize the use of carbon-intensive fuels and technologies and help shift incentives toward low-carbon transport and production, while generating significant savings.[35]

Reduction of Tax Expenditures

Prior Action DPF	**PA#3.** To reduce tax expenditures, the Borrower has established a cap on tax expenditures for tax incentives granted under investment contracts for 2024, which cap is to be reviewed each fiscal year. Evidence: Ministerial Agreement No. 028 issued by MEF on June 17, 2024.

37. **Rationale and Background.** Revenue forgone due to tax expenditures amounted to 4.5 percent of GDP and 34 percent of tax revenues in 2022 (*Ministerio de Economía y Finanzas*, 2023). Specifically, the revenue forgone from income tax expenditures was particularly significant, representing 2.7 percent of GDP, which is among the highest in the Latin America and Caribbean region (OECD, 2023). The WB Public Finance Review (2019) identified that tax

[32] Import Parity Price (IPP) levels plus the costs of domestic distribution.
[33] For more detail information on the history of fuel subsidy reform see Ecuador CCDR (upcoming).
[34] ESMAP/World Bank. 202). "Energy Subsidy Reform in Action: Cash Transfers in the Context of Energy Subsidy Reform - Insights from Recent Experience: Technical Report (English). Washington, DC: World Bank Group.
[35] The Bank will continue to provide technical assistance in the implementation of this reform through the Ecuador Fiscal and Green Growth ASAS (p506112), as well as through activities financed by the Whole of the Economy Trust Fund, and the Energy Sector Management Assistance Program (ESMAP).

expenditures represented a key constraint to tax revenue growth. Since 2010, companies planning to invest in Ecuador have had the option to sign an investment contract, which details the investment timeline and employment generation goals in return for tax incentives. Tax incentives provided under these contracts include a 5-percentage point reduction in the standard Corporate Income Tax rate, as well as exemptions from the currency outflow tax (ISD) and import tariffs. In fact, securing an ISD exemption on imports is exclusively available through an investment contract. The government, with the assistance of the World Bank, developed criteria to determine the relative share of incentives to the total investment amount committed in each investment contract. Indicators considered in the methodology with varying weights include the additional employment generated, the size of the firm and the share of total investment involving clean technologies and whether the company has received certification for reducing pollution (*Punto Verde*), achieving carbon neutrality, and implementing practices to prevent gender violence (*Sello Violeta*).

38. **Substance of Prior Action (PA#3).** Through Ministerial Agreement No. 028, the government has established a ceiling on total revenue forgone through tax incentives under investment contracts for 2024. Total revenue forgone will not be able to exceed US$104,849,832 in 2024. Tax incentives will be assigned on a 'first come, first served' basis. This ministerial agreement states that the ceiling will be reviewed each fiscal year. The government has committed in the letter of development policy (LDP) to set ceiling annually.

39. **Expected results and Indicators.** This measure will reduce revenue forgone from tax expenditures of new investment contracts from US$300 million in 2023 to US$105 million in 2025. The investment contracts that will be granted a tax incentive are expected to carry out investments in sectors that are a priority for the government and are expected to generate additional employment.[36]

Strengthening the fiscal balances of SOEs and Subnational Entities

Prior Action DPF	PA#4. To reduce the wage bill of the SOEs and GADs, the Borrower has introduced measures to strengthen SOE and GAD compliance with public sector salary caps. (Completed). Evidence: Ministerial Agreement No. MDT-2024-039 issued by the Ministry of Labor on March 17, 2024.

40. **Rationale and Background.** Wage expenditures of SOEs' and subnational governments amount to 13 percent of the NFPS total wage bill, reaching US$1,536 million in 2023. Wage disparity between the public and private sector in Ecuador is one of the highest in the region. Public sector salaries can be up to three times higher than in the private sector, the biggest gap being at mid-level technical staff.[37] Capping public sector salaries will help reduce the NFPS deficit, reduce central government transfers to SOEs, and enhance public sector spending efficiency and market competition. Transfers from the Central Government to SOEs amounted to US$122 million in 2023.

41. **The Organic Law of Public Service[38] mandates that no public administration employee, including the dependencies of the Executive, Legislative, and Judicial functions, together with autonomous decentralized entities (GADs) and State-Owned Enterprises (SOEs), should receive a monthly salary exceeding that of the President of the Republic.** The president's salary is set at US$5,072 per month, the highest rank on the salary scale established in 2019. However, the Ministry of Labor has found instances where remunerations are not aligned with the scale and the salary cap has been exceeded in various public sector entities. Notably, in municipalities and prefectures, salary ceilings have been set higher, and in four strategic sector SOEs—Petroecuador, CNT

[36] Upcoming Ecuador Fiscal and Growth ASA (P506112) will continue providing support on tax expenditures to the GoE, and will continue providing TA in the implementation of this reform.
[37] World Bank. 2019. "Ecuador Public Finance Review: Phase Two." Washington, DC. http://hdl.handle.net/10986/32359 License: CC BY 3.0 IGO.
[38] LOSEP, promulgated in 2010.

(*Corporación Nacional de Telecomunicación,* National Telecommunications Corporation), CNEL (*Corporación Nacional de Electricidad,* National Electricity Corporation), and Celec (*Corporación Electrica del Ecuador,* Electrical Corporation of Ecuador)—employees have been identified with monthly earnings surpassing the stipulated maximum. This situation arises partly because the Public Enterprises Law, in Article 17, allows the boards of directors of each SOE to set the remuneration for officials. Additionally, approximately 72 percent of employees in these firms are under collective contracts and are members of the respective company unions. Finally, in many instances, the base salary is within the ceiling, but it surpasses it when adding complementary income, such as bonuses, subsidies, and extra payments.

42. **Substance of Prior Action (PA#4).** Ministerial Agreement No. MDT-2024-039 implements the Seventh General Provision of the LOSEP. It sets the monthly remuneration for all workers of public sector entities, including the dependencies of the Executive, Legislative, and Judicial functions, as well as SOEs and GADs, with the highest remuneration scale ranging from US$2,115 to US$5,072, effective as of March 17, 2024. The new scale is applied to both, new and existing contracts of the upper hierarchical level, addressing both wage compression and wage inflation issues. For the purposes of applying this agreement, remuneration includes everything the worker receives in terms of bonuses, premiums, and any other additional compensation, except for the payment of travel allowances, living expenses, and supplemental or overtime hours.[39] The Ministerial Agreement requires that SOE boards of directors' issue normative acts to ensure that monthly remunerations are in line with the national remuneration scale set by the Ministry of Labor. Representatives of other public sector institutions, entities, and companies are to instruct their administrative and financial departments or units to adjust salaries to comply with the Ministerial Agreement. The agreement also clarifies that Collective Bargaining Agreements cannot establish remunerations that exceed the stipulated limits. The Ministry of Labor will report any noncompliance to the relevant appointing authority and the General Comptroller's Office, which will determine the necessary responsibilities and sanctions. Audits will be conducted for each institution. The Ministry of Labor has started enforcing this reform. In one entity, this enforcement alone would save more than US$60 million in 2024.

43. **Expected results and Indicators.** The Ministerial Agreement requires entities to issue their own remuneration scale in accordance with the agreement, effectively capping salaries. The Ministry of Labor estimates that about 10 percent of public employees have salaries above the ceiling, which will be adjusted downward. Strengthening compliance with the monthly remuneration scale and the ceiling below the President's level is expected to reduce the public wage bill of SOEs and GADs from US$1,536 million in 2023 by at least US$200 million by the end of 2025, representing a 13 percent reduction.

Pillar 2 Enabling Private Investment and Female Labor Force Participation

44. **Actions under Pillar 2 focus on enabling private sector investment and female labor force participation.** Reforms supported under this pillar include two new laws on Public-Private Partnerships (PPPs) and enabling private investment in the energy sectors. In addition, to enhance female labor force participation, firms will be mandated to review human resource and remuneration practices to remove undue barriers to quality employment opportunities for women. These initiatives are anticipated to transition workers from lower to higher productivity activities, thereby creating new or better jobs and fostering an environment where women can thrive professionally. In line with fiscal measures under Pillar 1, growth measures under Pillar 2 will also support Ecuador's transition from oil dependency towards carbon neutrality. Complementarily to increasing the price of

[39] There are eight institutions under Special Regimes that have their respective laws and are therefore exempt from complying with the national scale: the Armed Forces, National Police, Education and Health professionals, SNAI *(Servicio Nacional de Atención Integral a Personas Adultas Privadas de la Libertad y a Adolescentes Infractores*, National Comprehensive Care Service for Adults Deprived of Liberty and Adolescent Offenders), customs, and legal and forensic medicine.

carbon emissions, it has enacted a law to boost its alternative (renewable) energy capacity. This will help expand access to electricity in an affordable, reliable, modern, and sustainable way. To complement the economic reforms, the Government will expand the social protection program.

Enhancing the PPP framework

Prior Action DPF	PA#5. To leverage the private sector in closing the infrastructure gap, the Borrower has enacted a new PPP law and issued its implementing regulations. Evidence: (a) Book II of Title XI of *Ley Orgánica de Eficiencia Económica y Generación de Empleo*, as published in the Official Gazette (*Suplemento*) No. 461 on December 20, 2023 and (b) Book III of Executive Decree No. 157, as published in Official Gazette (*Tercer Suplemento*) No. 496 on February 9, 2024.

45. **Rationale and Background.** Ecuador faces a large infrastructure gap, requiring annual investments equivalent to 3.6 percent of GDP until 2040, with an additional 0.8 percent needed for maintenance (CAF 2020). Lack of infrastructure undermines competitiveness and job creation but also amplifies challenges linked to security and increasing vulnerability to climate risks. The growing need for climate finance for adaptation and resilient investments in the infrastructure sector will also have to be met by the private sector. Despite Ecuador's endeavors to attract private investment through reforms, results have been modest. The 2015 Organic Law on Incentives for Public-Private Partnerships laid a foundation for collaboration but fell short in regulating project life cycles and ensuring transparency. Recognizing these deficiencies, the government established the PPP Secretariat in November 2021 to stimulate private engagement in infrastructure development, as well as promotion of climate smart and sustainable development. However, large gaps in the legal framework for PPPs remained. A key recommendation of the WBG Country Private Sector Diagnostic (2021) was to strengthen the PPP framework by introducing a comprehensive PPP law addressing the remaining gaps and shortcomings of current legislation.

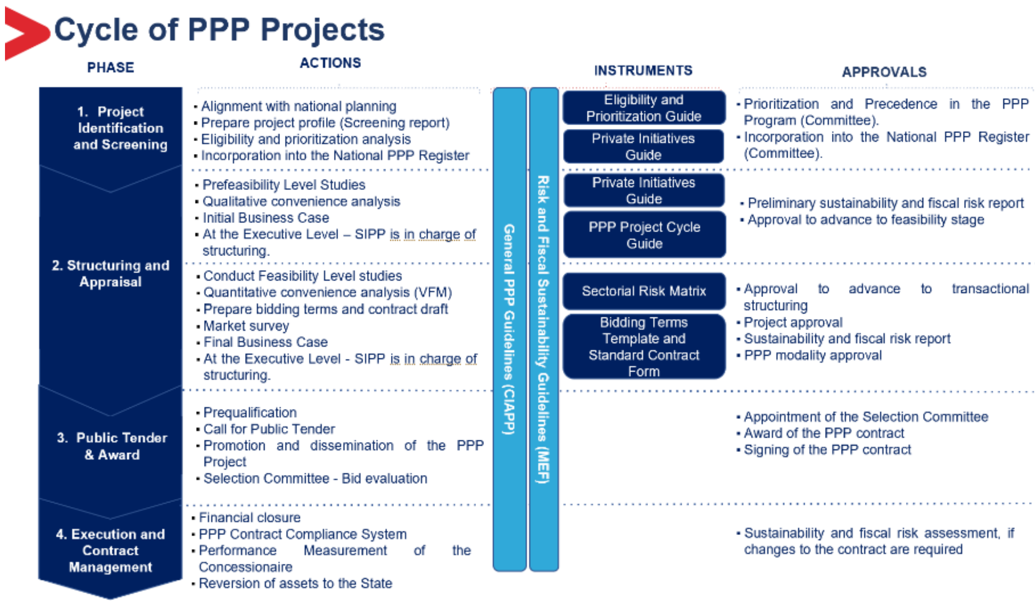
46. **Substance of Prior Action (PA#5).** On December 20, 2023, the Government of Ecuador enacted the Organic Law for Economic Efficiency and Employment Generation. This law introduced the "Creation of the Regime for the Attraction of Investments, through Public-Private Partnerships (PPPs)," which establishes a new institutional framework for PPPs. With this law, Ecuador not only aligns itself with international sound practices in PPPs but also lays the groundwork for efficient and transparent collaboration between the public and private sectors. [40]

47. The new PPP Law addresses key aspects lacking in the previous legislation and offers greater legal certainty to investors by (i) aligning the country's needs with the PPP program; (ii) regulating the complete PPP project cycle; (iii) including clear procedures, roles, and responsibilities for all entities involved; (iv) ensuring fiscal sustainability; (v) ensuring full compliance with social and environmental considerations (including Ecuador's climate commitments in achieving net zero emissions by 2050 and enhanced climate resilience); (vi) strengthening transparency processes; and (vii) protecting private investments. All PPP projects will have to be developed under the conformity of environmental laws and Paris Agreement commitments by focusing on demonstration of GHG reductions and increased greater resilience to climate change.

48. The PPP Law mandates the establishment of the "National Registry of Public-Private Partnerships." This registry is the last step of the "Project Identification and Screening" phase (see Integral Cycle of PPP Project below). The law's implementing regulations, which are part of this prior action, contain provisions that allow the registry to become operable. Resolution No. CIAPP-A-2024-0001, dated May 23, 2024, approved the registration of seven PPP projects prioritized by the government in the National PPP Registry. Six of these projects pertain to

[40] The new PPP law is informed by UNCITRAL'S Model Legislative Provisions on Public-Private Partnerships (2019) and the World Bank's Guidance on PPP Legal Frameworks (2022).

the road sector.



Source: (SIPP, 2024) General Process Guide for the Submission and Approval of Projects under the Public-Private Partnership modality.

49. **Expected results and Indicators.** The abovementioned law and regulations will enable the registration of at least 10 projects in the PPP registry by the end of 2025. The PPP law will facilitate the engagement of private investments in the country's strategic sectors and further contribute to the implementation of national climate goals of reduction of GHG emissions and climate-smart development.[41] Expected private capital enabled is $200 million in investment by 2028.

Facilitating private investment in the electricity sector

Prior Action DPF	PA#6. To secure affordable electricity generation solutions, optimize the use of public funding, and unlock private investments to help overcome the electricity crisis due to increasing climate impacts, the Borrower enacted a law that allows additional market participants, including joint ventures in which the state has the majority interest, to enter the electricity market and establishes the National Energy Efficiency Investment Fund (Completed). Evidence: *Ley de Competitividad Energética,* as published in Official Gazette (*Segundo Suplemento*) No. 475 on January 11, 2024.

50. **Rationale and Background.** Ecuador is confronting a severe electricity supply crisis due to the impacts of recurrent drought risks caused by El Niño/La Nina Southern Oscillation (ENSO). The country's vulnerability to these events is heightened due to its heavy reliance on hydropower for electricity generation where droughts caused by these events significantly reduce the amount of electricity generation and ability to meet electricity demand. Additionally, the rapidly growing electricity demand and substantial delays in essential power sector investments are contributing to the severity of the crisis. The Ministry of Energy and Mines (MEM) estimates that new hydro and renewable energy projects to meet rising electricity demand until 2032 will cost US$6.5 billion (11.5 percent of 2022 GDP). It will be difficult for the GoE to cover all these costs with public financing. In October 2023, MEM declared an electricity sector emergency and began rationing power for two to four hours per day until January 2024. According to government estimates, the cost of importing more expensive electricity from

[41] The implementation of this reform will be supported by the technical assistance from the IFC and the World Bank's Transport Global Practice.

Colombia from September to December 2023 to help confront the electricity crisis was around US$280 million. However, the economic impact on the economy could be more than twice this amount. In April 2024, the country faced a second electricity crisis with longer power cuts and a two-day national shutdown to reduce demand.[42] There is a significant risk of additional supply crises in upcoming dry seasons unless the country can rapidly enhance its adaptation actions and implement energy efficiency and demand-side management measures to rationalize energy use.[43][44] In December 2021, the MEM launched a 500 MW tender to procure NCRE to diversify the power matrix. However, despite issuing awards to various solar, wind, and small hydropower projects in January 2023, the associated contracts for these projects remain unexecuted. Private sector stakeholders remain apprehensive about the government's ability to meet financial commitments to purchase power, in large part because current tariff rates are fixed and do not fully reflect costs and are not sufficient to allow private generators to recuperate the investment costs of new generation.

51. **<u>Substance of Prior Action (PA#6)</u>.** To secure expansion and access of affordable renewable electricity generation solutions, optimize the use of public funding, and unlock climate-smart private investments to help overcome and adapt to the electricity crisis, the Borrower has enacted the Organic Law on Energy Competitiveness (*Ley Orgánica de Competitividad Energética -LCOE*). This law allows for *additional participants to enter the electricity market* through creating a short-term electricity market for transactions between the public and private participants to enhance access renewable energy and promote diversification of the energy matrix away from fossil fuels. It also allows commercial and industrial electricity clients to build their own distribution networks for self-supply, opening the power system to greater private investment that can support the access of rural populations to energy sources. Additionally, the LOCE broadens the types of services energy storage systems are permitted to provide, including those that will strengthen power system quality and reliability during extreme events and shortages due to droughts. In addition, the LCOE: (i) *establishes the National Energy Efficiency Investment Fund* (FNIEE for its acronym in Spanish)to promote renewable and efficient renewable energy investments, (ii) *provides specific criteria for installing renewable distributed generation systems* for self-supply (up to 10MW) with reduced regulatory requirements but increased commitments of surplus revenues for

[42] https://www.primicias.ec/noticias/economia/cortes-luz-ecuador-ministro-energia/.

[43] At the same time, Ecuador needs to address legal and regulatory gaps that will enable bringing in new electricity generation capacity and making critical investments for a resilient power network. Despite important efforts, the government has struggled to attract private sector investments in the power sector for generation, including new NCREs. In December 2021, MEM launched a tender for 500 MW for the installation and acquisition of NCRE that would contribute to reducing dependence on hydroelectric plants. Despite issuing awards for the full 500 MW to solar, hydro, and wind projects in January 2023, the associated contracts remain unsigned, given the remaining payment uncertainties that the government is working to overcome. Because of the regulated tariffs that did not allow for solar and wind projects in January 2023, the associated contracts lacked competition within the electricity market, as the public sector was responsible for most segments, new private investments throughout the electricity sector value chain were limited. However, given constrained public financing, this situation has resulted in significant investment delays for generation, transmission, and distribution, and weakening of the capacity of utilities to invest and maintain the system to guarantee reliable and continuous supply.

[44] Furthermore, there is limited investment in energy efficiency in the residential, industrial, and public sector, and past public programs to invest in energy efficiency have been discontinued and had a limited duration. Ecuador needs to scale up investment in energy efficiency, such as through the establishment of an energy efficiency fund that could provide financing for energy savings measures across various sectors. There is also a need for greater clarity on the requirements and size of distributed renewable energy systems that can be installed in the country that could help further reduce demand to confront the crisis. These types of renewable and energy efficiency measures would help reduce demand to mitigate the risks of power cuts and ensure the country is better prepared for future droughts. If measures to enable greater investment in electricity generation, particularly from NCRE, and to reduce energy demand are not enacted, climate risks will continue to impact the country’s electricity supply, which could have lasting fiscal and socio-economic impacts that could impair the country’s long-term economic growth.

enhanced resilient rural development; and (iii) *allows more cost-reflective criteria for calculating the cost of electricity service*. The LCOE thus supports attracting greater investment in RE generation and reduced energy consumption to prevent future electricity crises.

52. One of the LCOE's main provisions is the establishment of a national energy efficiency investment fund for financing energy efficiency and renewable programs and projects that enable achievement of the country's National Energy Efficiency Plan (PLANEE) 2016–2035. Spurring great investment in energy efficiency (EE) is key to increase climate adaptation and resilience and reducing energy demand to address expected future electricity supply shortages. The LCOE mandates that the fund's administration will be supported by the National Committee for Energy Efficiency (CNEE) and provides for several financing sources for the fund.[45] The World Bank is currently providing technical assistance to the GoE to support the design of the legal, technical, operational, and financial structure of the fund. The LCOE also provides specific criteria for developing distributed renewable generation to facilitate these types of investments that are critical to help reduce electricity demand and increase climate resilience particularly under drought conditions and expands the type of services energy storage systems can provide to make these investments more attractive to investors.[46] At the same time, the LCOE expands the type of investors that can invest in electricity generation, transmission, and distribution segments, so that public, private, and joint ventures in which the state has the majority interest, are all able to invest and creates a short-term electricity market to facilitate transactions between public and private market participants. Furthermore, the LCOE establishes a more cost-reflective methodology for determining the cost of electricity service that now includes investment costs and returns on private investment. These measures will help unlock greater investment in renewable generation, EE, and to strengthen the power system, to confront future crisis and facilitate climate adaptation while supporting Ecuador low carbon development plans.

53. The law is further a critical complement to the fuel subsidy reform, which effectively increases the price of carbon and creates incentives to invest in alternative sources of energy. The electrification investments in the shrimp sector following a previous reform to eliminate diesel subsidies for shrimp farms demonstrate the importance of a swift increase in the supply of renewable energy, while enhancing resilience due to greater climate extreme events.

54. **Expected results and Indicators.** The Energy Competitiveness Law is expected to enable increased (non-hydro) renewable energy capacity (GW), facilitating increased NCRE capacity installed by private operators from 310 MW to at least 672 MW by 2028 and wider distribution to rural communicates and off-grid communities for climate-resilient development. Once the country achieves energy security with the current demand, many sectors of the economy, such as industry, would need to be further electrified to achieve a low-carbon development, along with measures to promote energy efficiency.[47] Expected private capital enabled is US$407 million by 2028.

Enabling Women's Labor Force Participation

Prior Action DPF	PA#7. To incentivize women's labor participation and gender equality in the workplace, the Borrower has issued the implementing regulations for the *Ley Organica para Impulsar la Economía Violeta*. Evidence: Executive Decree No. 928, as published in Official Gazette (*Segundo Suplemento*) No. 444 on November 24, 2023.

[45] Financing sources for the FNIEE include resources from replacing inefficient equipment, resources provided by multilateral agencies, and the 1 percent contribution from the value of the registration of private combustion vehicles.
[46] "*Ley Orgánica de Competitividad Energética", Segundo Suplemento Nro. 475 del Registro Oficial. 11 de enero de 2024*.
[47] The implementation of this reform will be supported by the technical assistance from the Energy GP and the Ecuador Fiscal and Green Growth ASA (p506112).

55. **Rationale and Background.** In Ecuador, women who participate in the labor market have jobs of less quality, and, on average, receive lower remuneration compared to men. Only 54.2 percent of working-age women participate in the labor market, whereas the share among men is 77.5 percent. [48] Women are less likely than men to work as salaried employees (37.2 vs. 53.4 percent) and are more involved in vulnerable employment, that is, contributing to family and own account (58.3 vs. 41.6 percent) [49], which implies a higher level of informality and job insecurity.[50] Working women in Ecuador are confined to low-productivity sectors, and their access to managerial positions is limited.[51] Among the drivers of these disparities are gender norms that are deep rooted in the different spheres of women's lives. Gendered norms in recruitment, selection, hiring practices, evaluation and promotion practices, and overall workplace culture all contribute to horizontal and vertical occupational segregation.[52] Gender gaps in the labor force can undermine economic growth: GDP per capita in Ecuador may be undermined by around 13 percent in the long term due to these gaps.[53] To tackle such disparities, the Ecuadorian government approved the Law to Foster a Violet Economy[54] (Violet Law), supported under the Third Green and Resilient Recovery DPF. Overall, the law establishes principles of equality and nondiscrimination between genders in accessing economic opportunities.

56. **Substance of Prior Action (PA#7).** This Prior Action supports measures for implementation of the Violet Law in the workplace. Among other measures, the Regulatory Decree sets a mandate for large firms (50+ employees), a universe that comprises around 6,000 firms, to develop a "Gender Equality Plan" and register it with the Ministry of Labor.[55] This plan should contain, at a minimum: (i) an assessment of staff composition across grades; the firm's hiring, promotion, and remuneration practices, and the firm's measures in place to prevent and respond to gender-based harassment and violence; and (ii) in response, outline concrete measures to address identified disparities with a timeline for implementation, monitoring mechanisms; and human and financial resources. The decree also introduces a mandate for large firms to build capacity among staff to prevent, act, and respond against sexual harassment, and adapt their HR protocols accordingly.[56] Building on these mandates, the decree creates the "Violet Seal" to recognize the best performers on their Gender Equality Plans who demonstrate high standards of gender-inclusive working environments. As such, firms applying for Violet Seal are subject to an audit process by certifying bodies delegated by the Ministry of Labor.[57] Firms awarded the Violet Seal have access to a series of incentives, including preferential access to technical assistance and training (by the Ministry of Labor and Ministry of Production, Foreign Trade, Investments and Fisheries) and to international trade fairs, as well as multiple mechanisms for higher national and international visibility and recognition. Benefits linked to the Violet Seal, together with reputational benefits, might represent a valid incentive to motivate a change in a firm's behavior. The GoE expects these firms to be large in size and presence, with potential signaling effects for

[48] World Bank. 2018. Gender gaps in Ecuador. An overview; World Bank. 2023. Ecuador - Gender Scorecard (English).
[49] World Bank. Ecuador Gender Landscape (English). Washington, DC: World Bank Group.
[50] Ministerio del Trabajo, Gobierno de Ecuador (2024). PPT Estratégicas para fomentar el empleo formal.
[51] Ministerio del Trabajo, Gobierno de Ecuador (2024). PPT Estratégicas para fomentar el empleo formal.
[52] Carranza, Das, and Kotikula. 2023. Gender-Based Employment Segregation: Understanding Causes and Policy Interventions (English). Jobs Working Paper #26 Washington, DC: World Bank Group.
[53] Sharmila Devadas, and Young Eun Kim. 2020. "Exploring the Potential of Gender Parity to Promote Economic Growth," World Bank Publications - Reports 34698, The World Bank Group.
[54] *Registro Oficial Suplemento* 234, January 20, 2023.
[55] The Decree defines the minimum content of the gender assessment and the Equality Plan. Additional details are provided in "*Suplemento Nº 492 - Registro Oficial*" and related Annex "*Guía Práctica para Diagnósticos y Elaboración de Planes de Igualdad.*" These Plans should be updated every four years.
[56] This provision builds upon the recent approval of the *"Ley Orgánica Reformatoria para la Erradicación de la Violencia y el Acoso en todas las Modalidades de Trabajo" in Suplemento Nº 559 - Registro Oficial*.
[57] Once granted, the certification is expected to be valid for one year, and it can be renewed indefinitely, subject to requirements compliance.

stakeholders and across sectors.

57. **Expected results and Indicators.** The reform is expected to foster workplace gender equality. Evidence indicates that integrating women and men more equally as leaders, employees, entrepreneurs, and customers is reported to spur firms' productivity and competitiveness.[58] In the timeline of this operation, the results will be measured by the number of firms with 50 or more employees with verified adoption of standards for a gender-inclusive workplace (*Sello Violeta*).

Table 5: DPF Prior Actions and Analytical Underpinnings

Prior Actions	Analytical Underpinnings
Pillar 1: Enhancing Fiscal Sustainability	
PA#1. To increase tax revenues, the Borrower has increased the VAT rate from 12 to 13 percent.	• World Bank. 2019. "Ecuador Public Finance Review: Phase Two." Washington, DC. http://hdl.handle.net/10986/32359 License: CC BY 3.0 IGO. • Gunter et al. 2019. "Policy Implications of Non-linear Effects of Tax Changes on Output," World Bank Policy Research Working Paper 8720.
PA#2. To reduce expenditures and vehicle GHG emissions, the Borrower has increased the prices of gasoline to international market levels and established a price smoothing formula to protect consumers from excessive price volatility.	• *Ministerio de Economía y Finanzas. "Subsidios a los combustibles: Plan de acción y hoja de ruta de implementación de reforma."* Presentación. Abril 2024. • World Bank. "*Asistencia Técnica para proponer una metodología para fijar los precios del diésel y la gasolina que reflejen sus costos en el Ecuador*." Final Report. July 2023. • World Bank (2023–2024) Technical Assistance.
PA#3. To reduce tax expenditures, the Borrower has established a cap on tax expenditures for tax incentives granted under investment contracts for 2024, which cap is to be reviewed each fiscal year.	• *Ministerio de Economía y Finanzas (2023) Estimación del gasto tributario. Año 2022*. • OECD et al. 2023. Revenue Statistics in Latin America and the Caribbean 2023, OECD Publishing, Paris, https://doi.org/10.1787/a7640683-en. • World Bank. 2024. *Asistencia técnica para determinar una metodología de priorización de incentivos tributarios.* • Freedman et al. 2023. "Combining rules and discretion in economic development policy: Evidence on the impacts of the California Competes Tax Credit." https://doi.org/10.1016/j.jpubeco.2022.104777. • Hyman et al. 2023. "Firm responses to state hiring subsidies: regression discontinuity evidence from a tax credit formula" https://www.nber.org/papers/w30664 • https://www.gub.uy/ministerio-economia-finanzas/Comap
PA#4. To reduce the wage bill of the SOEs and GADs, the Borrower has introduced measures to strengthen SOE and GAD compliance with public sector salary caps.	• World Bank. 2019. "Ecuador Public Finance Review: Phase Two." Washington, DC. http://hdl.handle.net/10986/32359 License: CC BY 3.0 IGO.
Pillar 2: Enabling Private Investment and Female Labor Force Participation	
PA#5. To leverage the private sector in closing the infrastructure gap, the Borrower has enacted a new PPP law and issued its implementing regulations.	• *"Ley Orgánica de Eficiencia Económica y Generación de empleo" publicada en el Suplemento Nro. 461 del Registro Oficial. 20 de diciembre de 2023.* • *Decreto Ejecutivo Nro. 157 publicado el 7 de febrero de 2024.* • *"Guía General de Procesos APP" publicada en el Segundo Suplemento Nro. 435 del Registro Oficial. 13 de noviembre de 2023.* • World Bank. 2024. Technical Assistance. ASA: Green, safe and efficient transport infrastructure (P179175).
PA#6. To secure affordable electricity generation solutions, optimize the use of public funding, and unlock private investments to help overcome the electricity crisis due to increasing climate impacts, the Borrower enacted a law that allows additional market participants, including joint ventures in which the state	• *"Ley Orgánica de Competitividad Energética," publicada en el Segundo Suplemento Nro. 475 del Registro Oficial. 11 de enero de 2024.* • MEM. Ayuda Memoria/Ley Orgánica de Competitividad Energética. • World Bank. 2024. Technical Assistance.

[58] IFC. 2017. Investing in Women: New Evidence for the Business Case. IFC.

Prior Actions	Analytical Underpinnings
has the majority interest, to enter the electricity market and establishes the National Energy Efficiency Investment Fund.	
PA#7. To incentivize women's labor participation and gender equality in the workplace, the Borrower has issued the implementing regulations for the *Ley Organica para impulsar la Economía Violeta*.	• World Bank. 2022. Gender Responsive Procurement in the Caribbean – A Tool Towards More Inclusive and Resilient Societies. • World Bank. 2023. Attracting more young women into STEM fields.

4.3. LINK TO CPF, OTHER BANK OPERATIONS, AND THE WBG STRATEGY

58. **The DPF plays a central role in the WBG's engagement with Ecuador and is fully aligned with the WBG's FY19–FY23 Country Partnership Framework (CPF) (Report No. 135374-EC, discussed by the Board in June 2019), and the DPF is aligned with the FY23–FY25 PLR (Report No. 175329-EC, considered by the Board in May 2023).** The CPF focuses on achieving the WBG's vision—a world free of poverty on a livable planet—through three interdependent areas: (i) Supporting Fundamentals for Inclusive Growth, (ii) Building Human Capital and Protecting the Poor, and (iii) Enhancing Institutional and Environmental Sustainability. Pillar 1 and Pillar 2 of the proposed DPF support CPF objectives under results areas (i) and (iii).

59. **The DPF complements ongoing operations, such as additional financing for the Social Safety Net Project.** The DPF supports various reforms to increase revenues that will support the government in expanding social protection transfers. The social safety net project supports improvement in the targeting of Social Safety Net (SSN) beneficiaries and the provision of integrated relevant social protection packages.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

60. **Consultations on the reforms included in this DPF operation have taken place through various forms of stakeholder engagements and multiple channels of information exchange and feedback.** For instance, in the case of subsidy reform (PA#2), discussions were held with academia, student leaders, transport sector stakeholders, indigenous communities, and private sector representatives from oil, mining, and other industries. Additionally, multiple technical roundtables have been convened with key agencies involved in the reform process. In a similar vein, various technical discussions were organized to deliberate on setting limits for tax expenditures due to investment incentives (PA#3). The Violet Law implementation regulations covered by PA#7 were introduced to the Chambers of Commerce in Guayaquil and Quito and to the Chamber of Industries in Guayaquil. These initiatives complement the transparency measures inherent in the Ecuadorian legislative process, which mandates that all legal reform proposals be published online and undergo two open consultation periods of at least 30 days each in the National Assembly before formal consideration. Appendix F provides further details on the myriad ways in which the Ecuadorian populace has been able to voice their opinions on these and other prior actions proposed in the operation.

61. **This DPF operation forms part of a package of coordinated technical and financial assistance from international partners, including the IMF, IADB, and CAF.** The institutions' staffs have met regularly to coordinate

efforts and align messages. Strong complementarities, which exist in selected areas of support, are derived from coordinated technical assistance activities. For example, PA#1 and PA#3 under Pillar 1 involved coordination between the IMF (which provided financing and technical assistance) for the VAT reform and the IADB (which provided technical assistance) for tax administration.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

62. **The supported Prior Actions are expected to have positive and neutral effects on distributional outcomes over the long term.** With the strong analytical foundations that exist, including a model on the distributional impact of fiscal policies, Appendix E further details the diagnostic of the impact of the Prior Actions.

63. **Pillar I is expected to have neutral to slightly negative impacts on the poor in the short run, mitigated through targeted transfers, with potential positive impacts in the long run.** From a distributional perspective, household-level microsimulations indicate that increasing VAT (PA#1) is expected to have minimal negative welfare impacts on the poor. While the VAT in Ecuador is slightly regressive, and the tax pressure (relative weight of the VAT in households' budgets) of households at the bottom of the income distributions already higher than those at the top, the VAT increase would result in impacts of less than 1 percent on household budgets. Similarly, the effects on the vulnerable and the middle class are small. Removing gasoline subsidies (PA#2) is estimated to have a small negative impact on equity and poverty since households in the lower part of the income distribution consume little gasoline. The indirect effect is mostly through diesel transportation, which is not affected by this reform. The impact would result in less than 1 percent in household budgets for those in the lowest deciles. To mitigate these effects, the government plans to expand the *"Bono de Desarrollo Humano"* cash transfer program by at least 45,000 households, particularly for the poorest (deciles 1 and 2). Additionally, the government will provide targeted transfers to the transport sector to prevent tariff hikes and protect public transportation users. The fiscal measures covered by PA#3 and PA#4 are expected to have limited distributional effects, as they are expected to affect mostly non-poor households (especially in the case of measures affecting public employees) or have negligible direct impacts.

64. **Pillar 2 is expected to have positive distributional impacts, including advancements in gender equality.** While reforms to the electricity market (PA#6) are not expected to affect poverty and inequality in the short run, positive effects could be expected in the medium and long run. This could occur through increased private sector investment in electricity generation projects, reduced generation costs, improved energy efficiency, and job creation. Reforms that promote the Violet Economy (PA#7) are expected to have positive distributional effects and reduce poverty, particularly through the advancement in gender equality. Mandating larger firms to diagnose potentially discriminatory practices in recruitment, promotion, and remuneration, as well as certifying them for their demonstrated standards in fostering gender equality in the workplace, will enhance economic opportunities for women. Policy shifts regarding public-private partnerships (PA#5) are not expected to have any direct significant distributional impacts in the short run. However, they could have positive effects in the long run through job creation.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

65. **Measures supported under Pillar 1, aiming to increase fiscal revenues through the proposed DPF, are expected to have overall positive effects on the environment, forests, or other natural resources.** The proposed policy reforms under PA#2 aim to enhance a low-carbon development by gradually removing gasoline subsidies and establish a price smoothing formula is expected to incentivize more efficient fuel use and alternative low-carbon development and GHG emissions offset to ensure carbon neutrality. Actions proposed under PA#1 related to the VAT rate, PA#3, which aims to set a ceiling for tax expenditures of new investment contracts, and PA#4 related to salary caps are expected to have neutral effects.

66. **Policy measures supported by Pillar 2 are expected to have, overall, positive effects on the environment, forests, or other natural resources.** Positive long-term effects on Ecuador's environment are anticipated from PA5, which relates to fostering a PPP regime that includes sustainability principles and prevents activities that might harm the environment. Similarly, positive effects are expected from PA 6, which aims to unlock greater investment in renewable generation capacity and facilitate reduced energy consumption to prevent future electricity crises. This is expected to result in more efficient resource use and a reduction in energy consumption. While potential adverse effects on the environment might arise from PPP projects implementation, and the increased renewable energy capacity and potential associated infrastructure, Ecuador has a robust regulatory system, as outlined in the Environmental Organic Code, No. 983, 2017 (articles 172 to 190), to ensure appropriate environmental impact assessment and management. In addition, a recent Overview Assessment (technical assistance) on EIA conducted by the World Bank concluded that environmental management annual reports are mandatory for projects or activities of medium and high impact. The operator is obliged to comply with the approved content of the environmental audit (Art. 207 COAM). If control and monitoring mechanisms identify non-compliances, the operator must submit an action plan to mitigate them. As with other countries in the Region, the Environmental Authority faces limitations regarding staff capacity, structured procedures, and standardized criteria for reviewing complex documents such as EIAs, resulting in delays. It was recommended that these aspects be strengthened to ensure timely responses and efficiency within the EIA process which presents an opportunity for World Bank support going forward. PAs 7, is expected to have a neutral impact on the environment as they support the incentivization of women's participation and gender equality in the workplace.

5.3. PFM, DISBURSEMENT, AND AUDITING ASPECTS

67. **The Public Financial Management (PFM) environment in Ecuador partially aligns with international best practices[59] underpinned by a strong legal and regulatory framework, but its implementation remains mixed.** Ecuador's policies and priorities are explicit in the regulatory framework. The 2024 annual budget, which includes fiscal forecasts for 2024–2027 based on economic budget classification, was approved by the National Assembly and published in the official gazette and on the Ministry of Economy and Finance's (MEF) website.[60] The central government resources are managed through the national treasury system using the centralized Integrated Financial Management System (IFMIS), known as *e-SIGEF*, which effectively records financial transactions at the central government level. Since 2016, Ecuador has been gradually aligning with International Public Sector Accounting Standards (IPSAS), issuing its first financial statements with partial IPSAS alignment for the 2021

[59] This conclusion is the result of the Public Expenditure and Financial Accountability study carried out in April 2019.
[60] https://www.finanzas.gob.ec/wp-content/uploads/downloads/2024/04/Publicacio%CC%81n-Proforma-Suplemento-del-Registro-Oficial-No.530.pdf.

calendar year. These financial statements are publicly available on the MEF's website. The normative framework establishes the obligation to present financial statements to the Supreme Audit Institution (*Contraloría General del Estado*, CGE). Nevertheless, there is no specific deadline for this presentation, and the CGE has no obligation to issue an opinion on the financial statements. The most recent audited financial statement of the nonfinancial public sector is from 2022. However, there are still some challenges related to (i) a need for greater transparency in public finances; (ii) weaknesses in asset and liability management; (iii) insufficient fiscal discipline; and (iv) ineffective internal and external audit arrangements. Reforms initiated in July 2020[61] aimed to improve fiscal frameworks, rules, budget approval processes, and better integration of the public investment operations into annual budgets. In light of these facts, the fiduciary risk from the use of the country's PFM environment is assessed as *moderate*.

68. **The FOREX control environment of the Central Bank of Ecuador (BCE) has made important improvements and does not pose substantial risks to the flow of funds.** The BCE has bolstered transparency and accountability in foreign exchange (FOREX) management through IMF-agreed reforms, including audit enhancements and the adoption of International Financing Report Standards (IFRS)[62]. The IMF's December 2022 review confirmed strengthened BCE independence. The BCE's financial statements for the year 2023, audited by an international audit firm[63] in accordance with international standards, are published online, ensuring effective control over resources, including World Bank funds. These are channeled through Ecuador's Treasury Single Account (TSA), with a *moderate* risk to development objectives of this operation. The current operation will adhere to the same funds flow and disbursement arrangements as previous DPFs. In this regard, the WB will disburse the financing proceeds, denominated in US dollars, into a bank account held by the BCE that forms part of the country's official foreign exchange reserves. Upon receipt of these funds in such an account, the GoE will promptly transfer the proceeds into the TSA managed by the MEF. The Borrower, within 30 days of the withdrawal from the loan account, shall report to the Bank (i) the exact sum received into the bank account held by the BCE; (ii) the details of the account to which the equivalent of the financing proceeds will be credited; and (iii) the record that an equivalent amount has been accounted for in the Borrower's budget management systems.

69. **Public procurement is governed by the Public Procurement Law (*Ley Orgánica del Sistema Nacional de Contratación Pública*), with its amendments and rulings, which establishes the criteria to carry out procurement with transparency, efficiency, competitivity, equality, and integrity.** The law complies with good international practices on the control of public procurement regarding independent control institutions and the existence of defined control mechanisms under the direction of the General Comptroller. In 2021, the President approved a new decree (Decree No. 155) that requires the country's Supreme Audit Institution (*Contraloría General del Estado*, CGE) to issue a pertinence report for public procurements before they can be initiated. In addition, the National Procurement Entity (*Servicio Nacional de Contratación Pública*, SERCOP), after numerous consultations with several sectors, prepared a new regulation of the Public Procurement Law that was made official through a Presidential Decree in June 2022. This regulation includes clauses related to beneficial ownership and sustainable procurement, among other topics. For public procurement, the electronic procurement system (*Compras Públicas*) is mandatory, easily accessible, and free for all user levels, providing information on contracting terms and the variety of goods available. The GoE developed a sustainable public procurement

[61] In July 2020, the National Assembly approved a COPLAFIP reform, which introduced key adjustments to the normative framework. Some of these reforms were supported through previous DPF operations: First Inclusive and Sustainable Growth DPF (P169822), Second Inclusive and Sustainable Growth (P171190), and Third Inclusive and Sustainable Growth Development Policy Loan (P174115).
[62] As part of the 2023 audit, auditors noted the BCE has adopted IFRS.
[63] Kreston Ecuador, part of Kreston Global: International Accounting Network.

strategy that was made official through a resolution issued by SERCOP in October 2022. This strategy enables government entities to utilize sustainable procurement criteria in their processes, focusing on a direct reduction in dangerous wastes, improving efficiency, and other benefits in purchasing goods and services. SERCOP is developing specific tools and guidance notes to better implement the objectives of the sustainable procurement strategy. In March 2024, the GoE published a Presidential Decree that modifies several National Regulations, seeking the adoption of management systems for compliance with anti-bribery, anti-money laundering, anti-corruption; and other regulations related to the control of its resources, as well as the use of international best practices for civil works in the case of the Public Procurement Regulation. Considering these events, no major procurement risks related to implementation of the Prior Actions are expected.

70. **The closing date of the proposed operation is December 31, 2025.**

5.4. MONITORING, EVALUATION, AND ACCOUNTABILITY

71. **The MEF will be the main coordinating agency for monitoring and evaluating other participating ministries.** The Prior Actions detailed in this operation are the prime responsibility of the following ministries and agencies: MEF, Ministry of Labor, MEM, the Ministry of Environment and Water and Ecological Transition (MAATE), the Internal Revenue Service, and the Office of the Presidency. MEF will coordinate with other ministries to monitor the results indicators based on publicly available information. The WB will monitor implementation of the DPF through regular supervision missions.

72. **Program outcomes will be monitored by measuring progress toward achieving results indicators included in the policy and results matrix (Appendix A).** They will be evaluated following the disbursement of this operation. MEF will be responsible for presenting the information related to the reform implementation and progress made toward results on time upon request and in a format satisfactory to the WB.

73. **Grievance redress.** Communities and individuals who believe they are adversely affected by specific country policies supported as Prior Actions or tranche release conditions under a WB Development Policy Financing may submit complaints to the responsible country authorities, appropriate local/national grievance mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed to address pertinent concerns. Project-affected communities and individuals may submit their complaints to the WB's independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred or could occur due to WB noncompliance with its policies and procedures, and the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. Complaints may be submitted at any time after concerns have been brought directly to the WB's attention, and WB Management has been given an opportunity to respond. For information on how to submit complaints to the WB's corporate GRS, please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the WB's AM, please visit https://accountability.worldbank.org.

6. SUMMARY OF RISKS AND MITIGATION

74. **The overall risk of this operation is *substantial*.** Key risks include political and governance risks, macroeconomic risks, institutional capacity, and stakeholder risks, some of which cannot be fully mitigated (Table 6). Specific risks, along with mitigation measures, are discussed below.

75. **Political and governance risks are *high*.** As the February 2025 parliamentary and presidential elections approach, political activities are expected to increase, potentially impacting the pace and direction of reforms. Although there is a general consensus among parliamentarians and prospective government officials on the importance of macroeconomic stability and structural reforms, their approaches may vary. One-third of the reforms supported in this DPF (PA#1, PA#5, PA#6) were passed by the Assembly, where the government holds a minority. A key stabilizing factor is the widespread endorsement of the reform program backed by international institutions such as the IMF, World Bank, IDB, and CAF, along with its macroeconomic framework. To foster public understanding and support for these reforms, the government is proactively engaging in consultations and implementing communication strategies. In this effort, the World Bank is contributing through the ESMAP Trust Fund by aiding in the development of communication strategies for fuel subsidy reforms.

76. **Macroeconomic risks are *substantial*.** Increasing international interest rates, a slower-than-expected economic recovery, natural disasters, and lower commodity prices could lead to lower than expected private investment and revenue collection. Although the GoE is committed to improving the fiscal balance and investment climate, the materialization of these risks could prevent the country from achieving its result indicator targets within the projected timeframe. Therefore, the residual risk is assessed as *substantial*.

77. **Institutional implementation capacity risks are *substantial*.** The GoE is deeply committed to the proposed program, but implementation capacity is low. The authorities have mobilized technical assistance, including from the World Bank, in many areas supported by this operation to mitigate these risks. This includes the design of the expansion of social assistance, the incidence analysis of fuel subsidy reform, tax expenditure analysis, and the design of the National Energy Efficiency Investment Fund. Other multilateral donors have also provided significant technical support. The WB's dialogue is supported by and closely coordinated with the IMF, IADB, and CAF to avoid duplication and enhance synergies.

78. **Stakeholder risks are *substantial*.** Although the selection of Prior Actions has factored in local political economy considerations, political and social tensions can adversely affect successful implementation of the overall GoE reform agenda. For instance, previous fuel subsidy reforms posed challenges due to social tensions. This operation seeks to mitigate stakeholder risks by assessing the scope of potential opposition extending beyond the specific operation. The GoE mitigates these risks through consultations to ensure that critical reforms are well communicated and understood.

Table 6: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	High
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate

5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Moderate
7. Environment and Social	Moderate
8. Stakeholders	Substantial
9. Other	
Overall	Substantial

APPENDIX A: POLICY AND RESULTS MATRIX

DETAILED RESULTS FRAMEWORK

Objective	Results			
	Prior Actions under Stand-alone DPF (2024)	Indicator	Baseline, 2023	Target, 2025
Pillar 1. Enhancing Fiscal Sustainability				
1. Increasing fiscal revenues	**Prior Action #1.** To increase tax revenues, the Borrower has increased the VAT rate from 12 to 13 percent. Evidence: Paragraph 2 of the First Reformatory Provision of the *Ley Orgánica para Enfrentar el Conflicto Armado Interno, la Crisis Social y Económica,* as published in Official Gazette (*Suplemento*) No. 516 on March 12, 2024.	**RI#1.** VAT revenues as a result of the permanent increase in the VAT rate	$8,444.30	At least an additional $400 million
2. Reducing fiscal expenditures	**Prior Action #2.** To reduce expenditures and vehicle GHG emissions, the Borrower has increased the prices of gasoline to international market levels and established a price smoothing formula to protect consumers from excessive price volatility. Evidence: Section 2.2, the Second General Provision, and the First Transitory Provision of Executive Decree No. 308 issued on June 26, 2024.	**RI#2.** Expenditures on gasoline subsidies	$644 million	Less than $100 million
	Prior Action #3. To reduce tax expenditures, the Borrower has established a cap on tax expenditures for tax incentives granted under investment contracts for 2024, which cap is to be reviewed each fiscal year. Evidence: Ministerial Agreement No. 028 issued by MEF on June 17, 2024.	**RI#3.** Tax expenditures in new investment contracts	$300 million	$105 million
3. Strengthening the fiscal balances of SOEs and Subnational Entities	**Prior Action #4.** To reduce the wage bill of the SOEs and GADs, the Borrower has introduced measures to strengthen SOE and GAD compliance with public sector salary caps. Evidence: Ministerial Agreement No. MDT-2024-039 issued by the Ministry of Labor on March 17, 2024.	**RI#4.** GAD and SOE wage bills	$1,536 million	Less than $1,400 million
Pillar 2. Enabling Private Investment and Female Labor Force Participation				
4. Facilitating private	**Prior Action #5.** To leverage the private sector in closing the infrastructure gap, the Borrower has enacted a new PPP law and issued its implementing regulations. Evidence: (a) Book II of Title XI of *Ley Orgánica de Eficiencia Económica y Generación de Empleo*, as published in the Official Gazette (*Suplemento*) No. 461-on December	**RI#5.** Number of projects registered in the PPP registry	0	At least 10 projects

Objective	Results			
	Prior Actions under Stand-alone DPF (2024)	Indicator	Baseline, 2023	Target, 2025
investment in infrastructure	20, 2023 and (b) Book III of Executive Decree No. 157, as published in Official Gazette (*Tercer Suplemento*) No. 496 on February 9, 2024.			
	Prior Action #6. To secure affordable electricity generation solutions, optimize the use of public funding, and unlock private investments to help overcome the climate-induced electricity crisis due to increasing climate impacts, the Borrower enacted a law that allows additional market participants, including joint ventures in which the state has the majority interest, to enter the electricity market and establishes the National Energy Efficiency Investment Fund. Evidence: *Ley de Competitividad Energética,* as published in Official Gazette (*Segundo Suplemento)* No. 475 on January 11, 2024.	**RI#6.** (Non-hydro) Renewable energy capacity enabled by private sources (MW)	310 MW	At least 672 MW by 2028
5. Increasing Women Labor Force Participation	**Prior Action #7.** To incentivize women's labor participation and gender equality in the workplace, the Borrower has issued the implementing regulations for the *Ley Organica para impulsar la Economía Violeta.* Evidence: Executive Decree No. 928, as published in the Official Gazette (*Segundo Suplemento)* No. 444 on November 24, 2023.	**RI#7.** Number of firms with 50 or more employees with verified adoption of practices for a gender-inclusive workplace	0	At least 100

RESULTS INDICATORS BY PILLAR

Baseline	Closing Period
Enhancing Fiscal Sustainability	
VAT revenues as a result of the permanent increase in the VAT rate (Amount(USD))	
Dec/2023	Dec/2025
8444300000	At least an additional $400 million
Expenditures on gasoline subsidies (Amount(USD))	
Dec/2023	Dec/2025
$644 million	Less than $100 million
Expenditures on diesel and LP Gas (vehicles) subsidies (Amount(USD))	
Dec/2023	Dec/2025
189 million	0

GAD and SOE wage bill (Amount(USD))	
Dec/2023	Dec/2025
$1,536 million	Less than $1,400 million
Tax expenditures in new investment contracts (Amount(USD))	
Dec/2023	Dec/2025
300 million	100 million
Enabling Private Investment and Female Labor Force Participation	
Number of projects registered in the PPP registry (Number)	
Dec/2023	Dec/2025
0	At least 10 projects
Number of large firms with verified adoption of practices for a gender-inclusive workplace (Number)	
Dec/2023	Dec/2025
0	At least 100
Non-hydro renewable energy capacity enabled by private sources (Megawatt)	
Dec/2023	Dec/2028
310	At least 672 MW by 2028

APPENDIX B: FUND RELATIONS ANNEX

IMF Executive Board Approves 48-Month US$4 Billion Extended Fund Facility Arrangement for Ecuador

May 31, 2024

The IMF Executive Board approved a new 48-month arrangement under the Extended Fund Facility (EFF) for Ecuador, with access equivalent to US$4 billion. The Board's decision allows the authorities an immediate disbursement equivalent to US$1 billion.

The program aims to support Ecuador's policies to stabilize the economy, safeguard dollarization, and lay the foundations for sustainable and inclusive growth.

Key elements of the authorities' policy agenda include cementing fiscal and debt sustainability, expanding the social safety net, enhancing financial sector resilience, and further strengthening transparency and governance.

Washington, DC: The Executive Board of the International Monetary Fund (IMF) approved today a 48-month extended arrangement under the Extended Fund Facility (EFF) for Ecuador, with access equivalent to SDR 3 billion (430 percent of quota, equivalent to US$4 billion). The Board's approval allows the authorities an immediate disbursement of SDR 753 million, equivalent to US$1 billion, available to the public budget. This follows a previous EFF arrangement approved by the IMF Executive Board in September 2020 and completed in December 2022.

The Ecuadorian authorities have put together a robust plan and have started to take important policy steps to address the liquidity and fiscal situation. The IMF-supported program will build on these steps to strengthen fiscal and debt sustainability, protect vulnerable groups, rebuild liquidity buffers, safeguard macroeconomic and financial stability, and advance the structural reform agenda to lay the foundations for sustainable, inclusive, and stronger growth that benefits all Ecuadorians.

Following the Executive Board's discussion on Ecuador, Ms. Kristalina Georgieva, Managing Director and Chair, issued the following statement:

"The Ecuadorian authorities have undertaken swift and bold actions to tackle the fiscal and security crises. The IMF-supported arrangement under the Extended Fund Facility, which incorporates lessons from the earlier Fund arrangement, will support the authorities' policy plans to strengthen fiscal sustainability and protect vulnerable groups, safeguard dollarization and macroeconomic stability, rebuild liquidity buffers, enhance financial stability and integrity, and further advance the structural reform agenda to promote sustainable and inclusive growth. Strong commitment to the program and steadfast reform implementation will be critical for success. Continued engagement with official creditors and development partners, contingency planning, and a strong communication of the program's objectives to the public will also be important.

"The authorities are committed to implementing an ambitious fiscal consolidation plan, which will help mitigate Ecuador's structural fiscal vulnerabilities and cement fiscal sustainability over the medium term. It envisages balanced efforts on both the revenue and expenditure sides, with less reliance on oil sector developments, while protecting essential spending on security, the social safety net, and public investment.

“Work will continue to enhance the social safety net by expanding the coverage of cash transfer programs to families in need. This will help mitigate the adverse impact of fiscal consolidation on those vulnerable groups.

“Building on the recommendations of the IMF’s Financial Sector Stability Assessment for Ecuador, the financial policy agenda aims to strengthen financial sector oversight and coordination among relevant agencies, enhance the prudential framework governing capital and liquidity, and foster financial deepening and capital market development.

“The authorities are committed to continuing to strengthen their institutional framework by enhancing governance, transparency, public financial management, and public procurement. This will include advancing the audits of the state-owned oil company and healthcare expenditure, clearing arrears and improving cash management practices, and making progress with key AML/CFT legislation.”

APPENDIX C: LETTER OF DEVELOPMENT POLICY

REPÚBLICA DEL ECUADOR

Ministerio de Economía y Finanzas

Oficio Nro. MEF-DM-2024-023-O

Quito, D.M., 01 de julio de 2024

Mister
Ajay Banga
President of the World Bank

Ecuador: Climate Conscious and Growth Development Policy Financing (DPF) Program

Dear Mr. Banga,

Please accept my regards and my appreciation for your leadership to enhance the impact of the World Bank Group. Count on our gratitude, our commitment and our support towards those efforts.

Ecuador is undertaking reforms and implementing programs to address structural challenges to unlock opportunities at the national level, and contribute to tackling our common global issues. In many cases, these reforms and programs require the support of the international community. The program that is the foundation of the loan we are presenting today is an example of that work, one that we have designed on the bases of evidence and deep technical assistance We are proud to be partnering with the World Bank to ensure the expected results through careful implementation.

Recovering from the pandemic and other external shocks has not been easy. At the onset of our administration, Ecuador faced an extremely tight fiscal situation, sluggish growth prospects, an energy crisis that ended up rationing electricity, no access to credit markets, accumulated arrears of around 3.5% of GDP and the emergence and worsening of a security and violence crisis that has spilled over to other sectors of the economy and has taken away the sense of peace and cooperation that had long been the basis of Ecuadorian society. It was the scenario of a perfect storm and it called for ambitious and proactive action.

In that context, we took on the challenge by implementing some critical measures to address national priorities such as the fiscal imbalance and the challenging external environment, and to reorient a consolidation process in order to promote economic growth. Multiple critical reforms were adopted, including the strengthening of the social protection system to ensure support for the most vulnerable populations, safeguarding their well-being during these times of transition.

In order to reigninte economic activity, the administration initially promoted a limited and measured set of incentives to stimulate growth, youth employment, and investment in the energy sector -with an emphasis on renewables through Public private partnerships (PPPs) and other means. Most of the recent fiscal and growth-enhancing reforms were supported and approved in the National Assembly, demonstrating broad agreement.

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One of the swiftest and boldest actions was a law that increased the Value Added Tax (VAT) rate from 12% to 13% and empowered the government to further increase it to 15%. This measure is helping to alleviate liquidity constraints and mobilize domestic financial resources in a manner that will not disproportionately affect the poorest segments of the population. In Ecuador, basic goods are exempt from VAT which has shielded vulnerable populations from potential regressive effects.

We approached the international finance community with the main goal of harnessing these efforts and deepening a reform program that could benefit from international support. This path will enable the country to recover access to markets and continue the path towards fiscal soundness, inclusion, equity and sustainability. The loan we are requesting today is a key part of that strategy.

The program that is the basis of this loan contains two pillars. The first one is centered on enhancing fiscal sustainability by mobilizing domestic resources in the short, medium and long term. This includes better balancing revenues and spending in the central government, state owned enterprises, and decentralized governments, and protecting the vulnerable population. The second pillar focuses on enabling private investment as the main engine for growth and as the key factor in covering the needs for strategic infrastructure, including that in the energy sector and also enhancing female participation in the labor force.

Under the first pillar, we mobilized domestic resources by increasing the VAT rate by three percentage points as a one-year measure, but by one percentage point as a permanent change.
With the assistance of the World Bank, we developed criteria to determine the relative share of incentives to the total investment amount committed in each investment contract. Indicators considered in the methodology with varying weights include the additional employment generated, the size of the firm and the share of total investment involving clean technologies and whether the company has received certification for reducing pollution (Punto Verde), achieving carbon neutrality, and implementing practices to prevent gender violence (Sello Violeta). The methodology will also set a limit on the share of total incentives ceiling that can be granted to a single contract. It should be noted that the ceiling for tax expenditures under investment contracts will be set annually by the government. Additionally, we issued a ministerial agreement to ensure alignment in wage bill management and setting of wages at the same level for all public sector institutions which is expected to result to reduce and standardize wage spending across public sector organizations, including state-owned enterprises and local governments.

Ecuador has taken on long overdue subsidy reforms. We are reducing fossil fuel subsidies, by increasing the prices of low-octane gasoline and establishing a stabilization scheme to allow 5% increases and 10% decreases depending on the international price of oil. This will protect consumers from the volatility of the prices of oil. This measure is not only structurally necessary to ensure medium-term fiscal sustainability, but that is socially, distributionally, and environmentally improving. The savings generated from this decision will fund the expansion in the number of families with access to direct social protection cash transfers. Furthermore, in order to prevent price hikes for customers of public transportation, we established a compensation scheme for approximately 85,000 registered taxis, rural transport trucks and the motorized rickshaws commonly used as cabs in coastal areas.

We also consider it important, as part of the government's economic plan, to analyze and eliminate other categories of fossil fuel subsidies in our economy. Doing so will achieve several objectives

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Ministerio de Economía y Finanzas

at the same time. First, it will ensure that consumers do not substitute the subsidized fuel for another type of fuel. Second, it will reduce smuggling across the borders and subsidizing other illegal industries. Third, it will establish productivity instead of subsidies as the basis of competitiveness. And fourth, it will level the playing field for a fuel transition toward renewables. To this end, we have already begun dialogue with relevant stakeholders and will also be working with the technical assistance of the Bank and IFC toward designing a system that minimizes disruptions, ensures acceptability, and provides compensation as a buffer against potential adverse distributional effects.

These strategies are another step forward in our commitment to a better price of carbon, a topic we proudly co-lead as members of the Coalition of Finance Ministers for Climate Action.

The second pillar focuses on enhancing private investment by reforming our legal framework to allow more private sector participation in strategic sectors such as energy and infrastructure. PPPs can provide for a long overdue increase in infrastructure and capital spending that the public sector cannot absorb. With the introduction of the new PPP law and its regulations, the foreseen positive impacts are already unfolding.

In the energy sector, a new law was enacted which allows additional market participants to enter the generation segment and establishes the National Energy Efficiency Investment Fund to secure affordable electricity, optimize the use of public funding and unlock private investments to help overcome the climate-induced electricity crisis.

Aligned with this pillar, a fundamental priority for the government is the promotion of private investment to create quality jobs. Special attention is given to incentivizing women's labor participation and promoting gender equality in the workplace. To this end, we have issued implementing regulations for the Ley Orgánica para impulsar la Economía Violeta.

Our shared objective is to take Ecuador on a development path based on equity, sustainability, and equal opportunities, in a harmonious way with the planet. Collectively we face many challenges including conflict, violence, illegal industries, financial instability, and climate change. With the program presented in this letter, we are contributing to addressing those challenges. The support of multilateral organizations like the World Bank helps makes this possible. With this, we express our appreciation for the consideration of approval of this development policy loan to support this program.

Kindly receive my best regards, our standing invitation to hosting you in Ecuador and our gratitude for the support with this ambitious and challenging agenda.

Sincerely,

Mgs. Juan Carlos Vega
Minister of Economy and Finance,
Republic of Ecuador

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APPENDIX D: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social, or distributional effects: positive or negative
Operation Pillar 1: Enhancing Fiscal Sustainability		
PA#1. To increase tax revenues, the Borrower has increased the VAT rate from 12 to 13 percent.	Neutral.	PA#1 is expected to have neutral to small distributional negative effects without implementing compensation mechanisms.
PA#2. To reduce expenditures and vehicle GHG emissions, the Borrower has increased the prices of gasoline to international market levels and established a price smoothing formula to protect consumers from excessive price volatility.	Positive long-term effect expected derived from the gradual removal of gasoline subsidies.	Removing gasoline subsidies is expected to mildly impact equity and poverty, which will be mitigated through targeted transfers planned by the government.
PA#3. To reduce tax expenditures, the Borrower has established a cap on tax expenditures for tax incentives granted under investment contracts for 2024, which cap is to be reviewed each fiscal year.	Neutral.	No direct welfare impacts are expected from PA#3 in the short term. In the medium to long term, indirect positive effects on poverty and equity could arise if the increased tax collection from new investment contracts is targeted to redistributive policies.
PA#4. To reduce the wage bill of the SOEs and GADs, the Borrower has introduced measures to strengthen SOE and GAD compliance with public sector salary caps.	Neutral.	No poverty impacts are expected from PA#4, considering employees in SOE and GADs are not among the poor or vulnerable population.
Operation Pillar 2: Enabling Private Investment and Female Labor Force Participation		
PA#5. To leverage the private sector in closing the infrastructure gap, the Borrower has enacted a new PPP law and issued its implementing regulations.	Long term positive effect expected from the PPP regime including sustainability principles and preventing to implement activities that might harm the environment.	No significant effects are expected in the short run as the guidelines would not affect incomes for the poor or other welfare measures. In the long run, a potential small positive effect could be expected.
PA#6. To secure affordable electricity generation solutions, optimize the use of public funding, and unlock private investments to help overcome the climate-induced electricity crisis due to increasing climate impacts, the Borrower enacted a law that allows additional market participants, including joint ventures in which the state has the majority interest, to enter the electricity market and establishes the National Energy Efficiency Investment Fund.	Long-term positive impacts are expected to result in more efficient resource use and reduced energy consumption. Potential adverse effects on the environment might arise from the increased renewable energy capacity, but Ecuador has a robust regulatory system to ensure appropriate environmental management.	This PA is not expected to affect poverty and inequality in the short run. Yet, positive effects could be expected in the medium and long run by increasing private sector investment in electricity generation projects, reducing generation costs, improving energy efficiency, and creating jobs.
PA#7. To incentivize women's labor participation and gender equality in the workplace, the Borrower has issued a decree with the regulations for the *Ley Organica para impulsar la Economía Violeta*.	Neutral.	PA#7 is expected to positively impact welfare and increase equity in the short and long run.

PILLAR 1: ENHANCING FISCAL SUSTAINABILITY

Prior Action 1: To increase tax revenues, the Borrower has increased the VAT rate from 12 to 13 percent.

1. **Raising the VAT rate from 12 to 13 percent is anticipated to have minimal adverse distributional effects.** In Ecuador, the VAT constituted 48.5 percent of the national tax revenue in 2023, despite its differentiated 0 rate for essential household consumption and exemptions to promote economic activities like tourism and culture. A fiscal incidence analysis utilizing the Commitment to Equity (CEQ) methodology reveals a slight relative regressiveness of the VAT; the relative tax burden is heavier for households in the lower-income brackets, even when considering that for deciles 1 to 3, most of the household consumption is comprised of 0-rate goods and services and that over 49 percent of their monetary expenditure is from informal establishments[64] (Figures A4.1 and A4.2). VAT payments represent nearly 6 percent of household income for the lowest decile but only 3.7 percent for the highest. However, a significant portion of the tax revenue is sourced from higher-income households; the top 10 percent contribute more than 34.0 percent of the total VAT collection, whereas the bottom 10 percent contribute only 1.5 percent (Figure A4.3).

Figure A4.1. Share of household expenditure on goods and services by VAT rate

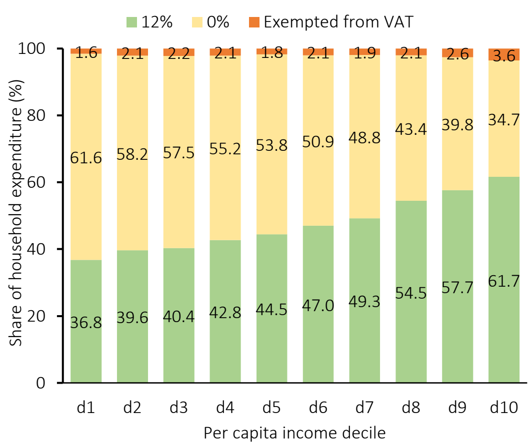


Figure A4.2. Share of household monetary expenditure on goods and services from informal establishments

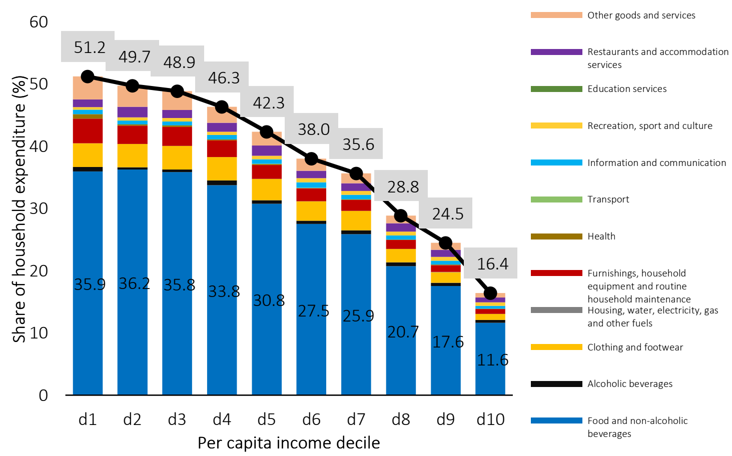
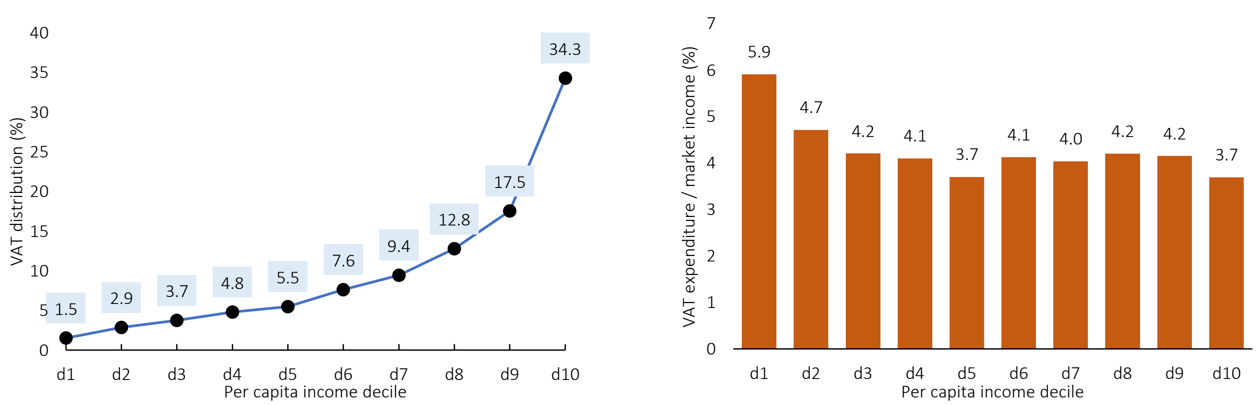


Figure A4.3. Incidence of VAT before the reform (in percentage)

Absolute **Relative**



Source: World Bank staff calculations using the Ecuador CEQ tool.

64 Informal establishments are neighborhood stores, markets, fairs, and street vendors that do not charge VAT in their sales. The consumption structure is from ENIGHUR 2011–2012, the most recent data on consumption.

2. **Raising the VAT rate from 12 to 13 percent may slightly increase the tax burden on households at the bottom of the income distribution.** The standard VAT rate in Ecuador has consistently ranked among the lowest in the region, surpassing only Panama and Paraguay and aligning with that of Guatemala.[65] The increase in the VAT rate means that households at the top contribute more to the additional tax collection than those at the bottom in absolute terms (Figure A4.4). However, those at the bottom are more adversely affected in relative terms. The rise from 12 to 13 percent implies that households in the first decile must allocate an additional 0.7 percent of their income to VAT payments, while it's only 0.4 percent extra for those in the tenth decile (Figure A4.5).

Figure A4.4. Change in average per capita household expenditure due to the increase in VAT from 12 to 13 percent (2024 USD)

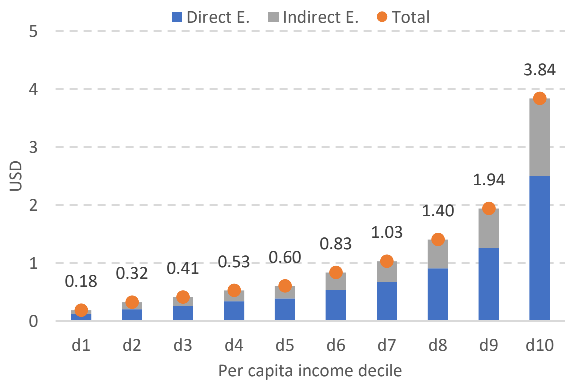
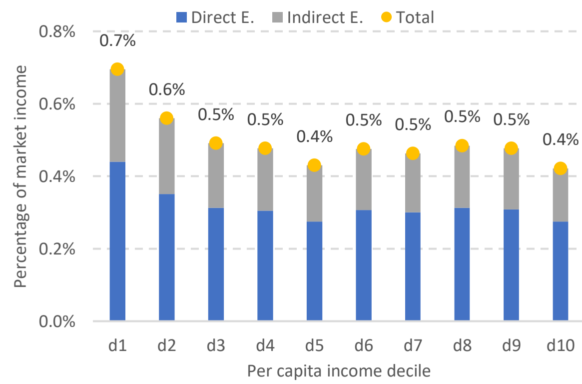


Figure A4.5. Change in average tax pressure due to the increase in VAT from 12 to 13 percent



Source: World Bank staff calculations using the Ecuador CEQ tool.

3. **When breaking down the total impact, we observe that the direct effect of the VAT rate increase is relatively more significant across the distribution, comprising over 60 percent of the total impact, with minimal variability by decile.** Both direct and indirect effects are more pronounced in transportation, miscellaneous goods and services, and clothing. Conversely, the direct and indirect effects stemming from changes in prices of food and beverages, health, and education services are negligible due to their exemption from VAT or being subject to a 0 rate.

Prior Action 2: To reduce expenditures and vehicle GHG emissions, the Borrower has increased the prices of gasoline to international market levels and established a price smoothing formula to protect consumers from excessive price volatility.

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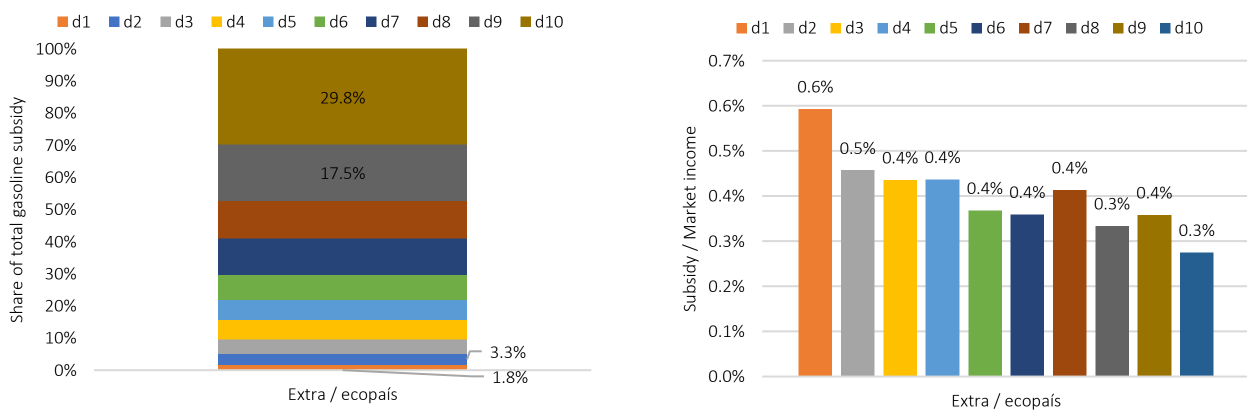
4. **Prior Action 2 is expected to have limited negative impacts on equity and poverty in the short term with potential positive long-term environmental co-benefits.** In 2023, gasoline subsidies for extra and *ecopais* fuels cost Ecuador US$644 million. The distributional analysis shows that more than one-half of total fuel consumption is concentrated among the top 20 percent of households, resulting in them receiving most of the subsidies.

[65] CIAT Data. 2024. Tax rates in Latin America - VAT. https://www.ciat.org/tax-rates-in-latin-america/?lang=en.

Specifically, over 47 percent of gasoline subsidies benefit the top 20 percent of households, while the bottom 20 percent receive only 5 percent of these subsidies (Figure A4.6 - left).

Figure A4.6. Gasoline subsidies in June 2024 by income decile

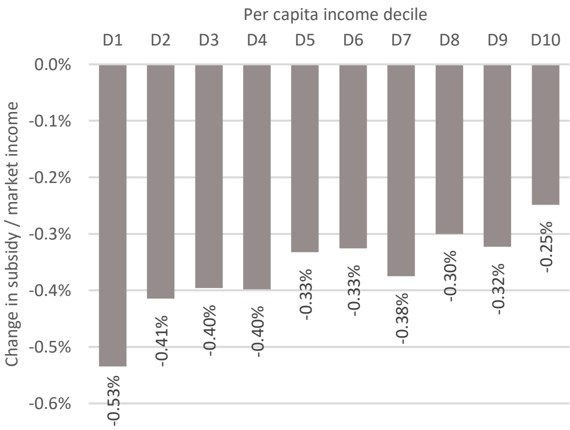
Distribution of total subsidies | **Relative incidence of subsidies (percentage of household market income)**

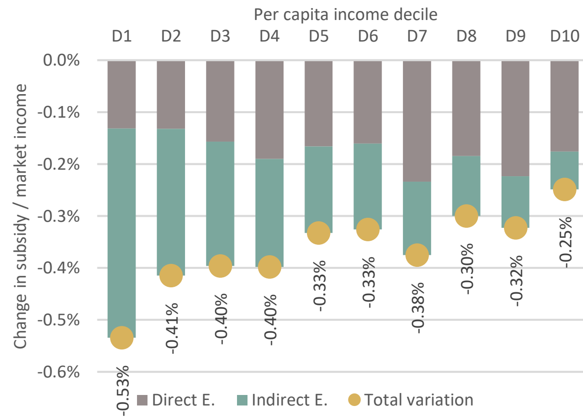


Source: Staff estimates using the Ecuador CEQ tool.

5. **Removing gasoline subsidies is expected to have a small negative impact on equity and poverty in the short term, while a price smoothing formula to attenuate excessive price volatility and a focalized compensation for transport will be applied in the medium term, protecting consumers.** The government plans to remove gasoline subsidies with a one-time price increase of USD 0.26 per gallon in the first month of the reform. Afterward, price bands of minus 10 percent/plus 5 percent will be implemented to prevent major price shocks. Although most of the subsidies benefit the higher-income groups in absolute terms, they are more significant for those at the bottom in relative terms. In June 2024, gasoline subsidies amounted to 0.6 percent of household income for the bottom 10 percent, compared to 0.3 percent for the top 10 percent (Figure A4.6 - right). The removal of subsidies would thus impact the poor more significantly. In the first month of the reform, the new gasoline prices would reduce household disposable income by 0.53 percent for those in the lowest decile, while the impact on the highest decile would be 0.25 percent. For those in deciles 2 to 4 (comprising the low vulnerable middle class), the reform would reduce income by 0.40 percent, and for households in deciles 5 to 7 (middle class), it would drop by 0.34 percent (Figure A4.7). These impacts consider direct and indirect effects, with indirect effects being predominant for the bottom four deciles and roughly 30 percent of the indirect effects coming from transportation costs. To prevent transport price increases, the Government of Ecuador (GoE) will implement a targeted cash transfer to taxis, collective buses/trucks, and motorized tricycles to cover the difference between the subsidized gasoline price and the price after the reform. Additionally, the GoE will implement controls on regular transport services, penalizing those who increase prices by permanently excluding them from the targeted subsidy.

Figure A4.7 Change in the relative incidence of gasoline subsidies after the reform relative to June 2024 (left) and decomposition of effects (right)





Source: Staff estimates using the Ecuador CEQ tool.

Prior Action 3: To reduce tax expenditures, the Borrower has established a cap on tax expenditures for tax incentives granted under investment contracts for 2024, which cap is to be reviewed each fiscal year.

6. **No direct welfare impacts are expected from limiting tax incentives for new investment contracts.** Tax incentives for investment contracts in Ecuador encompass the reduction of 5 percentage points in the standard corporate income tax (CIT) rate and the exemption of the currency outflow tax (ISD) as well as import tariffs. In the past decade, tax expenditures related to corporate income tax have increased from US$861 million (7.8 percent of tax collection, 1.0 percent of GDP) in 2012 to US$946 million (6.2 and 0.8 percent of tax collection and GDP, respectively) in 2022.[66] Nearly one-half of the 2022 tax expenditure (48 percent) is explained by ISD payments that are considered tax credits for the CIT. To increase tax revenues, the GoE will establish a cap on the total revenue forgone through such tax incentives and create a methodology to evaluate investment projects and determine the proportion of the tax benefit that will be granted. Considering this normative change will apply only to companies planning future investments, no direct impacts on poverty should arise from this PA. In the medium to long term, indirect positive effects on poverty and equity could arise if increased tax collection is allocated to targeted social protection programs or other social expenditures that reach the poor and vulnerable segments of the population.

Prior Action 4: To reduce the wage bill of the SOEs and GADs, the Borrower has introduced measures to strengthen SOE and GAD compliance with public sector salary caps. (Completed).

7. **Reducing the wage bill of the SOE and GADs is not expected to significantly impact poverty, considering most employees in SOE and GADs are not among the poor or vulnerable population.** The Ministerial Agreement MDT-2024-039 establishes the monthly remuneration for workers of public sector entities, featuring a remuneration scale for the highest hierarchical level with 10 grades ranging from US$2,115 to US$5,072. The agreement mandates that SOE boards of directors' issue normative acts to ensure monthly remunerations align with this scale while introducing other provisions to strengthen compliance with the monthly remuneration ceiling. Over the past decade, an average of 8.2 percent of the occupied population has been employed in the

[66] SRI. 2023. *Manual de Gasto Tributario 2022 y otros*. https://www.sri.gob.ec/estudios-investigaciones-e-indicadores#gasto.

public sector (Figure A4.8), with their monthly incomes typically 2.5 times higher than those of private sector workers (Figure A4.9). Furthermore, as of 2023, only about 0.50 percent of public sector workers reside in poor households, and these individuals are unlikely to be employed in SOEs.[67] Additionally, this measure is expected to generate fiscal savings (around US$200 million), which could be better allocated to programs that directly benefit the poor.

Figure A4.8. Distribution of employment between public and private sector workers

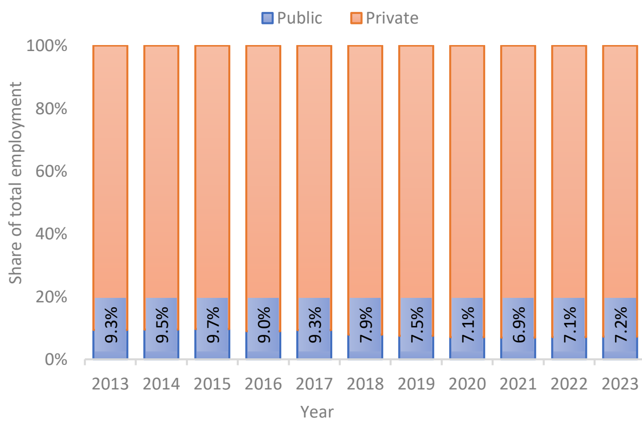
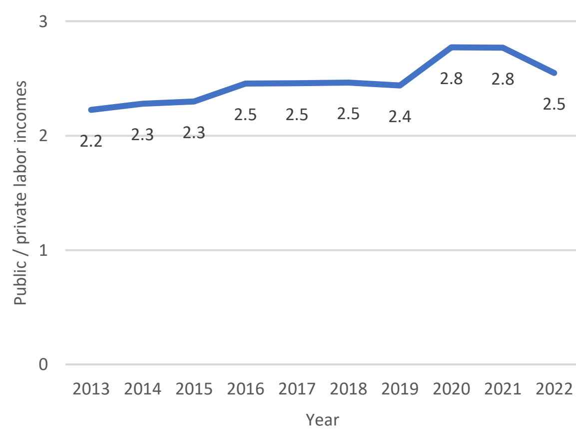


Figure A4.9. Ratio of public to private workers' monthly incomes



Source: Enemdu, December waves.

PILLAR 2 ENABLING PRIVATE INVESTMENT AND FEMALE LABOR FORCE PARTICIPATION

Prior Action 5: To leverage the private sector in closing the infrastructure gap, the Borrower has enacted a new PPP law and issued its implementing regulations.

8. **Prior Action 5 is expected to have a neutral impact on poverty reduction and shared prosperity in the short run.** Still, it holds potential for positive effects on welfare in the medium to long term through economic growth and enhanced infrastructure and public service delivery. The new public-private partnership (PPP) legislation aims to establish a robust institutional framework and procedures facilitating the participation of the private and popular economy sectors in significant public projects related to infrastructure and public services.[68] This law mandates the establishment of the "National Registry of Public-Private Partnerships," a centralized repository for essential information concerning each PPP project of national significance. Operating under standardized protocols and guided by principles of transparency, the registry ensures accessibility and accountability throughout project execution.

9. **Evidence about PPP's effectiveness in providing value for money and people is mixed.**[69] On the one hand, PPP contracts have proven "more effective and efficient for infrastructure development in terms of lower

[67] Enemdu Annual survey used for these estimations, and there are not enough observations to disaggregate more into the public workers.
[68] The General Regulations of the PPP Law establishes that the total value of the project must be equal to or greater than US$20 million (with US$10 million for GADs), with a duration of 5 to 30 years but no more than 40.
[69] Leigland, J. 2018. Public-Private Partnerships in Developing Countries: The Emerging Evidence-based Critique, The World Bank Research Observer, Volume 33, Issue 1, February 2018, pages 103–134, https://doi.org/10.1093/wbro/lkx008.

cost overruns and delays, better quality and greater benefits to users."[70] On the other hand, there have been negative perceptions of PPP contracts due to perceived unfairness. This is primarily because efficiency gains have not translated into lower user charges, thus disproportionately affecting the poor. These concerns have also contributed to constant renegotiations of these contracts and a lack of transparency in the tendering processes and their subsequent implementation. Leigland (2018) finds little empirical evidence that PPP projects have provided the poor with improved and affordable access to services. This is largely attributed to efficiency gains being achieved at the expense of employment, weak regulatory oversight, and a lack of involvement from all stakeholders throughout the project phases, leading to ineffective measures for benefit distribution.

10. **Public infrastructure that ensures basic services is necessary for people's quality of life and is key for economic growth.**[71] Generating a clearer legal framework for PPP investments, as this PA does, is necessary for the success of PPP projects. The PPP Law lays the foundations to create a clearer, more consistent, and more transparent environment to attract private participation in prioritized projects, which could improve public infrastructure and service quality and access in the medium to long run. Still, it is not expected to significantly improve access to public goods or services in the short run. Moreover, there are other requirements to ensure that the PPP regime serves people, reduces inequity, and contributes to the fight against poverty. To the very least, "positive poverty impacts must be purposely designed into projects, and then monitored by regulators."[72]

Prior Action 6: To secure affordable electricity generation solutions, optimize the use of public funding, and unlock private investments to help overcome the climate-induced electricity crisis due to increasing climate impacts, the Borrower enacted a law that allows additional participants, including joint ventures in which the state has the majority interest, to enter the electricity market and establishes the National Energy Efficiency Investment Fund.

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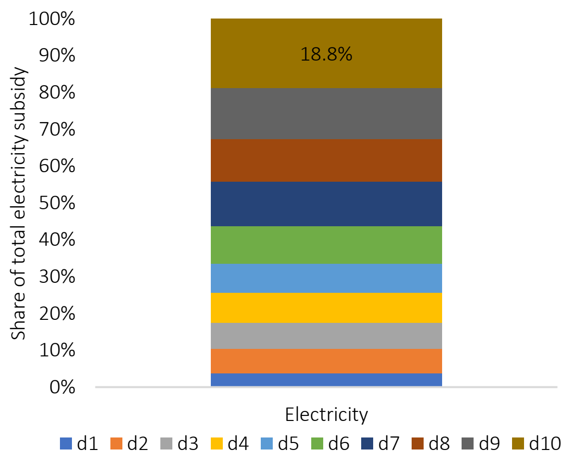
11. **This Prior Action is not expected to have significant distributional effects in the short run but may have positive impacts that could materialize in the long run.** In Ecuador, 97.5 percent of households have access to electricity (connected to the grid), with 99.0 percent in the urban and 95.0 in the rural areas.[73] Although there are considerable territorial differences in electricity access across the country (three provinces in the Amazon have less than 90 percent of coverage), Ecuador ranks above the LAC and upper-middle-income countries.[74] However, the electric sector is facing a crisis due to droughts caused by the El Niño Southern Oscillation (ENSO), rapidly growing electricity demand, and inadequate investment in the power sector. Consequently, power rationing commenced in the latter months of 2023, leaving households without electricity for several hours each day, with an estimated economic impact of nearly half a million dollars. Unfortunately, ongoing droughts and the absence of short-term solutions have led to a new wave of rationing in April 2024, resulting in longer hours without power and potentially larger socioeconomic impacts. In January 2024, the *Ley de Competitividad Energética* was enacted. This law aims to enhance the participation of mixed, privately-owned, foreign public, and popular economy companies in the electric sector by (i) introducing public tendering processes; (ii) promoting non-conventional renewable energy projects; (iii) establishing the National Energy Efficiency Investment Fund to finance all energy

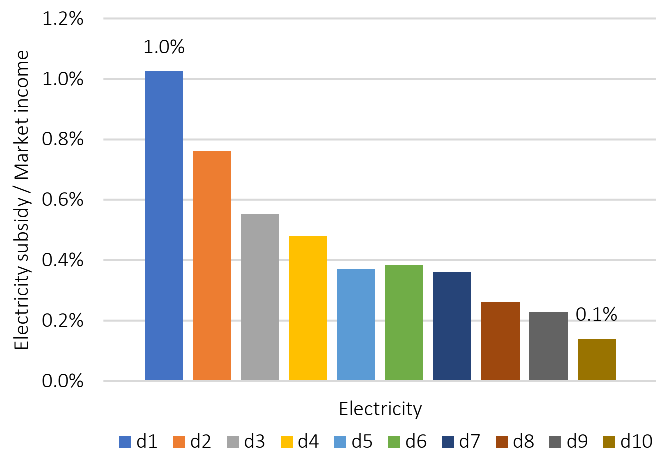
[70] ECLAC, 2020, p. 4.
[71] Inter-American Development Bank. 2018. Latin American and Caribbean Macroeconomic Report 2018: A Mandate to Grow. Washington, D. doi http://dx.doi.org/10.18235/0001026
[72] Leigland, 2018, p. 128.
[73] INEC. 2023. Population Census 2022. https://www.censoecuador.gob.ec/resultados-censo/.
[74] World Bank. 2024. World Development Indicators: Access to electricity series. https://databank.worldbank.org/source/world-development-indicators#.

efficiency and diversification plans, programs, and projects; and (iv) adjusting the cost of electricity to incorporate investment needs and better reflect other costs, among other measures.

12. **Although necessary, adjusting electricity tariffs could have distributional effects.** Similar to other energy subsidies in Ecuador, the electricity subsidy was predominantly directed toward the upper deciles in absolute terms: the top 20 percent of households received almost 33 percent of the total subsidy, while the bottom 20 percent accounted for barely 10 percent in 2019 (Figure A4.10 - left). However, in relative terms, as a proportion of households' income, the electric subsidy has been globally progressive: it represented over 1 percent of decile 1 households' income, while it was 10 times lower, at 0.1 percent, for decile 10 (Figure A4.10 - right). Modifying electricity prices is imperative to improve the sector's condition toward higher quality, uninterrupted service; however, it could have immediate negative impacts on people's budgets, necessitating compensation measures in the short run to alleviate them.

Figure A4.10. Electricity subsidy by income decile: Distribution of total subsidy (left) and relative incidence of subsidy (percentage of household market income) (right)





Source: World Bank staff calculations using the Ecuador CEQ tool.

13. **Access to reliable, quality energy is essential for economic activity and growth, which are important means to reducing poverty.**[75] Poverty reduction should result from the productive use of energy, that is, creating or improving (or not interrupting) income-generating activities. There are also other documented welfare gains from electricity access, such as in education and employment. A higher quality of electricity—consistent supply—is as important, with positive impacts on income, land and investment decisions, consumption expenditure, and women empowerment.[76] On the other hand, power outages negatively impact the production and revenues of companies, economic growth, and labor productivity,[77] and they cause welfare losses in general.[78]

[75] Indrawati, S. M. 2015. What you need to know about energy and poverty. World Bank Blogs. July 28, 2015. https://blogs.worldbank.org/en/voices/what-you-need-know-about-energy-and-poverty.
[76] Wilcox, M. et al. 2015. Utilising Electricity Access for Poverty Reduction. Institute of Development Studies. https://www.ids.ac.uk/download.php?file=files/dmfile/UtilisingElectricityAccessforPovertyReduction-MainReport.pdf.
[77] Anna T. Falentina, and Budy P. Resosudarmo. 2019. The impact of blackouts on the performance of micro and small enterprises: Evidence from Indonesia. World Development, Volume 124, 104635, ISSN 0305-750X. doi:https://doi.org/10.1016/j.worlddev.2019.104635.
[78] Abinet Tilahun Aweke, and Ståle Navrud. 2022. Valuing energy poverty costs: Household welfare loss from electricity blackouts in developing countries. Energy Economics. Volume 109, 105943, ISSN 0140-9883. doi: https://doi.org/10.1016/j.eneco.2022.105943.

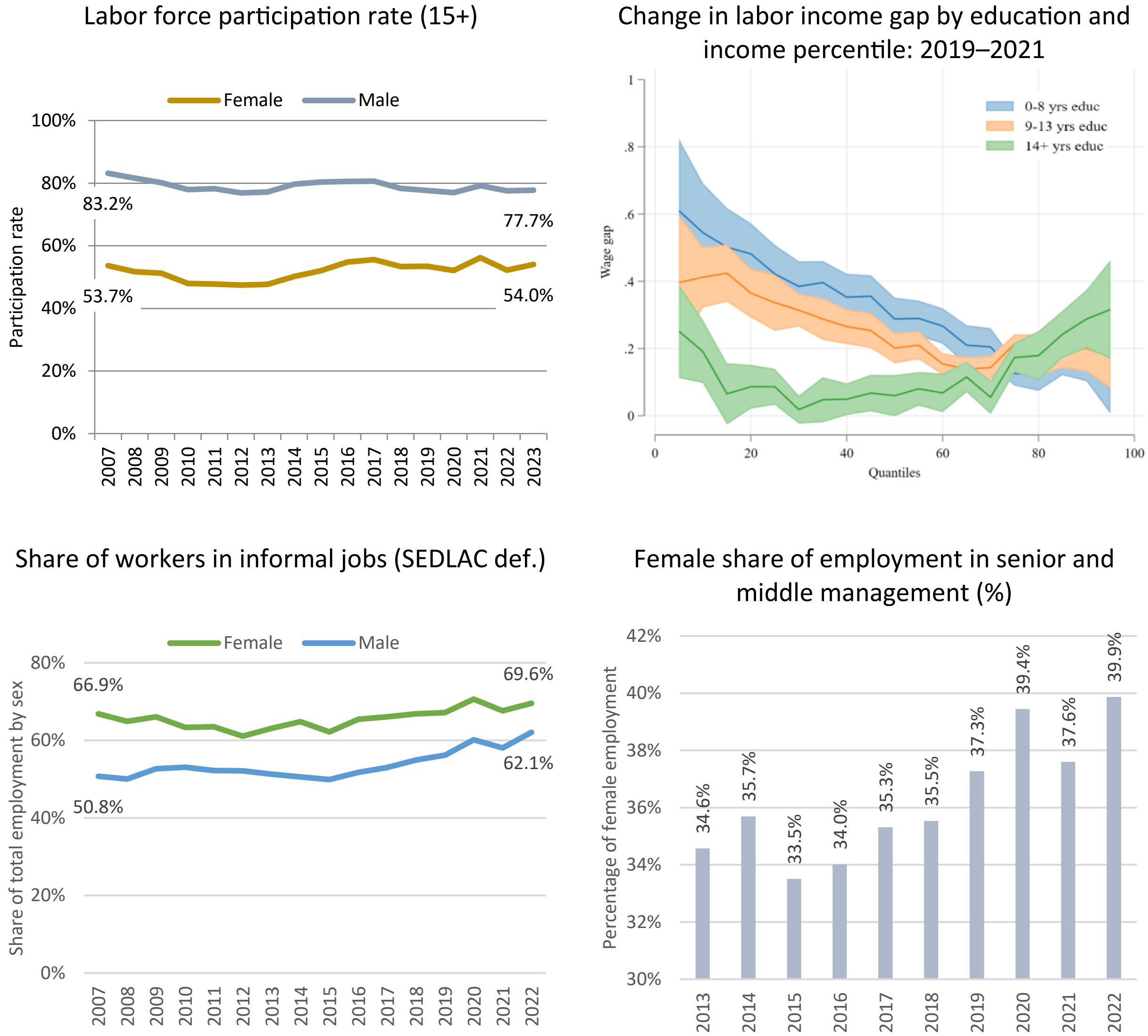
14. **Considering that PA#6 tackles some barriers that prevent the necessary investments in renewable energy generation, positive effects could be expected in the long run by increasing generation capacity, reducing generation costs, improving energy efficiency, and creating jobs.** It is also important, however, that other conditions are met so that improvements in access and reliability translate to reducing energy poverty and insecurity: among others, maintaining fair prices that do not deter households from staying formally connected to the grid, encouraging other small-scale renewable solutions (i.e., low-cost solar home systems) to include those who are not connected,[79] and implementing other actions toward securing a consistent and sustainable electricity supply in a changing climate.

Prior Action 7: To incentivize women's labor participation and gender equality in the workplace, the Borrower has issued the implementing regulations for the *Ley Organica para impulsar la Economía Violeta*.

15. **Prior Action 7, once implemented, is expected to have positive welfare impacts by narrowing gender inequalities in the labor market, increasing women's participation, improving conditions for their employability and retention, and reducing gender-based violence (GBV) in the workplace.** Ecuador has made some notable advances in promoting gender equality, but disparities persist. Employment and representation in decision-making positions are some of the usual areas where inequalities continue, hindering economic development and growth and impeding efforts to alleviate poverty. As of 2023, only 54 percent of women in the working-age group actively participated in the workforce, in stark contrast to the 78 percent of men who were engaged in the workforce. This persistent gap has shown minimal improvement over the past 16 years. Additionally, women still earn less than their male counterparts. On average, women have earned 78 cents for every dollar earned by men in the past 16 years. By 2023, the female-male labor income gap was 83.4 percent. This disparity is particularly pronounced among women who fall into the lower-income brackets and possess less formal education. In terms of employment quality, the share of women in informal jobs has been consistently higher, although the gap has been closing. Still, by 2022, 69.6 percent of female workers had an informal job compared to 62.1 percent of male counterparts. In general, women are 17 percentage points more likely than men to be in vulnerable employment (self-employed or contributing to family employment); and, young women (15–24 years old) are 17 percentage points more likely than young men to be out of employment, not in education, or in training.[80] Additionally, although women's participation in tertiary education surpasses men's, less than 40 percent of working women are in senior and middle management positions (Figure A4.11). Although the share of firms with female participation in ownership grew impressively from 24.1 to 70.4 percent between 2010 and 2017, only 22.9 percent have a woman as the top manager.[81] In the public service, the share of women in ministerial-level positions decreased to 25.0 percent by 2022 (from 32.5 in 2010).[82] Lastly, in 2019, nearly 8.0 percent of women reported suffering from GBV in their work environment during the previous year, and mostly in the urban areas (9.2 percent).[83]

[79] Sokhanvar, A. 2023. The impact of electrification on energy poverty in Honduras. Environ Sci Pollut Res 30, 73009–73017.
[80] Maquera Sardon, D.; Galeano Servian, D. 2023. Ecuador - Gender Scorecard (English). LAC Country Gender Scorecards FY23 Washington, DC: World Bank Group.
[81] World Bank DataBank. Data from Gender Statistics.
[82] World Bank. 2024. Ecuador Gender Landscape.
[83] INEC. Encuesta Nacional sobre Relaciones Familiares y Violencia de Género Contra Las Mujeres – ENVIGMU 2019. https://www.ecuadorencifras.gob.ec//violencia-de-genero/.

Figure A4.11. Selected Labor Market Indicators by Gender



Source: INEC-Enemdu, SEDLAC, and World Bank Gender Statistics.

16. **The regulations to implement the Violet Economy Law bring the law closer to being in practice, addressing some of the barriers that keep women at a disadvantage in the workplace.** Among others, the decree mandates that the national and subnational governments develop policies to (i) create conditions to level the playing field between women and men professionally, as well as in terms of political, social, cultural, and economic participation; (ii) implement actions to help employers include women without discrimination; (iii) strengthen compliance controls to sanction gender disparities in the workplace; (iv) develop education and training programs to prevent gender discrimination, harassment, and violence, and to promote gender equality across all areas.[84] In particular, it specifies criteria and procedures to develop and implement a "Violet Certification" for large firms (50+ employees) with demonstrated standards of anti-discrimination practices in recruitment, hiring, and salary practices; and in the prevention and response to sexual harassment. More broadly, the decree mandates large

[84] *Registro Oficial Ecuador. 2023. Reglamento General A la Ley…. Segundo Suplemento No. 444, 24 de noviembre 2023*.

firms to develop a Gender Equality Plan and register it with the Ministry of Labor. The plan should specify specific measures to address existing inequalities and the principles of investigation and sanction of sexual harassment. *Sello Violeta* builds on this mandate.

17. **Gender equality is a moral imperative and a condition for poverty reduction.** Legal reforms are critical to enable gender equality. They can affect the economic participation of women, their pay, discrimination in employment, education, health, marriage and parenthood, access to assets, and freedom in general.[85] Regulations such as the Violet Economy Law and its guidelines are a positive step toward fighting gender-based discrimination in the labor market and GBV. However, changes will only occur if this legislation is effectively enforced, leading to a change in behavior among employers.[86] Ecuador scored 92.5 in the legal frameworks score—which measures legal rights in 10 areas (mobility, workplace, marriage, parenthood, entrepreneurship, assets, pay, pension, childcare, and safety). Still, the mark decreased to 63.3 when considering whether supportive frameworks for the implementation of laws are in place (policies, plans, programs, budgets, inspections, and sanctions). This reveals that the gap in legal gender parity widens when considering the written law and the instruments that make it a reality. Evidence also indicates that integrating women and men more equally as leaders, employees, entrepreneurs, and customers is reported to spur firms' productivity and competitiveness.[87]

[85] Shanthosh, J. 2023. Effective laws to achieve equality for women. https://sdg-action.org/effective-laws-to-achieve-equality-for-women/
[86] World Bank. 2024. Women, Business and the Law 2024. © Washington, DC: World Bank. http://hdl.handle.net/10986/41040 License: CC BY 3.0 IGO
[87] IFC (2017).

APPENDIX E: PARIS ALIGNMENT ASSESSMENT

Program Development Objective(s): is to support reforms by the Government of Ecuador (GoE) to enhance fiscal sustainability and to enable private investment and female labor force participation.	
Taking into account our climate analysis, is the operation consistent with the country's climate commitments, including, for instance, the NDC, NAP, LTS, and other relevant strategies?	Yes, the operation is consistent with the country's NDC and National Development Plans. It also aligns with Ecuador's long-term goals of low-carbon growth and net-zero emission. Several Prior Actions supported by this operation will contribute to a decrease in CO_2 emissions from transportation, which will contribute to meeting NDC GHG emissions targets and long-term development plans. The reform program is expected to reduce GHG emissions and does not introduce any barriers to transition to low GHG emissions. In particular, the fuel subsidy reform (PA#2 and PA#3) will help reduce Ecuador's dependence on oil exports and advance NDC commitments. Also, the operation will facilitate energy sector legal reforms that enable greater investments in non-conventional renewable energy (NCRE), and that establish a financial mechanism to promote energy efficiency and renewable energy access that would help reduce electricity demand and emissions (PA#7). Furthermore, it aligns with key CCDR findings and recommendations, including energy decarbonization and sustainable and climate-informed resource management. Therefore, the operation addresses critical mitigation levers identified by the Intergovernmental Panel on Climate Change (IPCC) and the NDC plan to implement its goals under the Paris Agreement.
Mitigation goals: assessing and reducing the risks	
Pillar 1: Enhancing Fiscal Sustainability	
PA#1. To increase tax revenues, the Borrower has increased the VAT rate from 12 to 13 percent.	
Step M2.1: Is the Prior Action likely to cause a significant increase in GHG emissions?	**Answer:** No. **Reasoning:** The PA raises the price of taxes on emissions-intensive activities including gasoline, which could contribute to a decrease in CO_2 emissions from land transportation.
Conclusion for PA#1: ALIGNED	
PA#2. To reduce expenditures and vehicle GHG emissions, the Borrower has increased the prices of gasoline to international market levels and established a price smoothing formula to protect consumers from excessive price volatility.	
Step M2.1: Is the Prior Action likely to cause a significant increase in GHG emissions? Step M.2. Is the prior action likely to introduce or reinforce significant and persistent barriers to transition to the country's low-GHG emissions development pathways?	**Answer:** No. **Reasoning:** The PA might raise the price of gasoline, an emission-intensive activity, which could contribute to a decrease in CO_2 emissions from transportation. In addition, PA#2 and PA#3 do not present barriers to Ecuador's transition to low GHG emissions. The government is also committed to showing progress in increasing renewable energy sourcing and has initiated policy changes, including those that are supported in Pillar II of this operation. So, the PA will contribute with Ecuador net zero goals and will not reinforce barriers to low carbon development pathways.
Conclusion for PA#2: ALIGNED	
PA#3. To reduce tax expenditures, the Borrower has established a cap on tax expenditures for tax incentives granted under investment contracts, which cap is to be reviewed each fiscal year.	
Step M2.1: Is the Prior Action likely to cause a significant increase in GHG emissions? Step M.2. Is the prior action likely to introduce or reinforce significant and persistent barriers to transition to the country's low-GHG emissions development pathways?	**Answer:** No. **Reasoning:** Reducing tax incentives for new firms will increase the cost of establishing a firm in Ecuador, and therefore, it is likely not to cause an increase in GHG emissions. PA#3 does not present barriers to Ecuador' transition to low-GHG emissions
Conclusion for PA#3: ALIGNED	
PA#4. To reduce the wage bill of the SOEs and GADs, the Borrower has introduced measures to strengthen SOE and GAD compliance	

with public sector salary caps.	
Step M2.1: Is the Prior Action likely to cause a significant increase in GHG emissions?	**Answer:** No. **Reasoning:** The prior action focuses on lowering the wage bill of SOEs, which is not likely to have an impact on GHG emissions.
Conclusion for PA#4: ALIGNED	
Pillar 2: Enabling Private Investment and Female Labor Force Participation	
PA#5. To leverage the private sector in closing the infrastructure gap, the Borrower has enacted a new PPP law and issued its implementing regulations.	
Step M2.1: Is the Prior Action likely to cause a significant increase in GHG emissions? Step M.2. Is the prior action likely to introduce or reinforce significant and persistent barriers to transition to the country's low-GHG emissions development pathways?	**Answer:** No. **Reasoning:** The law introduces a PPP regime based on a guiding principle of sustainable development and the promotion of low-carbon activities. Such reforms are aligned with Paris Alignment commitment. The prior action will likely introduce or reinforce significant and persistent barriers to transition to the country's low-GHG emissions development pathways
Conclusion for PA#5: ALIGNED	
PA#6. To secure affordable electricity generation solutions, optimize the use of public funding, and unlock private investments to help overcome the electricity crisis, the Borrower enacted a law that allows additional market participants, including joint ventures in which the state has the majority interest, to enter the electricity market and establishes the National Energy Efficiency Investment Fund.	
Step M2.1: Is the Prior Action likely to cause a significant increase in GHG emissions? Step M.2. Is the prior action likely to introduce or reinforce significant and persistent barriers to transition to the country's low-GHG emissions development pathways?	**Answer:** No. **Reasoning**: The new law promotes an increase in the resilience to climate change by the energy sector and incentivizes investment in access to renewable energy in the country. This PA aligns with the NDC goals and the National Adaptation Plans. The government is also committed to showing progress to increase access to renewable energy sourcing and has initiated policy changes. Proposed reforms are universally aligned with Paris Alignment commitment and aligned activities actions. The PA do not present barriers to Ecuador's transition to low-GHG emissions as it contributes to the NDC commitments of enhancing the access to renewable energy and a diversification of the energy matrix.
Conclusion for PA#6: ALIGNED	
PA#7. To incentivize women's labor participation and gender equality in the workplace, the Borrower has issued the implementing regulations for the *Ley Organica para impulsar la Economía Violeta*.	
Step M2.1: Is the Prior Action likely to cause a significant increase in GHG emissions? Step M.2. Is the prior action likely to introduce or reinforce significant and persistent barriers to transition to the country's low-GHG emissions development pathways?	**Answer:** No. **Reasoning:** This measure is unlikely to cause a significant increase in GHG emissions. The PA do not present barriers to Ecuador's transition to low-GHG emissions
Conclusion for PA#7: ALIGNED	
Adaptation and resilience goals: assessing and managing the risks	
Pillar 1: Enhancing Fiscal Sustainability	
PA#1. To increase tax revenues, the Borrower has increased the VAT rate from 12 to 13 percent.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objectives?	**Answer:** No **Explanation** The prior action is not susceptible to climate hazards
Conclusion for PA#1: ALIGNED	
PA#2. To reduce expenditures and vehicle GHG emissions, the Borrower has increased the prices of gasoline to international market levels and established a price smoothing formula to protect consumers from excessive price volatility.	

Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objectives?	**Answer:** No **Explanation** The prior action is not susceptible to climate hazards
Conclusion for PA#2: ALIGNED	
PA#3. To reduce tax expenditures the Borrower has established a cap on tax expenditures for tax incentives granted under investment contracts for 2024, which cap is to be reviewed each fiscal year.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objectives?	**Answer:** No **Explanation The prior action is not susceptible to climate hazards.**
Conclusion for PA#3: ALIGNED	
PA#4. To reduce the wage bill of the SOEs and GADs, the Borrower has introduced measures to strengthen SOE and GAD compliance with public sector salary caps.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objectives?	**Answer:** No. **Explanation The prior action is not susceptible to climate hazards and help address salary constraints critical for growth.**
Conclusion for PA#4: ALIGNED	
Pillar 2: Enabling Private Investment and Female Labor Force Participation	
PA#5. To leverage the private sector in closing the infrastructure gap, the Borrower has enacted a new PPP law and issued its implementing regulations.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objectives?	**Answer**: No. **Explanation** the PA will actually promote the engagement of private sector to promote investments in infrastructure that can also be climate smart.
Step A3: Does the design of the prior action reduce the risk from climate hazards to an acceptable level, considering climate adaptation good practices applicable to the country context?	**Answer:** Yes. **Explanation** The growing need for climate finance for adaptation investments will also have to be met by the private sector, via the facilitation of PPPs.
Conclusion for PA#5: ALIGNED	
PA#6. To secure affordable electricity generation solutions, optimize the use of public funding, and unlock private investments to help overcome the electricity crisis, the Borrower enacted a law that allows additional market participants, including joint ventures in which the state has the majority interest, to enter the electricity market and establishes the National Energy Efficiency Investment Fund.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objectives?	**Answer:** No **Explanation** With the expansion of climate smart energy access, Ecuador will be able to confront with greater ease the increase of drought and heat events and cuts of electricity.
Step A3: Does the design of the prior action reduce the risk from climate hazards to an acceptable level, considering climate adaptation good practices applicable to the country context?	**Answer:** yes. **Explanation** With the expansion of climate smart energy access and diversification of the energy matrix, most vulnerable people will be able to access energy under increasing drought conditions and extreme events.
Conclusion for PA#6: ALIGNED	
PA#7. To incentivize women's labor participation and gender equality in the workplace, the Borrower has issued the implementing regulations for the *Ley Organica para impulsar la Economía Violeta*.	
Step A2: Are risks from climate hazards likely to have an adverse effect on the prior action's contribution to the Development Objectives?	**Answer**: no. **Explanation** The prior action will increase gender equality in the workplace, and not susceptible to climate hazards.
Conclusion for PA#7: ALIGNED	
The operation contributes to improved climate resilience in alignment with the NAP by advancing access to energy under increasing climate extreme events (droughts) and creating a favorable fiscal environment for investments in adaptation.	
Conclusion for Adaptation Criteria: ALIGNED	
Adaptation and resilience: Conclusion of the Assessment for the Program	
OVERALL CONCLUSION OF PARIS ALIGNMENT ASSESSEMENT: ALIGNED	

APPENDIX F: DISSEMINATION AND CONSULTATION PROCESS FOLLOWED BY THE BORROWER FOR THE WORLD BANK DPF PROGRAM

Source: GoE.

Prior Action No. 1 To increase tax revenues, the Borrower has increased the VAT rate from 12 to 13 percent.

PARAGRAPH 2 OF THE FIRST REFORMATORY PROVISION OF THE LEY ORGÁNICA PARA ENFRENTAR EL CONFLICTO ARMADO INTERNO, LA CRISIS SOCIAL Y ECONÓMICA, AS PUBLISHED IN OFFICIAL GAZETTE (*SUPLEMENTO*) NO. 516 ON MARCH 12, 2024

The Organic Law was debated extensively in the National Congress in late January and early February 2024, with invited participants allowed to make in-person interventions. The interventions made by each of the participants can be found at the following link: https://www.asambleanacional.gob.ec/es/multimedios-legislativos/91823-proyecto-de-ley-organica-para-enfrentar

In addition, written submissions were received from numerous civil society representatives. In the Debate and Vote in Plenary, the 27 parliamentarians who took the floor agreed on the urgent need to generate resources to strengthen and equip the security forces to enable them to respond more effectively to terrorism and to combat organized crime. With voting on the legislation conducted section by section, two provisions relating to VAT increases were not approved.

Prior Action No. 2 To reduce expenditures and vehicle GHG emissions, the Borrower has increased the prices of gasoline to international market levels and established a price smoothing formula to protect consumers from excessive price volatility.

SECTION 2.2, THE SECOND GENERAL PROVISION, AND THE FIRST TRANSITORY PROVISION OF EXECUTIVE DECREE NO. 308 ISSUED ON JUNE 26, 2024

As part of the procedures prior to putting the measures to eliminate subsidies into practice, meetings focused on socializing the measures were held with academics, student leaders, transport operators, the business sector including mining and oil companies, and representatives of indigenous groups.

In addition, technical roundtables focused on the design and implementation of the measures were held with the Ministry of Economy and Finance, the Ministry of Energy and Mines, the Ministry of Transportation and Public Works, the Ministry of Economic and Social Inclusion, the Ministry of Production, Foreign Trade, Investments and Fisheries, the Agency for the Control and Regulation of Energy and Non-renewable Natural Resources, the National Agency for Regulation and Control of Land Transportation, Traffic and Road Safety, Petroecuador, the Social Registry Unit, the National Public Records Directorate, and the Internal Revenue Service.

Prior Action No. 3 To reduce tax expenditures, the Borrower has established a cap on tax expenditures for tax incentives granted under investment contracts for 2024, which cap is to be reviewed each fiscal year. **MINISTERIAL AGREEMENT NO. MDT-2024-039 ISSUED BY MEF ON MARCH 17, 2024** Prior to the issuance of the measure, a series of technical roundtables aimed at defining and bringing the measure into operation were held with the Ministry of Economy and Finance, the Ministry of Production, Foreign Trade, Investments and Fisheries, and the Secretariat of the Strategic Committee for the Promotion and Attraction of Investments (CEPAI). In compliance with the unnumbered article of the Regulation of the Organic Code of Planning and Public Finances which rules on the "Determination of policy on tax benefits and incentives and their limits," the Ministry of Economy and Finance, overseeing a joint effort between the Policy Divisions (undersecretariats) of the Real and External Strategic Sectors and of the Budget and Fiscal Programming divisions, recommended setting a tax expenditure ceiling for 2024, based on a technical methodology as required by the Strategic Committee for the Promotion and Attraction of Investments (CEPAI), aimed at prioritizing addenda and /or investment contracts.
Prior Action No. 5. To leverage the private sector in closing the infrastructure gap, the Borrower has enacted a new PPP law and issued its implementing regulations. **(a) Book II of Title XI of Ley Orgánica de Eficiencia Económica y Generación de Empleo, as published in Official Gazette (Suplemento) No. 461 on December 20, 2023 and (b) Book III of Executive Decree No. 157, as published in Official Gazette (Tercer Suplemento) No. 496 on February 9, 2024** The draft Organic Law on Economic Efficiency and Employment Generation was an initiative of the President of the Republic. The economic component of this draft law was classified as urgent. The draft law was taken up by the Legislative Administrative Council and submitted for consideration and necessary action by the Standing Specialized Commission on Economic and Productive Development and Microenterprises of Ecuador. As part of the socialization process, a number of key stakeholders were consulted, including from the Internal Revenue Service; the Ministry of Economy and Finance; the Chamber of the Construction Industry; tax experts; the *Constructores Positivos* organization; the College of Public Accountants of Pichincha; experts on PPPs and duty free zones; the El Oro Prefecture; ZEDE Santa Rosa; public health specialists; the Las Lomas Group; the Construction Chamber of Guayaquil; the World Free Zones Organization; the Ministry of Tourism; the Ecuadoran Business Committee; CONGOPE; and the Metropolitan District of Quito. The interventions made by each participant may be found at the following link: https://www.asambleanacional.gob.ec/es/multimedios-legislativos/90968-proyecto-de-ley-organica-de-eficiencia In the Debate and Vote in Plenary, 38 Assembly Members supported the proposal of the Executive to mitigate Ecuador's economic crisis and submitted comments to improve the draft. They made a number of suggestions, including the following: that popular and solidarity economy debts below $10,000 with public financial bodies be written off; that procedures be simplified to enable young people to benefit

from student loans forgiveness; and that a minimum of $50,000 be established for investments in rural tourism.

With 107 Assembly Members voting in favor, the National Assembly approved the draft Law on Economic Efficiency and Employment Generation.

Prior Action No. 6. To secure affordable electricity generation solutions, optimize the use of public funding, and unlock private investments to help overcome the electricity crisis due to increasing climate impacts, the Borrower enacted a law that allows additional market participants, including joint ventures in which the state has the majority interest, to enter the electricity market and establishes the National Energy Efficiency Investment Fund.

Ley Orgánica de Competitividad Energética, as published in Official Gazette (*Segundo Suplemento*) No. 475 on January 11, 2024

Representatives of the business sector participated in the socialization process for the draft Organic Law on Energy Competitiveness, an initiative of the President of the Republic. They submitted their views and comments on ways to improve the text, which is now being considered by the Economic Development Commission.

In their interventions, the representatives agreed that the proposal is a positive one as it advances the sustainability of the industrial sector, promotes private participation in power generation and self-supply, and encourages the production of clean, renewable energies.

In the Debate and Vote in Plenary, the Assembly approved the draft Law on Energy Competitiveness and classified its economic component as urgent, with 131 votes in favor. The draft law seeks to resolve the rationing of electricity on the basis of the following three pillars: investment, new generation of clean energy, and de-bureaucratization of this sector.

Prior Action No. 7. To incentivize women's labor participation and gender equality in the workplace, the Borrower has issued the implementing regulations for the *Ley Organica para impulsar la Economía Violeta*

Executive Decree No. 928, as published in Official Gazette (Segundo Suplemento) No. 444 on November 24, 2023

The regulatory documents for the Violet Economy Law and the methodology of how to prepare a Gender Equality Plan were presented to the Chambers of Commerce of Quito and Guayaquil, as well as the Chamber of Industry of Guayaquil.

Example of the invitation to these events:


Plan de Igualdad:
Diseño y Registro
Enlace de registro:
Evento gratuito
Expositoras del Ministerio de Trabajo:
• María Daniela Peralta, Directora de grupos de atención prioritaria.
• Gabriela Jaramillo, Directora de normativa, trabajo y empleo.
• María Verónica Jiménez, Experta de grupos de atención prioritaria.
Jueves 08 de febrero 2024
10:00 • Sala de Juntas
Edificio Las Cámaras, piso 9
Amazonas y República
Fecha límite de inscripción:
Martes, 06 de febrero de 2024,
Cupos limitados.
CÁMARA DE INDUSTRIAS Y PRODUCCIÓN
ECUADOR
Ministerio del Trabajo