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The International Monetary Fund (IMF) confirmed on Aug. 30 that it had tentatively approved a US$400 million standby-loan package for Ecuador. The IMF money, which will also give Ecuador access to about US$800 million in loans from other international lending institutions, came despite Ecuador's unprecedented deferral of interest payments on its Brady bonds. President Jamil Mahuad now must convince Congress to pass the 2000 budget and tax-reform measures required for disbursement of the funds.

Mahuad had announced the IMF agreement in a televised speech Aug. 27, as he appealed to opposition legislators to back the proposal. That announcement and the resignation of Finance Minister Ana Lucia Armijos closed a turbulent week in Ecuador, and followed the government's notice that it would defer for 30 days interest payments of US$96 million on Brady bonds due Aug. 31.

"Today we obtained the official assistance of the IMF for the government's economic and social plan, after many months of effort and negotiations," Mahuad said. "For the first time in our history, we have secured a social clause in the IMF agreement, which was never even discussed before. Now we can guarantee salary payments to teachers, doctors, and police."

At the same time, Mahuad announced the resignation of Armijos, the main negotiator of the IMF deal. She will be replaced by Guillermo Lasso, former governor of Guayas province. Armijos, who has headed the Finance Ministry since February, has had strong opposition from parties across the political spectrum, social movements, and business leaders because of her adjustment policies. Before leaving office, she said she hoped Congress would approve the necessary reforms.

Armijos resigned in large part to make possible a deal with Congress regarding pending legislation. "I believe it is necessary for me to resign to make political agreements possible to pass tax rationalization for the country and a financed budget," said Armijos.

Ecuador's interest deferment makes history Ecuador's failure to make the interest payment made it the first country to miss a payment on Brady bonds.

Mahuad said the country would defer the payment for 30 days while it negotiates debt restructuring with bondholders. Ecuador has a 30-day grace period before it technically defaults. Thus, the IMF has, for the first time, authorized a loan for a country that has postponed interest payments on Brady-bond debts. Brady bonds, named for former US treasury secretary Nicholas Brady, let countries repay debt by repackaging defaulted loans into bonds partly backed by US Treasury bonds.

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In New York, analysts predicted tough negotiations for Ecuador as it tries to become the first nation to restructure its Brady debt. Mahuad said his government will renegotiate US$6 billion in Brady bonds and will then renegotiate another US$2.2 billion with the Paris Club of lender nations. The restructuring must be agreed to before the grace period expires or Ecuador would automatically default on US$500 million in Eurobonds as well. Investors are watching reaction to Ecuador's deferment. "Other Latin American countries are under similar pressures, and, with the exception of Mexico, are in recession," said Jerome Booth of Ashmore Investment Management.

Among the factors being watched is whether the government will offer to exchange the debt for new bonds on a voluntary basis, or whether bondholders will be forced to accept the exchange. Some analysts expect that Ecuador, whose Brady bonds stem from a 1994 debt restructuring, will seek about 30% in debt forgiveness and an interest-free grace period of one to two years through an exchange offer.

The IMF's role worries some investors. Ecuador has become a test case of the IMF's new approach to bailing out countries in crisis. It is insisting that Ecuador negotiate debt relief from its private creditors a response to criticism that IMF loan funds often flow back out of recipient countries to pay off private creditors.

But some analysts see problems with the approach. Gary Hufbauer of the Institute for International Economics said, "Brady bonds helped countries pull themselves out of depression. They were thought of as superior debt, protected by collateral and a firm resolve to repay in full. For the fund to appear to be forcing Ecuador to default on these loans could make it impossible to use this device again."

Central Bank predicts recovery as budget goes to Congress

As Ecuador announced the IMF agreement, the Central Bank predicted that rising oil prices and a healthier construction sector could speed economic recovery next year. Ecuador's US$13 billion debt of which US$6 billion is in Brady bonds is expected to total 117% of GDP by year's end, and 62.5% of its population lives in poverty. The Central Bank estimated that GDP would grow 3% to US$15 billion in 2000 compared with an expected 7% contraction this year. The bank said the key to recovery would be the oil sector, expected to grow 5.8% in 2000 compared with a 2.6% decline this year.

Ecuador is Latin America's sixth-largest oil producer and fourth-largest exporter of crude. The Central Bank sees foreign reserves falling this year by US$352 million to US$1.346 billion, compared with US$1.698 billion last year, but expects them to rebound to US$1.696 billion in 2000. It also expects a US$1.2 billion trade surplus this year compared with a US$995 million deficit in 1998. For 2000, it expects both imports and exports to grow, leaving a trade surplus of US$986 million. Ecuador will only get the IMF loan if the opposition-dominated Congress approves the plan, much of which is reflected in the 2000 budget. The budget is based on an average oil price of US$14.70 per barrel and an increase in crude production to US$141 million, US$82 million of which would be exported.

Economy Minister Guillermo Lasso said the proposed budget will be US$4.2 billion and will contain tax increases and other reforms agreed to with the IMF. The spending plan will represent a sharp

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decline in real terms from this year's US$5.2 billion budget, he added. The government is expected to call for an increase in the 10% value-added tax (impuesto al valor agregado, IVA) to 15% as part of the IMF agreement. Under the IMF accord, the government needs to reduce the 4% budget deficit to 2.5% of GDP in 2000. Armijos said the economic program would slash inflation to 25% from the projected 60% this year the highest in Latin America.

Congressional opposition strong

The budget went to Congress Sept. 1, but approval could become mired in political squabbles. Legislators will have two months to study the budget and approve it. Although the budget contains tax reforms needed to seal the IMF accord, opposition is already being expressed. "It would be unheard-of for the government to push recipes that failed before like financing the budget with newly implemented taxes," said Napoleon Gomez, legislator from the powerful opposition Partido Social Cristiano (PSC).

Passage of the budget will not be easy. The governing Democracia Popular (DP) holds one-third of the congressional seats, and lacks the necessary votes to approve either the budget or the reforms. It must count on support from other parties, but negotiations to form alliances have so far been unsuccessful. And political leaders in both the PSC and the Izquierda Democratica (ID), which have previously backed Mahuad's tax increases, said they will not accept IMF demands for higher taxes. "I refuse to accept the possibility that an understanding with the IMF is based inevitably on new taxes," said Heinz Moeller, a leading PSC deputy. [Sources: CNN, 08/28/99; Associated Press, Clarin (Argentina), 08/29/99; Reuters, 08/27/99, 08/31/99; Notimex, 08/29-31/99; The Miami Herald, 08/30/99, 08/31/99; The New York Times, 09/02/99]

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